

The Politics of *Chaebol* Reform in Korea: Social Cleavage and New Financial Rules

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ABSTRACT *Korea's developmental state had long maintained the principle of "separation between industrial capital and financial capital," whereby the nation's industrial conglomerates – the chaebol – were restricted from having controlling ownership of financial institutions, especially banks. The financial crisis of 1997-98 renewed calls for regulating the chaebol, especially in terms of reinforcing corporate governance and competition policy. This process was supported and promoted by vibrant non-governmental organisations led by progressive activists who forged an effective alliance with the government and the ruling party whose platform followed a populist course. The reform movement has been resisted with equal fervour by conservative elements, led by the opposition party, chaebol-supported think tanks, and the conservative media. This cleavage is evident in the case of a pending legislation on chaebol ownership of financial institutions, the Financial Industry Structure Law. The controversy over this proposed law demonstrates that the contemporary chaebol reforms are deeply politicised. It also illustrates the path-dependent nature of the government-chaebol relationship.*

KEY WORDS: *Chaebol*, corporate governance, Financial Industry Structure Law, developmental state, Samsung Group

One of the crucial factors in the functioning of Korea's developmental state was the government's near-total control of financial resources and credit (Jones and Sakong, 1980; Masons et al., 1980). Modern banks in Korea were created during Japanese colonial rule and were mostly Japanese-owned. When Korea regained its independence, the newly formed government took control of these banks and sold them to wealthy businesses, but they were nationalised again after the military *coup* of 1961. The ensuing industrialisation drive was financed by a state-allocated credit system that utilised both foreign debt and financial resources at home (Cole and Park, 1983; Zysman, 1983). Dozens of *chaebol* were formed during the rapid growth period through highly preferential treatment extended by the government to industry champions (Woo, 1991).

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Chaebol are Korea's vertically integrated industrial conglomerate controlled by a founding family. While the *chaebol* have hired an increasing number of professional managers in recent years, family members continue to dominate the top executive positions (Kim, 1991: 266-7). As an organisation, the *chaebol* mirror their Japanese counterparts, which rely on a complex web of cross-company ownership to maintain tight managerial control of their group companies (Chang, 2003). In one crucial aspect, however, the *chaebol* and *keiretsu* can be distinguished: ready access to credit through direct bank ownership, which played a central role in the *keiretsu* business strategy and expansion, but not in the case of the *chaebol*. This was not by any design on the part of the *chaebol*; they were simply forbidden from engaging in banking business by the government. In fact, throughout most of Korea's modern economic development, the wide-ranging restrictions on *chaebol* bank ownership helped ensure that *chaebol* followed the dictates of the government.

The restriction on bank ownership provided "a separation between financial capital and industrial capital," a phrase that represented an important policy principle to prevent dominance by large non-financial industries ("industrial capital") over the nation's financial industry. With private ownership of banks effectively banned, the government had near-complete control of the financial industry and its resources, which in turn served as an effective means to secure *chaebol* compliance with the government's policy goals. In fact, in their early years, the *chaebol* had little choice but to follow the government's industrial policy faithfully in order to finance their expanding business through domestic financial institutions, which the Finance Ministry regulated directly through compartmentalised markets with limited entry at the expense of competition (Park and Patrick, 1994). Both foreign and domestic businesses were banned from the financial sector, which stymied competition and has contributed to the weakness of Korea's financial industry. Ironically, this weakness meant that the post-financial crisis restructuring required a temporary nationalisation of bankrupted banks (Lee, 2002).

Certainly, many countries discourage non-financial businesses from acquiring a controlling position in banks in order to prevent conflicts of interest. For example, commercial companies may weaken banks if they seek to enhance their liquidity through irregular lending practices by related banks. The *chaebol* ownership of banks has been regarded as particularly risky in view of their overly aggressive business strategies and the practice of expanding cross-shareholding equity positions among intra-group companies (IMF, 2006; 37-8). The ban on direct bank ownership was thus maintained as a principle from the early 1960s to the early 1980s, when the Korean government began to allow limited ownership by setting a ceiling. Such was not the case, however, for non-bank financial businesses, especially following a series of financial liberalisations that began in the 1980s. The relaxed regulations on *chaebol* ownership of non-bank financial companies have been seen as the main culprit in the ability of *chaebol* to expand the so-called "circular pattern" of cross-shareholding.

