

V&S Digest

The following are abstracts of papers appearing in this issue of 『Vision & Strategy』.

Surviving in Global Competition

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Korea's 1997 economic crisis resulted from the country's failure to adjust its development model to the trend of globalization. From 1960 to 1990, Korea pursued a developmental state model of economic growth, which was characterized by government intervention and protection of domestic industries. Although successful for decades, this model did not fit the accelerating globalization of the 1990's, and eventually this mismatch resulted in the 1997 crisis.

During the three years after the outbreak of the crisis, Korea made some progress in restructuring and economic stabilization. However, economic growth and national income stagnated during 1996 to 2000, with GDP and per capita GNI in 2000 recording levels similar to those in 1994 and 1995. This means that living standards have stagnated for 5 years.

The three goals of the national economy are efficiency, autonomy, and equity, and policymakers must decide on which of these to prioritize. The goal of efficiency tries to foster competitive firms by creating a competitive environment, although income inequality will increase as a result. A policy of autonomy tries to minimize the economy's external dependence and achieve self-sufficiency. An equity policy strives to reduce income inequality and may use government intervention to achieve an equitable society.

To revive the Korean economy, the most urgent task is to create conditions that are friendly to business. There are three types of business, including domestic companies, startup/venture firms, and foreign companies investing in Korea. The two main tasks of economic policy are to allow labor and capital markets to function by market principles, and to relax government regulation of business. In addition, considering that China's rapid economic growth is expected to accelerate in the future, it is essential for Korea to prepare for competition and cooperation with China.

It is hard to expect a decisive policy shift without a number of policy and attitude changes. For the Korean economy to become more efficient, equality of opportunity and impartial procedures are needed, which will allow anyone a fair chance at prosperity. To reduce bureaucratic inefficiency, official exams should not be the only way to attain high-level posts, and the government's hiring practices should be decisively liberalized. In addition, active privatization of public companies is needed, as well as a drastic reduction in the number of quasi-governmental organizations. Finally, for business to thrive, laws must be fairly enforced. 

Installing the Market Economy in Korea's Egalitarian Culture

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Human evolution is a differentiation process in response to environmental changes. Similarly, a market economy is a differentiation process for its participants. It is a mechanism that separates participants by their performance within a given set of rules; weeding out the losers while rewarding the winners.

For the market economy to properly develop, the principle of differentiation according to ability should apply to all sectors, and punishment and reward should be given accordingly. If a country is not able to deal with differentiation and inequality based on ability, it will not be able to accommodate a market economy.


After the 1960s, Korea pursued a government-led economic policy that pursued growth through exports. Although a market economy entails equality of opportunity and fair regulations, it also brings unequal results, and corporate competition allows only efficient companies to prosper.

In the three years of financial and corporate restructuring after Korea's financial crisis, the country made some progress in exiting ailing financial institutions, improving corporate finance and governance, and eliminating cross-guarantees of corporate debt. However, the basic nature of the bureaucratic, egalitarian system based on collectivist and paternalistic attitudes saw little change.

If even one ailing company is strictly exited according to market principles, other companies will restructure themselves to avoid the same fate. Therefore, restructuring should be targeted to the weakest companies and financial institutions.

For a market economy to thrive, differentiation should occur through market forces rather than government action. The government's economic role must be changed to invigorate the market economy. The government should enhance the market's differentiation process and thereby develop the market economy by guaranteeing freedom of entry, competition, and exit under transparent and fair regulations.

Government "design" of financial institutions and companies, and expecting them to operate by the principles of free competition and responsibility is not enough to create a successful economy. For a market economy to evolve, constant and careful examination and adjustment is required.

In recent years, the government has attempted to introduce a certain extent of differentiation in the economy and has tried to reduce intervention. One role of the government is to help rehabilitate the employees of exited firms by giving them training that will help them re-enter the market. An expanded social safety net will be needed for such a role. 

Creating an e-Korea


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Is it possible for Korea to become an advanced country through technological innovation? Korea's potential is certainly impressive. The information revolution is still in its early stages and the most important resources here, unlike in the agricultural and industrial revolutions which depended on land and natural resources, are educated human resources. Korea's enthusiasm for digitalization is seen as among highest in the world. Also, Korean society's high premium on knowledge and education has resulted in a surplus of talented human resources. If these resources are wisely used, Korea can become a world information leader, or "e-Korea".

In the digital age, countries need IT infrastructure to keep up with progress. IT is becoming a key component in boosting the competitiveness of Korea's industries, as well as being an important industry in itself. In addition, considering the rate of technological progress and the industry's characteristics such as its effects on other industries, the IT industry has a very important role in market leadership. Therefore, a comprehensive program to foster the IT industry is urgently needed in Korea. Before Korea can emerge as a world-class information leader, an information "revolution" is needed. One strategy for quickly attaining such a goal is to aggressively focus on a few large projects with high externality effects.

