SEOUL--Hasung Jang slumped back in his chair, exhausted. The 46-year-old Korea University finance professor had changed his cellular phone number twice, but still his phone rang relentlessly.

His outspoken advocacy of shareholder rights and U.S.-style free markets has made him a celebrity of sorts here. Foreign fund managers frequently call Jang, who received his PhD in finance from the University of Pennsylvania’s Wharton School. South Koreans call him, too, some urging him to expand his attacks on the freewheeling ways of the big-spending conglomerates, others accusing him of weakening South Korea’s industrial might.

“One editor of an economic daily newspaper called me a communist,” chuckled Jang. He was frankly unprepared for the onslaught of attention, figuring it would take several years before a shareholders rights movement gained any credibility in South Korea, where tycoons are accustomed to running their companies with iron fists.

But then came the economic crisis of late 1997, which forced Korea to beg for a $58 billion international bailout at a time when the Asian financial crisis was spreading fast and threatening the stability of the global economy. In return for a massive rescue package, Korea’s newly elected president, former dissident Kim Dae Jung, agreed to restructure the nation’s closed and debt-ridden economy and embrace the free market.

A key target of economic reform is the dominance of the nation’s large family-controlled business groups, known as chaebols, which ran up dangerously high levels of debt through their expansion into a wide variety of industries.

The top five chaebols -- Hyundai, Samsung, Daewoo, LG Group and SK Group -- account for more than one-third of the country’s gross economic output, giving them enormous power. The collapse of any one of those groups could be devastating to the economy.

Kim Dae Jung’s new government enacted a series of laws to strengthen minority shareholder rights and remove barriers to hostile takeovers and foreign investments. He also launched a campaign to convince the nation that the chaebols, not foreign investors, were to blame for Korea’s woes.

“Before, people were afraid to take action against the chaebols. They are so powerful, they are everywhere. People are still afraid, but at least the government is on their side,” said John J. Lee, a Korean-born American and senior vice president of Scudder Kemper Investments Inc. The New York-based firm manages the Korea Fund, one of the largest and oldest mutual funds in the country.
funds to invest solely in Korea, and has worked with Jang on shareholder rights issues.

"A year ago, I was cynical, quite pessimistic” about the reforms the government was promising, said Lee. "But now I’m quite impressed.”

Indeed, the reforms pushed by the government have stabilized the currency, pushed interest rates down and attracted foreign investment money at record rates. The trade account registered a surplus of $39.9 billion in 1998, its first surplus in years. The government, the International Monetary Fund and many private economists are predicting a growth rate of at least 2 percent this year.

The economy is still fragile, but signs abound of its improving health. Department store sales were up in January. On a recent afternoon, Lotte department store in downtown Seoul was packed with shoppers. “The last several weeks, it’s so busy,” said a salesgirl selling earrings. Gasoline consumption, car sales and traffic jams are increasing.

South Korea’s biggest immediate problems are its 1.76 million unemployed and the slowing global economy, which is hurting exports, its main growth engine.

The chaebols are a longer-term problem. Government rules require them to slash their debts this year, in an effort to force them to sell off inefficient operations and focus on their profitable ones. Many investors, however, suspect that chaebols may use accounting tricks to avoid radical restructuring. Frustrated with chaebol foot dragging, the government demanded that chaebols swap companies, an effort to force industry consolidation known as the “big deals.”

The big deals have drawn substantial criticism, especially after the government threatened to cut off bank credit to LG Group unless it agreed to sell its semiconductor subsidiary to Hyundai.

"The big deals are idiotic. They will fail, because neither party wants to participate in these absurd arrangements, and in failing they will inflict considerable damage on the economy,” said Stephen E. Marvin, head of research at Jardine Fleming Securities in Seoul.

Still, even some foreign investors say this effort may be necessary to shake things up at the fossilized chaebols. “It looks ugly. But I think in the beginning the government has to be involved,” said Lee.

Severing Old Ties

If there is a czar of the South Korean reform effort, it is Lee Hun Jai, chairman of the Financial Supervisory Commission. A stern, tough-talking
regulator, he has straddled all sides of the financial world here. Two decades ago, he was a bureaucrat at the powerful Finance Ministry. In the 1980s, he was an executive at Daewoo and then president of a Korean credit ratings agency.

