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CHAEBOL-STYLE ENTERPRISE DEVELOPMENT IN KOREA

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I. INTRODUCTION

THE *East Asian Miracle* by the World Bank (1993) and other studies on newly industrializing economies (NIEs) show that the Republic of Korea (hereafter Korea) and Taiwan have achieved similar macroeconomic performance in recent decades. However, we find striking differences between the two as we take a closer look at questions such as who founded the enterprises which acted as the main promoters of economic growth, how these enterprises grew, and what forms they assumed.

Looking at Taiwan, Ichiro Numazaki (1997) identified, vividly described, and analyzed "*laoban* entrepreneur capitalism," a pattern of capitalism particular to Taiwan. The picture he presented was one of numerous *laoban* entrepreneurs enmeshed in complex partnerships, expanding their business like amoebae, and swiftly switching from one business line to another. Business expansion and diversification in Taiwan have been achieved by these *laoban* entrepreneurs who moved nimbly to minimize equipment investment and to maximize capital-turnover and capacity-utilization ratios. The fact that all *laoban* entrepreneurs selected this type of behavior, which was optimal and rational under the given economic, social, and cultural circumstances, led to the emergence of numerous small and medium-scale enterprises in Taiwan.

In contrast, Korean development centered on large enterprises, and mostly on giant business conglomerates called *chaebol*. In the process of economic development, *chaebol* enterprises ceaselessly grew in size, giving rise to an industrial structure and formation very different from those of Taiwan. Why did this Korean-style industrial structure and organizational formation emerge? The aim of this paper is to answer this question.

Forestalling our conclusion, it may be said that the Korean pattern, like that of Taiwan, resulted from entrepreneurs' efforts to minimize their risks in a given environment. The consequence in Korea was the formation of *chaebol* conglomerates, with each engaged in a diversity of businesses. The difference between Korea and Taiwan was in their business environments. We will therefore begin by examining the differences in this area.

For an entrepreneur to establish a company and run it successfully, he or she must rationally and effectively integrate the factors of persons, money, things, and information in order to adapt to, and take advantage of, the existing business environment. Success depends on this ability. The entrepreneur seeks to minimize risks and maximize profits. At the same time, he or she will make efforts to preserve and increase his or her private properties. When the Korean entrepreneur families pursued the dual goal of expanding business under their monopoly control and of securing a sizable chunk of assets for themselves, they logically chose the path of business expansion and diversification through the establishment of subsidiaries.

II. OBJECTIVE CONDITIONS FOR "CHAEBOLIZATION"

There is no denying that Korea's initial conditions for economic development were inferior to those of Taiwan. First, it lacked the agricultural base which Taiwan possessed, and thus had to depend largely on foreign assistance until the early 1960s. Even in the subsequent economic development phase, foreign capital played a major role in Korea, and in fact foreign investment played a strategic role in the major projects (listed and unlisted alike) undertaken during the decade of the First and Second Five-Year Economic Development Plans (1962–71). For instance, under the First Five-Year Plan, foreign capital accounted for more than 60 per cent of the investment in the listed and unlisted projects of the textile industry, which was picked as a strategic industry. Other foreign investment ratios under the same plan were 76 per cent for cement industry projects and just under 60 per cent for the aggregate of projects in other industries. Even under the Second Five-Year Plan, foreign capital represented two thirds of the investment in the listed projects and more than half in the unlisted ones (Hattori 1994a, pp. 248–53). This heavy dependency on foreign investment remained unchanged in the subsequent period. We can demonstrate this using Korean government data.

Table I lists projects promoted with commercial loans from foreign sources (ROK 1993, pp. 171–72). It is no surprise that such funds were appropriated preferentially to state corporations such as Pohang Iron and Steel Co., Ltd. In addition, though the table includes the names of several *chaebol* conglomerates that grew rapidly in size during this period, such as Korean Air Lines (Hanjin Group), Daewoo Shipbuilding and Heavy Machinery, Ltd. and Daewoo Heavy Industries, Ltd. (both Daewoo Group), Hyundai Motor Company (Hyundai Group), Ssangyong Cement Industrial Co. Ltd. (Ssangyong Group), Samsung Petrochemical Co., Ltd. (Samsung Group), Tong Yang Polyester Co., Ltd. (Hyosung Group), and Sunkyong Ltd. (Sunkyong Group). The foreign loans were used to build the basic production facilities of these companies: purchases of Boeing 747 jet planes for Korean Air Lines, the construction of the Okpo Shipyard and related equipment

TABLE I

MAJOR COMMERCIAL LOAN PROJECTS, 1973–78

Loan Recipient	Projects	Country Providing Loan	Contract Value (Million)	Year of Contract Validation
Korean Air Lines Co., Ltd.	Introduction of aircraft (Boeing 747s etc.)	U.S., Can., H.K.	U.S.$327	1973, 1978
Daewoo Shipbuilding & Heavy Machinery	Okpo Shipyard construction and purchase of machines	U.K., Sw., Den., Fin.	U.S.$30, SKr3	1978
Daewoo Heavy Industries, Ltd.	Construction of diesel engine plant	H.K.	DM72	1974
Korea Shipping Corp., Ltd.	Purchase of container ships	Fr., U.S., H.K., LI., Bah.	U.S.$54, Fr22	1974, 1978
Hyundai Motor Co.	Construction of complete car-assembling plants	Fr., U.K., Japan, Austral., Bah.	U.S.$5, Fr56, ¥1,160, £20, $A6	1974, 1975
Onsan Copper Refining Corp.	Construction of copper refinery	Belg., U.K., Fin.	BF1,185, £13, U.S.$45	1974, 1975
Ssangyong Cement Industrial Co., Ltd.	Construction of additional cement plants	Ger., Fr., U.K., H.K., S.A., Switz., Den., Lux.	DM24, Fr261, £4, BF346, R5, SFr100, DKr8, U.S.$63	1976, 1978
Nam Hae Chemical Co., Ltd.	Construction of the seventh vinyl chloride plant (cash loan)	U.S., Japan, U.K., Panama	U.S.$226, ¥3,330	1974, 1976, 1977
Samsung Petrochemical Co., Ltd.	Construction of TPA plant	U.S., Sing., Den.	U.S.$50	1977
Honam Ethylene Co., Ltd.	Purchase of naphtha cracking plant machines	U.S., Japan, H.K., Sing.	U.S.$37, £13, ¥25,537	1976, 1978
Korea Pacific Chemical Corp.	Construction of three petro-chemical plants, including low-density polyethylene plant	U.K.	£34, U.S.$24	1976