In the information society, the software industry is an essential component in digitalizing the manufacturing and service industries, and a cornerstone in acquiring industrial competitiveness. More importantly, since software technology is a cumulative skill, advances are permanent once they are made. Therefore, development of the software industry can achieve two purposes by providing challenging jobs for skilled workers as well as improving national competitiveness.

Although there is currently a surplus of skilled workers in Korea, there are actually manpower shortages in the key industries required for an information society. A plan for creating an e-Korea would be to train 200 thousand software technicians annually for ten years, resulting in two million software experts. These programmers would be work in ten large-scale projects that would span three years and require a total of 10 trillion won in investment. If the public and private sector cooperate to realize this plan, Korea is bound to become a world-class software producer, and a digital leader in three years. With agreement already reached by government and business groups, hopes are high that the e-Korea project will be a success. 

Status of Chaebol Reforms

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After the IMF crisis, one of the biggest changes in Korean companies was unprecedentedly low debt ratios. Despite the apparent change, a large portion of the debt reduction was achieved by capital expansion through stock offerings, with little debt reduction or improved efficiency in asset management. Since the government's only criteria for financial structure improvement was that debt ratios fall below 200%, companies reduced their debt figures while failing to improve underlying financial structures. The reform would have been more effective if companies had been required to either lower debt ratios below 200% or reduce interest coverage rates below 2.0.

The corporate governance reform policies followed the IMF economic policy program, and they focused on improving management transparency. Key measures included creation and announcement of consolidated financial statements, the reduction of cross-guarantees, introduction of a system of external audit committee, expanded requirements for outside directors, recognition of institutional investor rights, strengthened rights for small shareholders, research on how to introduce class action suits by shareholders, creation of an independent organization for establishing private accounting standards, and introduction of audit committees. Such measures had a significant effect in improving some aspects of corporate governance, especially by diffusing management rights and increasing transparency.

Chaebol reform policies were rapid and many included direct intervention by the government. As a result, many policies were pursued, but they did not address the root problem. Therefore, although key reform tasks such as improved accounting transparency, reduction of cross-guarantees, financial structure improvement, and heightened responsibility for large shareholders were achieved, the success of the overall reform policy is still uncertain.

The best way to approach chaebol reform is to influence the environment surrounding the chaebol, or in other words, through market forces. Market forces should be allowed to reach the chaebol, which is the surest way to see that they will reform themselves.

Several considerations should be made in the continuing reforms. These include removal of regulations on chaebol except for the top five, the removal of restrictions on total loan amounts, expansion of the role of institutional investors, invigoration of the market for CEOs as well as outside directors, auditors, and internal audit professionals, strict enforcement of the external audit system, higher qualifications for board members, and reform of the decisionmaking process. In addition, "parachute" recruitment of financial institution or public corporation executives should be prohibited. 

Environmental Policy can Coexist with Economic Growth

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In the past, the drive for accelerated growth led Korean society and government to expand supply whenever any shortage arose. If energy was lacking, it was imported at a high price, if water was lacking, dams were constructed, and if land was insufficient, the government proceeded to clear new sites. Little attention was given to conservation or efficient use of natural resources such as energy, water, or land, and this carelessness has become commonplace.

Laws and regulations have been dominated by a supply-side mentality. Whenever a social problem emerged, the government quickly created laws and regulations to get rid of the symptoms, which resulted in a plethora of measures such as land regulations or restrictions on waste disposal. These supply-side policies have not only destabilized the economy and society, but are also ruining the environment.

The high-cost/low-efficiency structure currently plaguing society is partly due to this supply-side mentality. To allow a transition to a low-cost/high-efficiency structure, a demand-side mentality emphasizing efficiency and conservation needs to be adopted. This is urgent for harmony between the economy and the environment, and for sustainable economic growth.

According to a long term comprehensive plan for water resources, Korea is expected to face a water shortage of 1.8 billion tons in 2011. The government plans to prevent this shortage by investing nearly 20 trillion won into 30 new dams. However, if Korea reduces its daily water use by 4% and its agricultural water use by 10%, it can prevent the shortage without dams. This would save 20 trillion won in taxes and would prevent environmental damage caused by dam construction.

In the US, one measure for water conservation was to grant farmers the right to use a set amount of water according to their predicted need. This caused farmers to conserve water, so they could sell any reserves to nearby towns for a high price. This shows the effectiveness of economic incentives in conservation. Another way of maintaining economic growth while conserving the environment is to promote environmental technology and environmental industries.

While government policies are needed to ensure environmentally-sustainable economic growth, earth-friendly management by business is also essential. In the long term, such green management benefits the company's bottom line, as shown by dramatically higher stock prices of green companies compared to other companies in the US. 

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