This article examines the history of the Korean government's attempt to regulate *chaebol*'s ownership structure as a way of curbing economic concentration and the response of *chaebol* in adapting to the regulatory environment. It presents a case study of the attempt to revise the Finance Industry Structure Law (FISL) and

analyses the coalition pattern among major policy actors surrounding *chaebol* policies.

Evolution of *Chaebol* Corporate Ownership

By the mid-1980s, the *chaebol*, with 20 to 40 companies in each group, had become domestic powerhouses that had transformed into fully-fledged multinational corporations with billions of dollars in annual revenue (Kim, 2000). The pace of their growth was such that by the mid-1980s, the top 50 *chaebol* accounted for almost a fifth of Korea's gross domestic product and some 45% of mining and manufacturing sales. This was achieved by aggressive diversification and expansion into new industries, while forming oligopolist positions in major industries. The average number of manufacturing businesses held by the top ten *chaebol* in 1983 was 8.6 and that of the top 20 *chaebol* was 6.6 (Zeile, 1991: 306).

From the mid-1980s, the Korean government began to take more seriously the myriad of problems deriving from the organisational expansion of *chaebol*. From the perspective of the well-being of the national economy, the ever-increasing gap between *chaebol* and smaller businesses heightened the problem of economic injustice. Furthermore, the common *chaebol* practice of propping up unprofitable businesses through the support of other, profitable firms caused serious problems in resource allocation, while redundant investments in manufacturing businesses led to considerable overcapacity in some industries. To address these problems, the government had to switch its policy on *chaebol* from the traditional practice of extending subsidies and favours to one that invoked sanctions and regulations.

The *chaebol's* ownership structure was called into question first. In 1986, the revised Fair Trade Act banned additional cross-shareholding of intra-group companies for *chaebol* whose assets amounted to more than two billion Korean won. Under this "cross-shareholding restriction rule" [*sangho chulja jehan je*], between 30 and 40 top *chaebol* have been subjected to monitoring by the Fair Trade Commission (FTC). In the same year, the government introduced a new regulation called "equity investment sum caption rule" [*chulja chongak je*], restricting the total sum of intra-corporate investment by *chaebol* companies. The top *chaebol* (initially defined as companies with assets in excess of 400 billion won, and later assets in excess of six trillion won) were not allowed to invest more than 40% of their net assets in group subsidiaries, and this ceiling was further reduced to 25% during the fourth revision of the Fair Trade Act (FTA) in 1994. In 1998, however, this regulation was abolished temporarily in order to accelerate corporate restructuring after the financial crisis. A year later, the restriction was reintroduced but it exempted those *chaebol* that demonstrated "good" corporate governance. Its most recent revision, made in April 2007, relaxed the equity sum caption rule by moving up the scale of *chaebol's* assets to ten trillion won and the ceiling of its intra-group investment to 40% of its net assets (*Hankuk Kyungje* [Seoul], 3 April 2007).

Despite these restrictions, the extent of *chaebol* cross-shareholding remained high. Thirty-eight *chaebol* were subject to the cross-shareholding restriction rule in both 2005 and 2006. The average level of cross-shareholding is about 51% of their member companies' total shares. The total shareholdings of the owner and his or her family are less than 5% but cross-shareholdings of member companies stood at

around 44%. Nine *chaebol* were designated as large enterprise groups whose total equity investment was limited in both years. Their total cross-shareholding was 47% in 2005 and 48% in 2006. Again, owner family's total shares were only 4.6%, but about 41% of inter-corporate investment among group companies maintains *chaebol*'s group solidarity (Table 1).