TABLE I (Continued)

Loan Recipient	Projects	Country Providing Loan	Contract Value (Million)	Year of Contract Validation
Hankook Dow Chemical	Plant construction	U.K.	£34, U.S.$37	
Tong Suh Petrochemical Corp.	Construction of the second AN monomer plant	Japan, Panama	¥7,033, U.S.$3	1976
Tong Yang Polyester Co., Ltd.	Construction of polyester fiber plant	U.S., Panama	U.S.$30	1974
Choongnam Spinning Co., Ltd.	Construction of dyeing plant, purchase of fiber raw materials	U.S., U.K., H.K.	U.S.$107	1976, 1977
Hanil Synthetic Fiber Ind. Co., Ltd.	Introduction of synthetic textile equipment, purchase of raw materials	U.S., U.K., Ger., H.K., Belg.	U.S.$90, DM36, SFr7	1973, 1977
Sunkyong Ltd.	Construction of polyester short-fiber plant	U.K., Fr.	U.S.$31	1976
Kolon Industries, Inc.	Construction of additional polyester plant	U.S., U.K.	U.S.$35, £3	1973, 1975
Donghae Pulp Co., Ltd.	Construction of chemical pulp plant	Ger., Fin.	U.S.$33, DM24	1977

Source: ROK 1993, pp. 171–72.
Note: Country acronyms are as follows: Bah. = Bahamas, Belg. = Belgium, Can. = Canada, Den. = Denmark, Fr. = France, Ger., = West Germany, H.K. = Hong Kong, LI. = Liberia, Lux. = Luxembourg, S.A. = South Africa, Sing. = Singapore, Sw. = Sweden.

for Daewoo Shipbuilding and Heavy Machinery,[1] construction of a diesel engine manufacturing plant for Daewoo Heavy Industries, construction of an auto assembly plant for Hyundai Motors, and construction of a TPA plant for Samsung Petrochemical. This utilization of foreign capital was carried over into the Fourth Five-Year Plan (1977–81) and subsequent periods, as indicated by Table II.

Here, too, *chaebol* groups such as Daewoo, Hyundai, Samsung, Lucky-Goldstar (now LG), Hanjin, Sunkyong appear prominently (ROK 1993, pp. 225–26). In the case of Daewoo Shipbuilding and Heavy Machinery, additional foreign loans were used for the expansion of the Okpo Shipyard. Also with the help of foreign loans, the Lucky-Goldstar-owned Honam Oil Refinery Co. Ltd. built new refineries, Hyundai Electronics Industries Co. Ltd., Goldstar Semiconductor, Ltd., and Samsung Semiconductor & Telecommunications Corporation (formerly Hankook Semiconductor) introduced semiconductor production lines, and Sunkyong purchased from Gulf Oil the management rights and stock of the Korea Petroleum Corporation, which was then privatized. The above data, however, do not include the interest rates of the foreign commercial loans involved. The bank loan rates in that period ranged from LIBOR (London interbank offered rate) + 2% for a loan contract the Bank of Korea clinched in 1975 to LIBOR + 7/8% for loans the Korea Development Bank took out in 1978. In the 1980s, thanks to its economic achievement, Korea gained the ability to induct foreign loans at premium rates of less than 1 per cent above LIBOR. Considering that the Korean government offered repayment guarantees for commercial loans of this kind, the loans extended to *chaebol* companies must have carried similar interest rates and other. In the meantime, interest rates in Korea fluctuated greatly, but in the middle of the 1970s the major interest rates of general banks remained high, with the commercial discount rate at 15 per cent, export bill rate at 7–9 per cent, overdraft at 17–19 per cent, and the rate on Loans for Machine Industry Promotion at 12 per cent. The advantage of foreign commercial loans was thus definite (Bank of Korea 1980, pp. 22–23).

How were the enterprises able to obtain commercial loans? According to the *Oeja doip 30-nyon sa* (ROK 1993) explaining the procedures of the First Five-Year Economic Development Plan, "registered foreign enterprises and natural or juridical persons of the Republic of Korea may conclude a loan contract with a foreigner by presenting an application for approval on loan-linked projects to the Economic Planning Board (EPB) and obtaining the approval of the EPB minister after deliberation in the EPB and a decision by the Foreign Capital Inducement Deliberation Committee (FCIDC). The loans covered by this procedure included not only direct

[1] According to Ko Kwang-myon, the construction of Okpo Shipyard was originally undertaken by Korea Shipbuilding & Engineering Corp., but the project was taken over by Daewoo in June 1978, as Korea Shipbuilding & Engineering Corp. suffered from poor performance. Daewoo Shipbuilding & Heavy Machinery Ltd. was accordingly established in September the same year to run the shipyard. See Ko Kwang-myon (1995) for details.

