

STIMULATING M&AS IN THE KOREAN IT INDUSTRY: FOCUS ON STOCK SWAPPING

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Importance of M&As in the IT industry

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IT (Information and telecommunication) industry-related firms in Korea consider M&As as one of the survival strategies against environmental change. The chief environmental changes are the increasing importance of complex goods and services and the rising necessity to strengthen the profit basis of internet businesses.

As digitalization rapidly develops, the confusion of the internet, communication, broadcasting has proceeded in the IT industry. As a result, the competition structure is changing from competition between individual goods and services to competition between complex goods and services which are Internet, communication, broadcasting and circulation's consolidation. In order to cope with this environmental change, IT-related firms are trying to execute M&As between internet firms and broadcasting, communication, circulation, and manufacturing firms. The representative example is the merger between AOL and Time-Warner in the beginning of 2000. IT-related firms in Korea have also tried to execute M&As for the same reason.

Internet firms in Korea are also trying to execute M&As. They are now suffering from a shortage of profit-creating business models. Through M&As, they are trying to strengthen the profit basis of their businesses and take a large possession of the Internet market.

Stock swapping is the main means of M&A in the IT industry

Stock swapping consists of exchanging each firm's stock at a ratio decided when the M&A is agreed.

In executing M&As, there are many payment methods including cash, bonds and equity. Of these, stock swapping, which is a type of equity payment, has recently come into focus. Stock swapping consists of exchanging each firm's stock at a ratio decided when the M&A is agreed. IT-related firms which execute M&As prefer stock swapping because they can easily complete the M&A without the burden of cash payment. The M&A between AOL and Time Warner on January 10, 2000 and between Vodafone AirTouch and Mannesmann on February 7, 2000 were executed through stock swapping. Many other M&As were also executed by the same means.

Table 1. Strengths and Weaknesses of M&A Payment Methods

	effect to purchasing firm	effect to purchased firm
cash	<ul style="list-style-type: none"> • quick and easy payment • worsened liquidity 	<ul style="list-style-type: none"> • the burden of transfer income tax
Liability (bonds etc.)	<ul style="list-style-type: none"> • free from the burden of direct lage capital • the burden of interest payment 	<ul style="list-style-type: none"> • saving tax effect because interest income is raised in scattering forms over many years
Equity (stock, preferential, CB, DR etc.)	<ul style="list-style-type: none"> • free from the burden of cash payment • difficulty of appraising stock value • time-consuming 	<ul style="list-style-type: none"> • participation to purchasing firm's development • loss possibility according to purchasing firm's stock price change

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Present condition and problems of M&As in the Korean IT industry

Recently, M&As in the Korean IT industry have increased. In particular, M&As between internet firms through stock swapping have proliferated. But in Korea, M&As are executed not by the exchange of old stock but by the offering of new stock. The purchasing firm A buys the newly offered stock of the acquired firm B and firm B buys the newly offered stock of firm A. Through this roundabout formula, Korean IT firms get the result of stock swapping.

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Table 2. Important M&As utilizing Stock Swapping in Korean IT Industry

Purchasing Firm	Date	Purchased Firm	Purchasing Formula
HanSoft (S/W)	June 1999	Skylove (internet chatting service)	give new stock(16 bil. won), cash 5 bil. won and take equity 50%
Locus (computer-integrated communication)	Feb 2000	Sevenwave (internet solution)	give new stock(40 bil. won) and take equity 100%
Daum com. (portal service)	Feb 2000	UIN com. (messaging service)	give new stock(16 bil. won), cash 5 bil. won and take old and new stock equity 70%
Saerom tech. (internet phone)	Mar 2000	Naver (portal service)	merge by stock swapping
KT (communication)	Mar 2000	Hansol M.com (mobile communication)	give SK Telecom stock, cash, CP and take equity 47.85%

Source: various newspapers

The above table shows recent M&As in the Korean IT industry utilizing stock swapping. Most firms are using the roundabout means. Some are also using cash payment in addition to stock swapping.

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The reason why Korean IT firms prefer the round means of stock swapping is that they would have the burden of transfer income tax if they simply swapped existing stock. In foreign countries there is no burden of transfer income tax. Reduction of the transfer income tax in the course of stock swapping in Korea is only permitted in Big Deals between chaebols (Restriction of Special Taxation Act, article 46, limitedly adopted by the end of 1999) and strategic alliances between venture firms (Restriction of Special Taxation Act, article 46-2, limitedly adopted by the end of 2000).

Completing the roundabout method of M&As by offering new stock is time consuming. In the course of an M&A, stock price fluctuations may make the M&A difficult. The failure of the M&A between Saerom Tech and Naver was an example. Furthermore, new stock offerings may be an important reason for excess supply in the stock market.

Stimulating M&As by stock swapping

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For M&As to be stimulated by stock swapping, several measures are needed. First, it is necessary to permit cutting the transfer income tax in the case of stock swapping. This will help the Korean IT industry complete the task of making internet firms larger and developing a competitive force of complex goods and services. However, difficulties may appear, such as the use of stock swapping in illegal inheritance or donations, or the issue of unfairness between industries. So, the policy of cutting transfer income taxes should be applied limitedly, and side effects should be prevented.

Second, the environment for stock swapping should be improved. Transparent accounts of firms should be made. The uncertainty arising from the unclear accounts between M&A-related firms hinders M&As. And it is important to establish a cultural climate where firms that are small in size but have high stock values can buy large firms. In Korea, the case of a small, sound firm buying a large, ailing firm is considered to be extraordinary. **VIP**