The financial crisis radically altered the government-*chaebol* relationship. The generally positive public image of *chaebol* as national champions and exclusive family businesses became a negative one, as they were discredited by the events of the crisis, being seen as irresponsible and anti-social, and thus undeserving of protection. According to analysts, such as Kang (2000) and Haggard (2000), prior to the crisis, the deregulation of financial and capital markets created a "moral hazard," permitting excessive lending for the expansion of the *chaebol*. An inflow of large amounts of speculative capital and a sharp deterioration in the terms of trade by the late 1990s left the Korean economy vulnerable to external shocks, eventually falling victim to the Asian financial crisis of 1997. Much of the blame for the crisis was sheeted home to mismanagement by incompetent members of *chaebol*-founding families, with particularly severe criticism directed at the ownership structure of *chaebol*.

Responding to the crisis, strong monitoring activities and new competition policies were introduced under the new Kim Dae-jung government. The *chaebol* were now portrayed as barriers to the development of a fair and competitive market system. Foreign direct investment was courted actively and foreign businesses were even seen as a force to counteract the dominance of *chaebol* (Lee and Han, 2006). Newly empowered non-governmental organisations (NGOs) forged a close relationship with the government in advocating reform of *chaebol* corporate governance. *Chaebol* that survived the harsh corporate restructuring following the Asian crisis improved their financial conditions by restraining diversification ambitions and their corporate governance became more transparent due to monitoring mechanisms (Choe and Pattnaik, 2007). Nevertheless, the dominance of founding family management still remains unchanged so that *chaebol*'s corporate governance is subject to the scrutiny of NGOs.

The populist desire to discipline the *chaebol* was fuelled further under the succeeding President, Roh Moo-hyun, who was elected on the basis of his image as an outsider politician and an anti-establishment voice. The Roh government intensified *chaebol* reforms, investigating their illegal political funding and accounting irregularities, while pressuring them to improve their corporate governance. The calls for *chaebol* reforms became louder after the newly established ruling Woori party won a majority in the National Assembly after the General Election in April 2004. The revision of the FISL, in particular, showcased the effectiveness of the coalition between the regulatory government and progressive politicians and NGOs.

Adapting to Government Ownership Regulations

Although the Korean government has sought to limit collusion between financial capital and industrial capital, *chaebol* financial institutions quickly diversified to include insurance, securities, and investment and trust banking. In the early 1980s, the

Table 1. Korean *chaebol* ownership structure

	Year	Owner family total			Other than owner family			Total cross-shareholdings
		Chairman	Relatives	Sub-total	Group firms	Other	Sub-total	
<i>Chaebol</i> subject to cross-shareholding restrictions	2005	2.01	2.92	4.94	43.98	2.30	46.28	51.21
	2006	2.00	2.89	4.89	44.08	2.31	46.39	51.27
<i>Chaebol</i> subject to total investment limit	2005	1.83	2.82	4.64	40.69	1.80	42.49	47.14
	2006	1.72	2.92	4.64	41.54	2.02	43.56	48.20

Source: Fair Trade Commission (2005; 2006).

government began to divest its holdings in commercial banks but had set an 8% ceiling on ownership for any single individual or business group. This restriction, however, did not extend to the life insurance business, allowing several *chaebol* to assume control of large insurance companies. At a later date, the limit on bank ownership was reduced further to 4%. When the Banking Law was revised in April 2002 to raise the limit to 10%, restrictions on the *chaebol* remained. Specifically, while any individual – foreign or Korean national – may purchase up to 10% of a bank’s shares, in the case of a *chaebol*, their voting rights are limited to 4%.

Since the tightening of regulations of cross-shareholdings in the late 1980s, a number of *chaebol* tried to circumvent these restrictions by developing an even more complex “circular” system of cross-shareholding among intra-group companies. In this new system, their newly acquired financial institutions came to play a key linkage role. Among the 38 *chaebol* subject to cross-shareholding restriction in April 2005, 23 of them own financial institutions as part of their group. Of these, 13 have significantly incorporated financial institutions into their group. Table 2 shows that the 29 financial or insurance companies that belong to these 13 *chaebol* have invested 2430 billion won (about a 70 billion won increase over 2004) in their intra-group companies. Each *chaebol*-owned financial or insurance company holds an average of 12.58% (a 2.64% increase from the 2004 average) of shares in 78 intra-group companies. Samsung Group owns five financial institutions but the size of their capital investment is substantial, accounting for half of the total held by all 13 *chaebol* financial institutions. Those five institutions have investments in 27 intra-group companies, suggesting that the Samsung Group is actively combining finance capital with its industrial capital, relative to other *chaebol* groups. Due to this corporate governance structure, Samsung Group has been the target of tight government monitoring and intense protests by progressive NGOs.