TABLE II

MAJOR COMMERCIAL LOAN PROJECTS, 1979–85

Loan Recipient	Projects	Country Providing Loan	Contract Value (U.S.$ Million)	Year of Contract Validation
Daewoo Shipbuilding & Heavy Machinery, Ltd. (Daewoo)	Construction of Okpo Shipyard, purchase of machines	U.K.	30	1980
Korea Shipbuilding & Engineering Corp.	Construction of export ships	H.K.	31	1981
Honam Oil Refinary Co., Ltd. (Lucky-Goldsgtar)	Construction of additional oil refinary (including cash credit)	U.S.	200	1980
Kukdong Oil Refinary	Crude petroleum cracking plant	U.K.	202	1985
Kia Industrial Co., Ltd. (Kia)	Rolling stock, production facilities	France	50	1984
Daewoo Motor Co., Ltd. (Daewoo)	Development of small cars with front-wheel drive	Japan, Hong Kong	80	1985
Hyundai Motor Co. (Hyundai)	Production of cars with front-wheel drives	U.K., Japan, Hong Kong	142	1982, 1984
Hyundai Electronics Industries Co., Ltd. (Hyundai)	Additional semiconductor production lines	U.S., Hong Kong	80	1985
Goldstar Semiconductor, Ltd. (Lucky-Goldstar)	PBX, semiconductor production lines	U.S.	61	1981
Samsung Semiconductor & Telecommunications Co., Ltd. (Samsung)	Additional semiconductor plants and production lines	U.K., Japan	171	1984, 1985
Samsung Corning Co., Ltd. (Samsung)	Production of colar TV tubes	U.S.	43	1981
Korean Air Lines Co., Ltd. (Hanjin)	Purchase of Boeing 747 jet planes	Bahamas	500	1979
Sunkyong, Ltd. (Sunkyong)	Takeover of managerial rights from Gulf Corp.	France	95	1981
Cheil Synthetic Textile Co., Ltd. (Samsung)	Acrylic short-fiber yarn production	U.K.	37	1979
Hankuk Glass Industry Co., Ltd.	Construction of float glass plant	Hong Kong	36	1984

Source: ROK (1993), p. 226.

loans but also purchases (by foreigners) of loan bonds and debentures issued by Korean companies" (p. 57). With regard to the aforementioned government certification for commercial loans, "the EPB minister, upon receipt of an application for a payment guarantee, will approve it through FCIDC deliberation, and the applicants will offer a security for it within two months of the approval" (p. 58). The important point here, however, is that the procedure allowed a plant built with a loan to be offered as collateral in case the applicant failed to provide a security of the required value in advance (p. 58). This means that it was a kind of leveraged buyout. Incidentally, the FCIDC was composed of the Minister of Economic Planning Board, Minister of Foreign Affairs, Minister of Finance, Minister of Trade and Industry, Minister of Agriculture, Forestry and Fisheries, President of the Bank of Korea, President of Agricultural Bank, President of the Korea Chamber of Commerce and Industries, and two knowledgeable persons appointed by the President.

Under this "leveraged buyout" system, even entrepreneurs with little capital of their own were able to inaugurate new or expand businesses simply by applying for commercial loans and obtaining the EPB minister's approval.[2] Once they obtained a loan, they could expect the government to take most of the business risks involved. Given this system and practices, Korean capitalists made rational calculations about how to avoid risks. It is obvious that these were behind their decisions to make huge investments into heavy and chemical industries under the Third Five-Year Economic Development Plan (beginning in 1972) as well as in the heavy and chemical industrialization process that got off to a start in 1973, a movement that took place in spite of slow returns and long pregnancy periods. In order to shed light on this aspect of business practices, we will examine how the major *chaebol* groups expanded their business in different areas.

Let us begin with the Samsung group. Beginning with trade, the group accumulated capital in the so-called "three white" (*sambaek*)[3] businesses during the second half of the 1950s and then went into insurance and finance. It did not enter manufacturing on a full scale until 1969, when it founded Samsung Electronics. We pointed out earlier that Samsung's entry into electronics was prompted by the enactment of the Electronics Industry Promotion Law that same year (Hattori 1988, p. 72). Following this, it inaugurated one subsidiary after another in the electronics area, and in the second half of the 1970s founded Samsung Semiconductor & Telecommunications Corporation which was later absorbed by Samsung Electronics

[2] If we look at companies established under the First-Five Year Plan, we learn that Korean investment accounted for only 1 per cent of the capital needed for the inauguration of Dong-il Textile Co., 11 per cent for Korea Cement Mfg. Co., Ltd., 14 per cent for Hyundai Cement Co. Ltd., and 17 per cent for Union Steel Mfg. (Hattori 1994). As the "own investment" figures include loans, the entrepreneurs' real investment ratios are even lower.

[3] This refers to crude sugar, raw cotton, and wheat flour. These were the major U.S. aid items in the 1950s. Korean enterprises gained windfall profits from refining and selling them.

Co., Ltd. Originally, the group was strong in light industries such as textiles and foodstuffs, as well as trade, and in the period of Korea's heavy and chemical industrialization it branched out into heavier industries such as synthetic textiles, heavy machines, chemicals, and precision machines, becoming an integrated business group (Hattori 1988, p. 69).