The 55-year-old Lee Hun Jai, who has a master’s degree in economics from Boston University, moved quickly after taking the reins of the commission last spring. Under Lee, the government seized a number of insolvent banks, closed five, and then pumped massive amounts of money into the system. The result is that the banking system has stabilized after teetering near collapse.

More significantly, the government has agreed to sell Seoulbank to the London-based HSBC Holdings PLC and Korea First Bank to a U.S. investment group led by Newbridge Capital Ltd. The government sought foreign buyers for these nationalized banks in hopes the newcomers would spur reforms.

The sales also are an attempt to sever the historic links between banks and the government.

“There is suspicion that the management of banks has not been independent, that they are influenced by the government. But HSBC and Newbridge, surely they will be independent,” said Lee Hun Jai. “And if there was still some government influence over other banks, they would lose their competitiveness to the foreign-owned banks. So that will keep the government from doing that kind of thing.”

The same reasoning led the government to hire foreign fund managers to run a new Korea Development Bank program for small and medium-size companies.

“In Korea, there might be pressure from the government or other power elite to influence fund managers to invest in such-and-such company. We didn’t want any Korean powers to interfere with the fund managers, so we decided to select only foreign fund managers,” said Park Soon Hwa, a top official at the government–run development bank.

Scudder Kemper, Rothchild Inc., State Street Bank & Trust Co. and Templeton Asset Management Ltd. were chosen to manage the new $1.4 billion Corporate Restructuring Fund.

All of these efforts were an attempt to ensure that capital would be allocated to companies based on profits and risk, not connections. Government officials contend this will force chaebols to reform. “The government will no longer be able to bail out the chaebols,” declared Lee Hun Jai.
A New Standard of Value

This realization has sunk in for some executives. Milton Kim, the 37-year-old chairman of Ssangyong Investment & Securities Co., lobbied hard to get his older brother, the chairman of Ssangyong Group, to sell the securities company to foreign investors. Milton Kim was born in the United States, attended Brown University and worked at Citibank for a while. He understood the realities of the new environment.

He finally persuaded his brother to sell the company to an investment group led by Hambrecht & Quist. The San Francisco investment bank installed a new president and San Francisco–based chairman, but Milton Kim retains the title of chairman and will focus on long-term strategy. “Our aim is to become very transparent. The company will be managed very much according to the standards of a Wall Street firm,” he said.

Such reforms may come more slowly at other chaebols. But the pressure is intensifying as foreign investors and South Korean activists join forces.

John Lee first read about Jang in a South Korean newspaper more than a year ago. “I was very impressed by what he was trying to do. I told him, we’re shareholders in companies like SK Telecom and Samsung Electronics, so I’m willing to help,” Lee said.

Lee introduced Jang to other foreign fund managers, including managers of Julian Robertson’s Tiger Management Corp., a private investment fund. “They were delighted to see him. They never imagined such a person existed in South Korea,” said Lee.

Last year, Tiger Management and Scudder helped Jang convince SK Telecom Co., a major cellular phone service provider, to appoint an outside director. Under the agreement, the director must approve certain types of financial transactions.

Later this month Jang will propose similar, although broader, changes at a shareholders meeting of Samsung Electronics Co.. Jang recently visited 30 institutional investors in Hong Kong and Singapore to argue his case. The president of Samsung Electronics visited the same investors a week later to explain his concerns.

“The problem is this: How do you balance the seemingly contradictory issues of enhancing shareholder rights” and still maintain the “dynamism” of the Korean business system, which “requires taking risks and quick decision making and strong leadership by top management,” said Chang Il Hyung, a vice president of Samsung Electronics.

Foreign investors hold 51 percent of Samsung Electronics’ shares, a large amount but still below the two-thirds needed to pass the proposal.

“We may not get the rules changes approved this time, but the management
of Samsung Electronics will be fairly frustrated,” Lee said, adding that shareholders will return each year asking for changes until the company agrees.

Investors also may protest another way, Lee said, by withholding new funds from chaebols that don’t change and investing instead in newer South Korean companies run by entrepreneurs whom he described as “far more sophisticated” about issues such as profits and corporate governance.

“In the old days, we invested heavily in big-name manufacturing companies. We are increasing our investments in companies less than five years old, with new ideas,” said Lee. “The return on investment will be coming from these companies, because the chaebols keep destroying value.”

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