The *chaebol*-owned financial institutions have also been investing in their major industrial groups. As seen in Table 3, Samsung Card holds about a quarter of Samsung Everland, which belongs to the Samsung Group. Samsung Life Insurance

Table 2. Intra-group investment by *chaebol*-owned financial-insurance companies, 1 April 2005

<i>Chaebol</i>	No. of intra-group financial institutions (IGFIs)	No. of intra-groups companies	Volume of capital investment by IGFI (billion won)	Average % share of IGFIs in intra-group companies of each <i>chaebol</i>
Samsung	5	27	1275.6	16.40
Dongyang	6	12	614.3	42.74
Dongbu	4	9	144.9	9.32
Hyundai Auto.	1	4	122.7	4.67
Hanhwa	2	6	112.2	2.76
CJ	1	1	62.5	91.80
Hyundai Heavy Industry	1	2	32.5	65.03
SK	3	5	29.5	2.62
Lotte	2	2	17.4	4.54
Taekwang	1	4	9.2	16.12
Hyundai	1	3	5.8	6.15
Geumho	1	1	2.4	6.24
Kolon	1	2	0.7	2.50
Total	29	78	2430.7	12.58

Source: Fair Trade Commission (2005).

Table 3. Intra-group investments by *chaebol* financial institutions

<i>Chaebol</i>	Major <i>chaebol</i> companies owned by intra-group financial institutions
Samsung	Everland (Samsung Card 25.64%) Samsung Electronics (Samsung Life 7.23%, Samsung Fire and Marine Co. 1.26%) Samsung Corporation (Samsung Life 4.8%, Samsung Investment Trust Management 0.10%)
SK	SK (SK Life 0.47%) SK Telecom (SK Life 0.01%)
Hanhwa	Hanhwa (Hanhwa Securities Co. 4.94%)
Dongbu	Dongbu Corporation (Dongbu Life 9.46%, Dongbu Insurance 13.73%)
Dongyang	Dongyang Leisure (Dongyang Capital 35%), Dongyang Major (Dongyang Life 1.63%)
Taekwang	Taekwang Industrial Co. (Hungkuk Life Insurance 9.99%)

Source: Fair Trade Commission (2005).

and Samsung Fire and Marine Insurance hold 7.23% and 1.26%, respectively, of Samsung Electronics. Samsung Life Insurance and Samsung Investment Trust Management Co. hold 4.8% and 0.1%, respectively, of Samsung Corporation. Dongbu Life Insurance and Dongbu Insurance hold 9.46% and 13.73%, respectively, of shares of Dongbu Corporation, which is the Group's construction arm. Dongyang Capital holds 35% of Dongyang Leisure.

Thus, Korea's 14 largest *chaebol*, with more than 5000 billion won in assets, have found an effective means of bypassing regulations on intra-group investments in the form of a "circular pattern" of investments using in-house financial institutions. Each circle of intra-group investment includes several companies and major *chaebol* groups have several circles. For example, Samsung Everland holds 19.34% of shares of Samsung Life, which holds 4.8% of Samsung Corporation, which holds 1.48% of Samsung Everland. The circle continues as Samsung Corporation holds 4.02% of Samsung Electronics, which owns 20.38% of Samsung SDI, which then owns 4% of Samsung Everland. Similar practices are carried out by other major *chaebol*. Hyundai Motor Company owns 38.67% of Kia Motors Co., which in turn owns 18.19% of Hyundai MOBIS, which has again 14.59% of Hyundai Motor Company. Hanhwa Corporation has 24.21% of Hanhwa Petrochemical, which owns 100% shares of Hanhwa L&C Co. It again holds 6.44% of Hanwha Securities Co., which owns 4.94% of Hanhwa Corporation (Kim, 2006: 36-7).