By contrast, Hyundai, another representative Korean *chaebol*, had its origins in the "heavy" area. It was originally a construction company, but in 1967 split off its car-manufacturing branch as an independent company. In the 1970s, it set up a series of heavy industrial and chemical firms in quick succession, including Hyundai Shipbuilding & Heavy Industries Co., Ltd. which was set up in 1973. The group stepped into cement and construction materials in the 1960s and into chemicals in the 1970s, but when the government's *chaebol* decentralization policies went into effect in the mid-1980s, the subsidiaries which were in these businesses were made independent. In the early 1980s, Hyundai went into electronics. It now has a large share of the personal computer and semiconductor markets (Hattori 1988).

Thus, though they originated in different business areas, Samsung and Hyundai came to have nearly the same industrial composition during the 1970s, the decade of Korea's heavy and chemical industrialization. After Samsung's entry into car manufacturing in 1994, the two groups found themselves rivals on all fronts as integrated business groups.

The second-liner *chaebol* groups, such as Daewoo, Lucky-Goldstar, Ssangyong, and Hanjin, also actively advanced into heavy and chemical industries during the 1970s. Daewoo and Ssangyong were particularly active in the heavy and chemical industries. Daewoo moved into this new area by buying out[4] electronics, heavy industrial, and car manufacturing companies (Ko 1994, pp. 38–39). By contrast, Lucky-Goldstar and Hanjin developed their business in goods distribution and trading as well as electrical machinery and electronics, effectively utilizing foreign loans as shown by Table II (Hattori 1988, pp. 70–71). The big *chaebol* enterprises were given preferential treatment regarding the induction of not only foreign loans but domestic funds as well, and this privilege automatically had a dampening effect on the availability of funds for small and medium-scale enterprises. This point has

[4] The Korean term is *insu* (acceptance). The transfer of the management of Okpo Shipyard from Korea Shipbuilding & Engineering Corp. to Daewoo Shipbuilding & Heavy Machinery Ltd. as mentioned in footnote 1 is a typical case of "acceptance" in Korea. From the second half of the 1960s through the early 1970s, a number of enterprises suffered from deteriorating business conditions (*busil kieoup*) because of business expansions that went beyond their capacities or simply because of poor management. The control of these companies shifted first to the banks which had issued their loan certifications, and then, with governmental or government bank arbitration, the management rights were shifted to other companies. Daewoo rapidly grew in size and diversified its business lines using the "acceptance" method.

TABLE III

Chaebol's Value Added Production Share in GNP

(%)

	1973	1978	1983	1989	1993
Top five *chaebol* groups	3.5	8.1	10.0	8.4	6.2
Top ten *chaebol* groups	5.1	10.9	13.0	10.4+	8.3
Top twenty *chaebol* groups	7.1	14.0	16.0	13.0+	10.2

Sources: For 1973–89, Hattori (1994a), for 1993, NIMA (1995).

been repeatedly raised in criticism of *chaebol* in Korea. Accessibility to funding was a major concern for Korean entrepreneurs throughout the period of economic development.

This select group of Korean enterprises which later came to be called *chaebol* were able to grow in size and influence thanks largely to the relatively generous provision of funds they were afforded. Consequently, they greatly increased their weight within the Korean economy (Table III). The share of value added ascribed to the five *chaebol* groups in Korea's GNP jumped from 3.5 per cent in the first half of the 1970s to 10 per cent in the first half of the following decade. The same can be said with regard to the share of the ten or twenty *chaebol* groups. It is certain that they were the leading force of the Korean economy from the 1970s through the first half of the 1980s (Hattori 1994b, pp. 110–11).[5] As was already pointed out, the *chaebol* groups were in an extremely advantageous position in terms of obtaining necessary funds.

It seems clear that Taiwan differed from Korea in this respect. In Taiwan, local entrepreneurs who were mostly "local Taiwanese" (*benshengren*) were forced to develop their business in the absence of access to government funds, whereas in Korea the entrepreneurs who conducted business in compliance with the government's industrial policies enjoyed a double benefit—firstly in the form of the export financing provided to all export firms, and secondly in the form of preferential government treatment regarding foreign and domestic loans for equipment funds. Moreover, the government took the risks involved in loan induction.

[5] The share in GNP of the *chaebol* peaked sometime in the first half of the 1980s, and declined continuously through the early 1990s. This author has argued that this phenomenon showed a relative decline in the *chaebol*'s positions in the wake of the upgrading of Korea's industrial structure, as well as the growth of the nonmanufacturing sector (Hattori 1994b, pp. 113–16). However, later developments failed to bear out this observation, as the share of the *chaebol* began to rise again around the mid-1990s. This upturn has reflected their active participation in infrastructure building, which was permitted by the government under the slogan of "utilization of private business energy." Consequently, the share of the thirty major *chaebol* firms in GNP reached 16.58 per cent, and that of the twenty leading *chaebol* firms 15.8 per cent, according to *Hanguk 30-dae chaebol jaemu bunsog 97-nyon-pan* (NIMA 1997).

III. BUSINESS DIVERSIFICATION THROUGH SUBSIDIARIES

Thus, financial factors can explain why the big corporations came to dominate the Korean economy. But there are other questions about *chaebol* behavior which remain to be answered. The first is why they diversified their business lines; the second is why they "chaebolized" through the establishment of subsidiaries; and the third is how they were able to obtain accurate information about the government's industrial promotion policies.

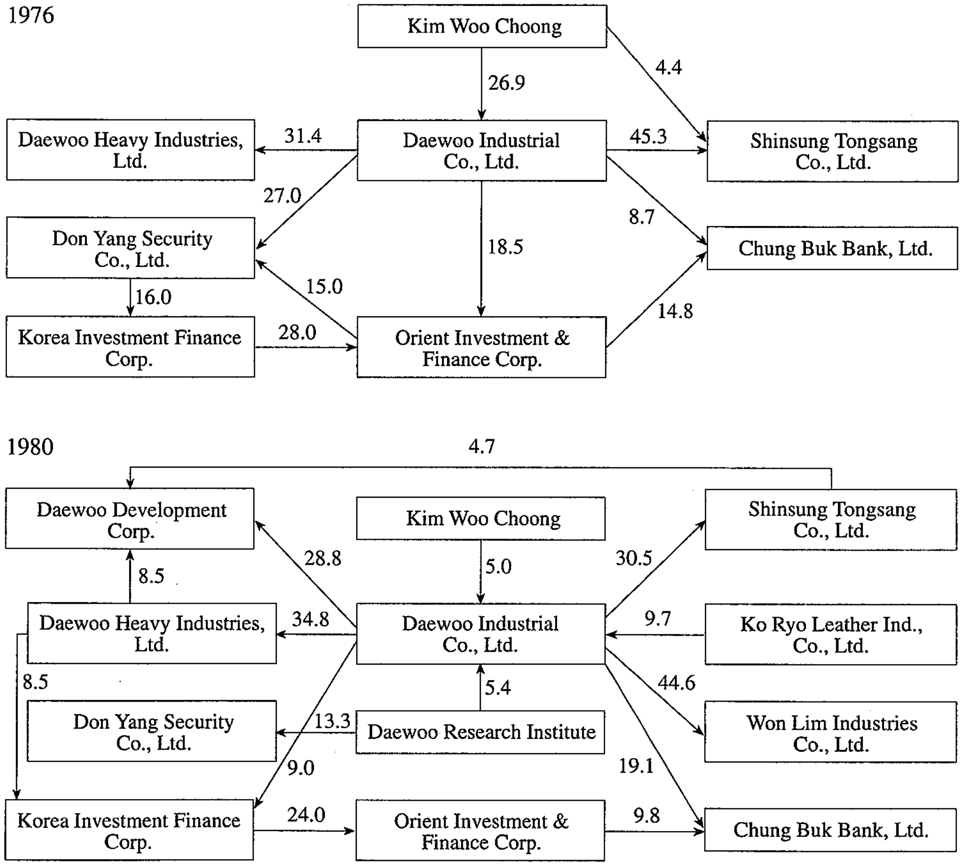
The first question has been answered to a considerable degree by a number of studies, including ones contained in this special issue, and so we feel we do not need to discuss the matter here. Certainly, this behavior can be explained by the Korean government's industrial promotion policy. The Korean government designated strategic industries under its long-term economic development plans, and fostered them with various incentives.

Let us therefore examine the second question. Basically, a corporation can use one of two methods to diversify its business lines. It can either integrate new business lines into itself or can establish subsidiaries to undertake these new businesses. Each method has advantages and disadvantages. The advantage of the first is that the company can directly control the new businesses and can absorb the risks itself. The disadvantage is that the company needs to augment its capital to finance the new operations, and that the failure of new businesses can cause serious damage to the company. These advantages turn to disadvantages, and disadvantages to advantages, if the subsidiary formula is followed. With this in view, let us examine the case of the Korean *chaebol.*

Figure 1 compares the Daewoo group's stock ownership pattern in 1976 with that in 1980, as the company expanded its business most rapidly in the 1970s. The stock ownership composition changed fairly drastically in this period with founder-owner Kim Woo Choong's ownership share falling sharply. In 1976, Mr. Kim owned 26.9 per cent of the group's core firm Daewoo Industrial Co. Ltd. (currently Daewoo Corporation), but by the end of the decade owned just a meager 5 per cent. Conversely, the share of aggregate Daewoo group stock owned by the Daewoo Corporation increased. This author characterizes this more recent pattern as "core company domination," meaning that the group is no longer controlled by direct stock ownership by its founder-owner but indirectly by the core in-group company, to which the founder-owner's stock ownership has been transferred (Hattori 1982, pp. 133–39).

This apparent change in the stock ownership pattern does not mean, though, that Mr. Kim's power of control over the group diminished. During that period, he served as the chairman of Daewoo Corporation, and concomitantly as the president of the major firms affiliated with the group. Moreover, he served as the president of

Fig. 1. Stock Ownership Relations of Daewoo Group, 1976 and 1980



Source: Hattori (1982).

the whole group. It is true that his nominal stock ownership ratio went down, but by staying on as the leader of the group-controlling Daewoo Corporation, he even retained the right to dispose of the group members' stock shares as he liked. Thus, not only did he retain his leadership in managerial matters, but also kept control over the group's stocks.

Let us now examine the case of Lucky-Goldstar. Table IV shows the stock ownership patterns of the group in the early 1980s. As is obvious from the table, the owning families (the Ku and Ho families) held only a very small share of the stock. Their share in Lucky Ltd., the core firm of the group, was a mere 14 per cent. Moreover, more recent official records show that their shares later fell to almost nil (Hattori 1994c, p. 29). The group has, in addition to this peculiar feature, another noteworthy characteristic: with the exception of the group's core firms, namely,

TABLE IV

OWNERSHIP AND MANAGEMENT OF LUCKY-GOLDSTAR GROUP, 1982

(%)