As this kind of circular investment pattern developed, the government began to reinforce rules restricting collusion between financial and non-financial businesses. The ruling party and progressive civic movement organisations took a more critical approach and pushed the pragmatic-minded bureaucrats to come up with a viable reinforcement. It is against this background that the FISL has undergone a highly contested policy co-ordination and revision process.

The Financial Industry Structure Law

The revision of the FISL was one of the most politically controversial and contested issues in recent memory. The law was renamed in March 1997 to replace the existing Law on Merger and Transfer of Financial Industry. A key revision included an article that regulates investments by financial companies in non-financial businesses. Specifically, the article requires a financial company to obtain approval from the Minister of Finance and Economy (from May 1999, the Chairman of the Financial Supervisory Commission) if it intends to acquire 5% or more of the shares of a company belonging to the same business group; for companies not belonging to the same group, the limit is 20%. In January 2000, measures specifying fines for violation of this regulation were added.

FISL was the key piece of legislation designed to implement the policy principle of separation between financial capital and industrial capital by restricting directly the circular investment pattern of *chaebol* companies. For some years following the Asian financial crisis, during which Korea's financial industry was undergoing unprecedented restructuring under the IMF-mandated financial reform drive, FISL received little attention. By 2004, however, it became one of the most hotly contested issues in Korean politics, with all the key players – the government, political parties, business, and civic movement organisations – fully engaged in the dynamic game of formulating new rules on the *chaebol* and their financial institutions.

Party Politics and the FISL

In April 2004 the Financial Supervisory Commission (FSC)¹ conducted a comprehensive probe into the activities of financial companies and reported that

ten companies were in violation of the FISL. This finding brought immediate public criticism that the existing penalties were too lenient to curb the illegal shareholding practices. Hardliners in the ruling Woori Party took the offensive, calling the law too soft and prompting the government to draft a revised FISL that was passed by the Cabinet on 5 July 2005. The government's revision included a "grandfather clause" that allowed the violation of the 5% ceiling if the shares were acquired before the introduction of the law (in March 1997). If not, however, no voting rights beyond 5% would be recognised.

Dissatisfied with government's revised draft, a number of parties proposed alternative drafts. The Woori Party independently drafted a revised FISL banning voting rights regardless of acquisition dates and requiring any company in violation of the new law to sell its excessive share over the next five years. A failure to comply would subject the company to daily fines. Even when excessive shareholding was approved by the government in cases of restructuring or a merger, the draft law would have required a financial company to seek new approval when the shareholding reached 25% and then again when it reached 33%. The Democratic Labor Party (DLP) also submitted its own revised draft, sharing the Woori Party's views and being even tougher by shortening the grace period for excessive shareholding to two years. In contrast, the major opposition Grand National Party (GNP) criticised both FISL revisions submitted by the government and other parties. It argued that government draft was too harsh in banning voting rights for excessive shares. As for the drafts of both the Woori Party and DLP, it criticised the elimination of the grandfather clause as essentially unconstitutional and said that limiting voting rights was sufficient rather than requiring the mandatory sale of excessive shares, which was an infringement of property rights. But, the GNP did not make this opposition position on the FISL its official party platform for fear of popular criticism of being lenient towards the *chaebol*. In June 2006, however, the GNP members in the Finance and Economic Committee of the National Assembly expressed interest in raising the shareholding ceiling to 10% for all companies, including the *chaebol*; the existing law allows 10% ownership only for foreign or domestic financial companies (*Money Today*, 27 June 2006).