	Capital (100 Million Won)	Relatives (A)	In-Group Enterprises (B)	Subtotal (A)+(B)	Other Companies[a]	Financial Institutions	Power of Managerial Control[b]	Other Remarks
Lucky, Ltd.	300	13.66	4.05	17.71			20/63	
Goldstar Co., Ltd.	350		18.26	18.26		8.29	25/84	
Goldstar Electric Co., Ltd.	60		8.02	8.02	20.00	5.13	3/26	Nippon Electric Co., Ltd. (Japan)
Goldstar Cable Co., Ltd.	96		14.07	14.07	33.34		20/70	Hitachi Cable, Ltd. (Japan)
Lucky Development Co., Ltd.	122			29.73		14.64	5/57	
Goldstar Telecommunication Co., Ltd.	56.5		10.45	10.45	33.50	3.32	22/42	Siemens + DCWG (West Germany)
Goldstar Instrument & Electric Co., Ltd.	60		10.13	10.13	33.40	15.54	0/36	Fuji Electric Co., Ltd. (Japan)
Lucky Continental Carbon Co.	36.3		17.47	17.47	35.00	1.29	10/39	Continental Carbon Co., Ltd. (U.S.)
Bando Trading Co., Ltd.	140		19.82	19.82	33.51	11.55	4/50	Mitsubishi Electric Corp. + Mitsubishi Corp. (Japan)
Shin Yeong Electric Co.	37.5		18.59	18.59	4.17		11/31	Halla Development (Korea)
Pan Korea Insurance Co.	15	28.53		28.53	27.31	5.11	3/27	Taihan Electric Wire Co. etc. (Korea)
Korea Mining & Smelting Co.	186		45.30	45.30	1.00		1/43	Pusan MBC-TV etc. (Korea)
Pusan Investment & Finance Corp.	45		30.53	30.53		9.95	0/21	
	1,504	3.25	17.42	20.64	16.70	5.37	(18.63)	

Source: Hattori (1984), p. 148.

[a] The ratio of shares of outside-of-group companies.

[b] The denominators are points given for all managerial positions and the numerators the points given for managerial positions held by family members.

Lucky Ltd., Goldstar Co. Ltd., and Bando Trading Co. Ltd., the group's affiliated firms have capital components owned by outsiders, and notably by foreigners. Table IV only includes the stock market-listed group members, but foreign participation is significant in non-listed group firms as well. Even with this capital composition, however, the Ku and Ho families, the original owners, have been able to maintain their grip on the group as a whole because their family members occupy the top-management positions at all the major group firms.

Even in the Hyundai group, where the founder family has a larger stock share than in Daewoo or Lucky-Goldstar, the family's control of the entire group is guaranteed by a supplementary role played by the core companies. Toward the end of the 1980s, the family owned just 6.3 per cent of Hyundai Motor Company, but this was bolstered by the 5.6 per cent and 11.2 per cent owned by the group's two core companies, Hyundai Engineering & Construction Co., Ltd. and Hyundai Heavy Industries Co., Ltd.. Similarly, the family held no stock in Hyundai Corporation, but Hyundai Heavy Industries and Hyundai Motor held an aggregate of 25.8 per cent. The family had no direct capital share in Hyundai Electronics Industries Co., Ltd., either, but Hyundai Engineering & Construction, Hyundai Heavy Industries, and Hyundai Motor together held a commanding share of 65.3 per cent (Hattori 1994b, p. 120).

The same can be said of the Samsung group. Before the founder's third son Lee Kun Hee succeeded his father in 1977, the group's nonprofit organizations, such as Samsung Foundation of Art and Culture and Samsung Mutual Aid, were the major stockholders in the affiliated companies. After the succession, the ownership was dispersed among the family, the non-listed company Dong Bang Life Insurance Co. Ltd. (now Samsung Life Insurance Co. Ltd.) and other companies within the group (Hattori 1982, pp. 157–60). After the death of the founder, the third son took over the whole group. Though his stock ownership is not overwhelming, he is still the top decision maker for the whole group, in the same manner as the leaders of other *chaebol* groups.

These cases indicate that business diversification through subsidiaries has been far more beneficial to the *chaebol* founders than the other formula, namely of diversifying the parent firm's own business lines. The founder was able to invest personally, but also was able to mobilize the parent company's resources to invest in the subsidiaries. As with Daewoo and Lucky-Goldstar, the founders did not put much of their own money into the new subsidiaries. It was the parent companies that provided most of the requisite funds. But since the parent companies were completely controlled financially and managerially by the owner families, this formula meant that the founders were in a position to exercise full command over the subsidiaries with only a small investment, or even no investment at all, disbursed out of their own pockets. If, conversely, an entrepreneur had chosen to diversify business lines without setting up subsidiaries, he would have had to put much additional money into it in order to augment the firm's capital. The subsidiary formula spared entrepreneurs this burden and risk. They were able to diversify and expand their businesses without making any additional personal investment.

Establishing joint ventures with foreign direct investors was even more beneficial to the entrepreneurs. By inviting foreign firms to invest, the Korean partners not only economized on their initial investment but were also freed from interest payments, though dividends of course had to be paid.[6] Additionally, the Korean entrepreneurs could expect transfers of managerial and production technology. Furthermore, the foreign investors could not easily withdraw from such joint ventures, as the amount of investment from the foreign partner was specified on approval by the Foreign Capital Inducement Deliberation Committee. The foreign partners' shares thus represented totally stable portions of capital, as these stock shares were never marketable on the stock exchange. The parent companies were therefore able to completely control the joint ventures by adding small shares of their own which, when added to the foreign shares, made up secure controlling shares. The advantages of joint ventures for Korean entrepreneurs therefore were not limited to the widely known ones, namely access to capital, technology, and managerial know-how. Rather, the greatest merit was that it offered to the Korean partners control over the whole joint venture with a minimum of their own resources.