With increasing controversy over the law's revision, by October 2005 the Blue House (Office of the President) intervened with a compromise position, stating that the acquisition of excessive shareholdings before the FISL's introduction should be allowed and that only those shares acquired after the law's enactment needed to be sold. Despite the Blue House's attempt at a compromise, the government and the ruling Woori Party were unable to narrow their differences.² The Blue House came in to mediate this conflict and, in late November 2005, the Woori Party recommended that those companies that acquired excessive shares before the law's enactment would be allowed to keep them and would only face a restriction on voting rights. At the same time, any excessive shares acquired after the law's enactment would have to be sold (Woori Party, 2005). This new draft finally passed in the Committee on Finance and Economy on 27 February 2006 after ten months of debate in the Assembly following the government's submission of an earlier draft in November 2004. Nevertheless, ambiguity and confusion remained regarding the ultimate ceiling of ownership acquired before the law's enactment. The last government FISL draft stipulated that this law is subject to Article 11 of the Fair

Trade Act specifying that financial or insurance companies could have a voting right up to the total sum of 15% shares of all intra-group companies in the case of a merger or a business transfer.

Political controversy has not ended, however, and the prospect for the law's ultimate passage remains uncertain. The Assembly's Finance and Economy Committee passed the draft with a margin of just one vote. The draft was expected to be passed in the April 2006 session of the National Assembly after the Judicial Committee's voting but the Assembly ended its regular session before doing so. The Assembly has yet to resume debate on the law and is unlikely to do so until after the December 2007 presidential election. The fate of the FISL will likely depend on the new government's policy approach on *chaebol*.

The Samsung Group and the Korean Business Community

The corporate governance of the Samsung Group emerged as the focal point in the controversy surrounding the revision of the FISL. When investigations were conducted into the financial companies of leading *chaebol* groups, Dongbu Group and Hyundai Group were also found to have violated the law. However, the move to reinforce the FISL soon became intermingled with highly public criticism of Samsung's corporate governance. Samsung Everland, in which Chairman Lee Kun-hee and his son Lee Jae-Yong hold 3.72% and 25.1% of total shares, respectively, was charged with maintaining a key position in the Group using the circular investment strategy with intra-group financial institutions. Samsung Card owns 25.64% of the shares of Everland, which owns 13.35% of Samsung Life Insurance's shares. Samsung Life Insurance again owns 7.24% of shares of Samsung Electronics, which owns 46.9% of total shares of Samsung Card. Thus, Samsung Card is in obvious violation of the FISL by owning 20% more shares of Everland than is legally allowed, while Samsung Life Insurance has an excessive holding of 2.24% of Samsung Electronics' shares. If the revised FISL were to be enacted, within two years Samsung Life Insurance would lose 2.24% of its voting rights, representing the excessive shares of Samsung Electronics. But, it would be able to keep the excessive shares since they were acquired in 1998, before the introduction of the original FISL. On the other hand, Samsung Card's purchase of Everland shares occurred after the law's enactment, so that it would have to sell the excessive 20.64% of Everland shares within five years, in addition to the immediate nullification of its voting rights for the same excessive amount in the management decisions of Everland.

The nullification of voting rights of Samsung Life Insurance was criticised by both the business community and the GNP, since the revised FISL would penalise purchases made before the inception of the original FISL. The business community formally expressed concern over the finance industry's competitiveness through its lobbying arm, the Federation of Korean Industries (FKI). Specifically, its research body, the Korea Economic Research Institute (KERI), raised the issue of the vulnerability of Korean business to hostile takeovers by large foreign merger and acquisition firms. If Samsung Life Insurance's voting right for the excessive 2.24% share of Samsung Electronics was nullified, the Group's total share in Samsung Electronics would be reduced to 13.81%, weakening its influence over Samsung Electronics and exposing it to takeover. Although the Samsung Group can increase

its combined shares in Samsung Electronics, this option is regarded as too expensive for the Group since each share of the Electronics costs about 700,000 won. The business community also protested that the revised FISL discriminated against domestic businesses in favour of foreign businesses, which do not face the same restrictions. KERI further stated that the revised FISL is likely to slow down the merger of financial institutions considered necessary for strengthening the financial industry's competitiveness. For example, Samsung Securities, Samsung Futures, and Samsung Investment Trust Management, each of which had less than 5% of the stocks of the Group's digital camera company Samsung Techwon, would have no incentive to merge since their maximum total share in Samsung Techwon would be reduced to 5% if they did so, rather than the combined 15% now (Lee and Kim, 2005).