The second advantage of the subsidiary system was that the parent company owner, who had relatively little investment into the subsidiary, could evade the risks in case the subsidiary failed. If a failure occurred, the parent company would certainly be hurt, but the damage would not be serious. For a Korean entrepreneur who desired to control his whole business group at a minimum of risk to his own resources, the most desirable way was to establish subsidiaries through the mobilization of external funds (external to his own funds and inclusive of the parent firm's funds). His control of the whole group would thus become indirect.

IV. PERSONAL CONNECTIONS BETWEEN GOVERNMENT AND BUSINESS

It is widely recognized that Korean economic development owed much to government leadership. In fact there are numerous institutions in Korea which allow the government to participate in economic development processes. They include the Economic Planning Board, which was established to enforce industrial promotion policies, the government's direct control over banks and other financial institutions, and the all-powerful Foreign Capital Inducement Deliberation Committee,

6 The dividend rates declared by listed companies at that time were not higher than the general bank loan rates.

which is composed of the top leaders of governmental economic agencies and business circles. But it is clear that this institutional framework alone could not have brought about rapid economic growth. There needed to be certain channels of communication to facilitate the flow of information between the government and private business. Through these channels, private business obtained information about decision-making processes, including government priorities in fiscal or tax support. Using the same channels, business firms lobbied the government to designate their industries as strategic branches.

This author once pointed out the importance in Korea of close personal relationships, based on kinship, home region, and alma mater (Hattori 1992). But we will not discuss the issue of general personal relationships. In a previous article, we pointed to the close personal relationships between business leaders in the cement industry and government officials. The cement industry, which inducted a large amount of foreign money under the First and Second Five-Year Plans, and in particular the leading cement-producing firm Ssangyong Cement Industrial Co. Ltd., systematically courted and hired former high-ranking government officials, especially those who had been in charge of the cement industry. The cement industry was one of the branches whose growth was encouraged in government planning. The ex-officials hired by the cement industry included a former Chief at the Division of Foreign Capital Inducement of the Economic Planning Board, Director of the Economic Cooperation Bureau, Director of the Electricity Board as well as Director of Mining Bureau of the Ministry of Commerce and Industry, as well as ranking officials in the Ministry of Reconstruction (Hattori 1994a, pp. 256–59). There is little doubt that these officials communicated government policies and priority considerations to the cement industry as a whole and to the specific cement companies they began to work for. Furthermore, it is certain that these ex-officials retained some influence in their original government agencies. It is thus highly likely that information about government industrial and foreign investment policies were communicated to the business world through these persons.

A look at the *Hanguk inmyon sajon 82-nyon-pan* [Korea who's who, 1982] (Yonhap New Agency 1982) may help further corroborate the personal relationships bridging government and business. It lists more than 900 business elites, including more than 60 persons who once served as high ranking officials at the Economic Planning Board and the Ministry of Commerce and Industry. By whom were these officials rehired after retirement? Of the 63 persons, 10 were excluded from this analysis, as their terms of office were too short. Of the remaining 53, one was the son of a *chaebol* owner, who went back to his father's business after retirement, so he was excluded as well. Of the remaining 52, 11 found work in business associations such as the Korean International Trade Association, Small and Medium Industry Promotion Corporation, Korea Association of Machinery Industry, and the Spinners and Weavers Association of Korea while five were hired by banks such as the Medium Industry Bank, Korean Development Bank, and Korea Exchange Bank. Four others moved to public corporations like the Korean Petroleum Corporation and Onsan Copper Refining Corporation, and one became a member of parliament. The remaining 31 all found jobs with private companies. While 10 were hired by non-*chaebol* firms, 3 later moved, one each, to Lucky-Goldstar, Doosan, and Dong Ah, all *chaebol* firms. Twenty-one moved directly to *chaebol* firms on retirement: 4 to Ssangyong, 3 to Korea Explosives Co. Ltd., 2 each to Daewoo, Lucky-Goldstar, Lotte, and Hyundai, and one each to Samsung, Kumho, Hanyang, Hyosung, Kukje, and Kolon. Three out of the 21 later moved from one *chaebol* firm to another. The above mentioned firms are all *chaebol* which have placed high on the list since the 1970s. They are all listed in Tables I and II.

What official positions did these retirees occupy before moving to *chaebol* companies? One, who was hired by Samsung, had worked at the Presidential Secretariat and then served as Deputy Chief of the Heavy and Chemical Industry Promotion Committee. Another who moved to Hyundai had been Chief of the Economic Planning Board and then became Prime Minister of the Republic of Korea. Another who also joined Hyundai had been a member of the Heavy and Chemical Industry Promotion Committee. Yet another, who joined Ssangyong Cement after retirement, was Chief of the Division of Heavy and Chemical Industry of the Ministry of Commerce and Industry. Another, who also joined Ssangyong, had served as deputy director of the Economic Planning Board, Deputy Minister of the Ministry of Agriculture, Forestry and Fisheries, and President of the Agricultural Development Company. One person who moved to Daewoo had been Assistant Deputy Minister for Heavy and Chemical Industries of the Ministry of Commerce and Industry. He first moved from the government bureaucracy to a trading association, later went back to the government to work for the Prime Minister's Secretariat, and then moved to Daewoo. The individuals who joined Korea Explosives had held high government posts, as Director of the Heavy and Chemical Industry Bureau and Director of the Enterprise Planning Board. These ex-officials must have been a rich mine of information at a time when the *chaebol* groups were all stepping into heavy and chemical industrialization under the government's promotional policies.