Samsung Group had strenuously opposed the move to reinforce the FISL throughout 2004. By 2005, however, the Group had experienced a number of legal setbacks, which produced an enormous negative public reaction. First, the courts ruled against the top managers of Everland for incurring significant loss by issuing convertible bonds at a deflated price to Lee Jae-yong, the Samsung Chairman's son, in 1996. The case was first brought by the People's Solidarity for Participatory Democracy (PSPD), which viewed the sale of the bonds as an illegal and unethical manoeuvre to accomplish dynastic succession. The Group Chairman himself was involved in a separate investigation into charges of high-level corruption. Facing mounting public criticism and pressure, the Chairman announced that he would donate 800 billion won of his personal wealth to "social causes," in a typical *chaebol* move to ameliorate negative publicity and the subsequent worsening group image. In the face of these setbacks, the Group withdrew its opposition to the revised FISL and formally took the position that it would comply with the new law if it was enacted.

Korean Civil Society and NGOs

Korean civil society has long been divided over the issues related to social and economic reforms, and their actions and reactions to these reforms reflect the existing cleavage. Progressives have emphasised distribution over growth and addressed the need to control business concentration into bigger companies. On the other hand, conservatives have argued for further growth and government deregulation to boost the market. Progressive NGOs have been most active in monitoring *chaebol's* corporate governance and pressuring the government for more reforms on the *chaebol* and their activities. The Citizens' Coalition for Economic Justice (CCEJ) and PSPD are the major civic movement organisations advocating economic reform.³ PSPD, in particular, has been an ardent *chaebol* reformer. Established in 1994 by progressive lawyers and professors, PSPD has played the role of challenger to *chaebol* management and ownership structure. Its most high-profile activity has been the "small shareholders movement." Initiated in 1997, the movement succeeded for the first time in gathering sufficient minority votes to call a general shareholders' meetings, in which they began to regularly and effectively challenge the top management of many *chaebol*, including such giants as Samsung Electronics.

PSPD has also been highly critical of the Ministry of Finance and Economy (MOFE) for its FISL enforcement – or lack thereof – especially toward the Samsung Group. Immediately upon the passage of the revised FISL by the Cabinet in early July of 2005, PSPD's Economic Reform Center Chief Kim Sang-jo (2005a) criticised the government for abandoning the principle of the separation between financial capital and industrial capital and sacrificing market order to guarantee the Samsung's management control by its founding family. He also accused the MOFE of effectively sanctioning the Group's various illegal share acquisitions by adding exemptions in the revisions (Kim, 2005b). The government's final draft of the FISL submitted to the National Assembly did not satisfy the PSPD either, which argued that the new law should not provide any grace period for voting right restrictions. It was particularly critical of the position of MOFE where it defended the grace period on the grounds that, beginning in April 2008, another law (Article 11 of Fair Trade Act) would restrict all combined shares of Samsung financial institutions in Samsung Electronics to 15% (PSDP, 2006a). PSPD also argued that the revised FISL should not be passed in its current form since Samsung Life Insurance would be exempt from the law's compulsory release of excessive shares and Samsung Card would be allowed to have five years of grace period (PSDP, 2006b).

In sharp contrast, pro-business NGOs were critical of the revised FISL for its infringement of private property rights and its retroactive enforcement. The Institute of Free Enterprise provided the main voice in this regard. It has vigorously opposed the nullification of the voting rights of Samsung Life Insurance's excessive shareholdings in Samsung Electronics, maintaining that mandatory stock sales of Everland shares by Samsung Card would be unconstitutional since the original FISL did not contain such a rule. It further argued that there is no such thing as "desirable" corporate governance and, if there were, it would only be to make profits (Institute for Free Enterprise, 2006a). Another Institute for Free Enterprise (2006b) commentary critically pointed out that the FISL revision is redundant and excessive because it adds more regulations on top of the Fair Trade Act, which it considers already harsh. It calls for a change in anti-*chaebol* sentiments that give rise to today's anti-business regulations. A research organisation run by the Hyundai Group echoes these sentiments, warning that stepping up the separation between financial capital and industrial capital will severely weaken the domestic capital market (Hyundai Economic Research Institute, 2005).