The Economic Planning Board's "Kanbu chikon wi pyondong" [Job changes of the leading staff] (ROK 1982), which overlaps somewhat with the above *Hanguk inmyon sajon,* shows cases of high officials moving to private firms. Eight officials who served as deputy ministers or assistant deputy ministers moved to Lucky-Goldstar, Hyundai, Korea Explosives, Ssangyong, Korea Association of Machinery Industry, and Byucksan Corp. Some then moved between *chaebol* groups—from Korea Explosives to Ssangyong, from Korea Explosives to Samho International Co., Ltd., from Hyundai to Byucksan, or from Korea Explosives to Lucky-

Goldstar. Another eight ex–planning office or bureau directors were hired by banks, or by Lotte, Daewoo, and Lucky-Goldstar. There are fewer cases of these ex-officials of further transfers to other *chaebol* groups than among the ex–deputy ministers and ex–assistant deputy ministers.

Many of the high officials of the Economic Planning Board had the opportunity to move to key positions in other ministries and the Presidential Secretariat as well as to top positions in banks. Thus, not many moved directly to private companies. But these ex-officials, and particularly those who worked in the Economic Planning Board, were certainly very useful to the private companies who hired them, for they had participated in major decision making in the government, and had cultivated close personal relations with key incumbent government officials. Those who had moved to other government posts or financial institutions were all the more precious as sources of information, as they could be expected to have accumulated more knowledge and broadened their personal relationships.

If one believes that human beings are extremely efficient vehicles for the transfer of information, one must conclude that the flow of high officials to private firms served to facilitate this transmission. In other words, their migration route covers a broad range of institutions, from the presidential secretariat and other government agencies, through financial institutions, semi-governmental agencies, and economic organizations, to key private firms. The aforementioned trajectories of the Economic Planning Board officials show the breadth of the areas encompassed by this migration. It can be said that these broad areas of activities were integrated into a single territory under the leadership of the Economic Planning Board, Ministry of Commerce and Industry, and the Ministry of Finance (whose importance goes beyond the scope of this paper). Information about the government's industrial policies was thus conveyed not only through home region-based and alma mater-based networks, but also by the movement of individuals from government to private business. They indeed acted as vehicles of information.

V. CONCLUSION

The Korean economy developed under powerful government leadership. The government was able to exercise this leadership because it exercised monopoly control over the acquisition and allocation of investment funds. As we stated earlier, the Korea Development Bank, the government's financial arm, provided certifications of payment for foreign investments. All commercial banks were state banks until their privatization in the early 1980s, and the government in fact continued to control the personnel matters of the private banks until the end of the decade. Although the government's tight grip on fund allocations had the negative effect of depriving the banks of their independence and of the tools to overcome low profit rates and deteriorating financial positions, there is no denying that it was very significant and positive in orienting economic development toward government-projected goals. Moreover, the system of designating high priority and strategic industries worked very effectively, as it was combined organically with loans from banks and the National Investment Fund as well as with tax incentives.

There were also, on the other hand, a number of private entrepreneurs with excellent entrepreneurship. Though in a slightly different way than their Western counterparts, they demonstrated a very strong will to initiate and expand their businesses. They fully availed themselves, of course, of the benefits of the environment with strong government leadership. The *chaebol* groups may have been few in number, but they had to engage in sharp mutual competition as they stepped into new business fields. Competition often caused problems such as the over-investment that occurred in the second half of the 1970s, but we also find that governmental intervention usually failed to bring about favorable consequences.[7] The entrepreneurs were as eager to build up their family fortunes and ensure family control over their business as they were to expand the sizes of their business. Thus they held large shares of their firms' stocks, or set up subsidiaries financed and controlled by the parent firms. In addition, they organized joint ventures with foreign firms in such a manner that the foreign partners' holdings were in practice under their control. They thus succeeded in preventing takeovers by the foreign partners. In many cases, they appointed family members and relatives to managerial positions in order to protect their management rights. For Korean entrepreneurs, establishing a number of subsidiaries and growing gradually into a *chaebol* was a short-cut which minimized risks and maximized benefits.

And finally, human networks based on shared home regions and alma maters, the most important channels of communication in Korea, worked to convey the thoughts and inclinations of the government to private firms and vice versa. The movement of persons from government to business was the most effective means of information transfer. This had merits not only to private businesses but to the government as well, since it enabled it to transmit its will to private business, heightening the efficiency of its administrative guidance and other informal means of coordination.

This integration of the government, financial world, and a portion of private

[7] During the "heavy and chemical industrialization" period in the second half of the 1970s, the *chaebol* groups rushed to enter into new promising industries. Thus, huge production plans were drawn up in the automobile, engine, and heavy electrical machinery industries, ignoring actual demand. In the 1980s, the government intervened to adjust these plans. As a result, for instance, the Kia group was burdened with heavy losses, and was forced to withdraw from passenger-car production (Hattori 1988, p. 138). Makoto Abe (1997) has also written about this (p. 138). In the 1990s, the government again attempted to concentrate the *chaebol* businesses so that each *chaebol* specialized in one area of business as a "major business policy," but failed to carry this out, as more than one *chaebol* group wanted to stay in the each business area.

business into a single system was the key to Korea's economic development.[8] Of course, as shown by Numazaki's analysis (1997) of Taiwan, this cannot be termed a universal method for development. It was the "sharp competition" amongst private firms, with the government remaining aloof, that made Taiwan what it is today, while it was "regulated competition" under the conditions of government-private business integration that brought about Korea's economic success.

[8] After Kim Yong-sam was elected president, his two predecessors were charged and convicted of receiving enormous political funds from *chaebol* groups. Several *chaebol* leaders were also convicted. At the time of this writing, in fact, Korea is being rocked by revelations that some medium-sized *chaebol* groups received huge loans through lobbying and the irregular exercise of political influence.

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