The Korea Institute of Finance (KIF) (2006: 135-9), established in 1991 by Korean banks, takes the position of essentially supporting the revised FISL. It sees the revision as being desirable in simplifying the regulations of the financial industry, which needs to be kept separated from industrial capital. In doing so, KIF is reflecting the interests of the Korean banking sector, which is mindful of the intrusion of *chaebol* into the financial industry.

Conclusion

Recent political entanglements over the revised FISL demonstrate the cleavages that have developed in reforming corporate governance in the *chaebol*. Policy actors such as ruling Woori Party politicians and progressive civic movement organisations had

taken the lead in criticising the *chaebol* and the government's tendency to compromise with them. They emphasise that their ownership structures are often illicit and are essentially undemocratic and must be reformed for the sake of fair competition and a stable market. On the other hand, liberal advocacy NGOs and think tanks representing *chaebol* interests defend them by emphasising free market principles and private property rights as well as the need for pragmatism and gradual reform. They include opposition party politicians who advocate improving the competitiveness of the financial industry by allowing increased *chaebol* investments. They stress that the principle of separation between financial capital and industrial capital is outdated and meaningless in today's universal banking system. The symbiotic government-business relationship, captured in the "Korea Inc." model, had broken up through the process of democratisation, deregulation and globalisation. The Korean government is increasingly taking up reform measures for democratic governance *vis-à-vis* the *chaebol*. With market opening pressure from foreigners, the government had liberalised the economy and eliminated rents that used to be channelled to the *chaebol*. At the same time, the *chaebol* themselves had become internationally competitive and more independent of government protection or subsidies. The 1997 financial crisis sorted out the weaker *chaebol* and the surviving *chaebol* have been successful in taking advantage of new business opportunities.

Despite encompassing economic reforms, both the government's regulations of *chaebol* and *chaebol* responses to these regulations demonstrate their path-dependent evolution. The government has built a complex regulatory regime that is often internally contradictory or redundant, leading to a patchwork of regulations that have resulted not only from the need to reform but also from an institutional inertia trying to maintain bureaucratic discretionary power. Complying with changing government regulations, the *chaebol* corporate governance has been quite successful in adapting to the evolving regulatory environment that was intended to be hostile to the management succession of the founding family. The institutional legacies of the developmental state and large business conglomerates are not likely to disappear in the near future; they will likely continue to evolve according to a changing economic environment.

Civil society, while sharing the sentiments and enthusiasm for reform, is divided over how to reform the *chaebol* corporate governance. Progressive civic movement organisations had demonstrated their capability in making their voices heard and even submitting their own reform proposals. In spite of differences and frequent conflicts, they have successfully forged a coalition with the reform forces in the government and the ruling party. In recent years, however, reform fatigue and weak economic performance have dampened their popular appeal. Still, traditional liberal voices critical of the government's regulations of *chaebol* have been unable to significantly defuse or redirect popularly held negative sentiments. It remains to be seen whether the possible power shift to the opposition party in the 2007 presidential election will reshape the delicate balance of the current social cleavages surrounding *chaebol* reforms. Whoever is in power, however, the developmental state is likely to maintain *chaebol* regulations to some extent, while the *chaebol* will continue to upgrade their corporate governance structure to their advantage. The game will go on.

Notes

- ¹ The FSC was created in April 1998 as an independent and superior decision body to integrate supervisory functions that had been scattered throughout several compartmentalised financial authorities. It is responsible for the promulgation and amendment of financial supervisory rules and regulations, the approval and permission for the business of financial institutions, and the deliberation and resolution of the supervisory agenda with respect to any inspections, examinations and sanctions on financial institutions.
- ² The apparent contradiction between the government and the ruling party can be understood if it is considered that government policy was planned by career bureaucrats who were more willing to accept free market and restrain excessive *chaebol* regulation. On the other hand, the ruling Woori Party politicians were eager to control the expansion of *chaebol* into the financial industry.
- ³ For an overview of their activities, see their websites: <http://www.ccej.or.kr> and <http://www.peoplepower21.org>.

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