

Role of Capital Markets and Reform of Corporate Governance in Korea

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I. Reform of Corporate Governance

- **Since the 1997 crisis, Korea has made important reforms to facilitate market-based restructuring of the corporate sector.**

- **A number of reform measures have been taken to improve the corporate governance framework and enhance transparency.**

- **Enhancing transparency of corporate information**
 - **International accounting standards were adopted in December 1998.**

- **Minimum ownership requirements for the exercise of shareholder rights have been further reduced.**
 - **Minimum share ownership requirements to exercise shareholder right to file derivative suits have been reduced from 1% to 0.01%.**

I. Reform of Corporate Governance (continued)

— Strengthening shareholders' rights

- Institutional investors were permitted to exercise their voting rights according to 1998 revisions of the Securities and Exchange Act.
- The scope of issues requiring shareholder approval has been expanded: disposal and transfer of essential assets and large-scale borrowing.
- Minority shareholders are becoming more active in monitoring corporate performance.

— Enhancing management accountability

- The legal liabilities of major shareholders involved in management in any form were increased to enhance their accountability.

I. Reform of Corporate Governance (continued)

— **Outside directors**

- **Starting in 1999, outside directors must account for at least a quarter of the total number of corporate board members for firms on the Korea Stock Exchange.**

— **Strengthening the role of boards of directors**

- **Related party transactions by large listed firms must be approved by directors and reported at the shareholder meeting.**

— **“Code of Best Practices” for corporate governance**

- **A “Code of Best Practices” for corporate governance using the OECD principle as a benchmark was introduced in September 1999.**

I. Reform of Corporate Governance (continued)

- **The corporate governance framework was made mandatory for large firms listed on the KOSDAQ**
 - **Companies listed on KOSDAQ that have more than 2 trillion won of capital must comply with the same corporate governance practices required of firms listed on the KSE.**

- **The shadow-voting requirements for mutual funds have been removed.**
 - **Mutual funds became a new monitor of corporate performance.**

- **The use of cumulative voting has been facilitated.**
 - **The threshold for proposing the adoption of cumulative voting has been lowered from 3 percent of shareholders to 1 percent.**

I. Reform of Corporate Governance (continued)

— Enhancing transparency

- **The government can impose fines up to 500 million won on accounting firms for improper audits.**
- **Accounting firms are liable for damages imposed on third parties, including shareholders, as a result of improper audits.**
- **Individual accountants were made subject to criminal charges and up to three years in prison.**

II. Corporate Restructuring

- **Corporate Restructuring**

- All forms of M&As, including hostile takeovers, were liberalized in May 1998.
- Efforts to boost foreign direct investment (FDI)

- **Activating mergers and acquisitions**

- Purchasers no longer have to report to the Financial Supervisory Commission (FSC)

- **“Capital Structure Improvement Plans”**

- Top 64 business groups
- Lead creditor banks
- Annual debt to equity targets

- **There have been a number of changes in the chaebol.**

- Of the top thirty business groups in 1997, 18 remained on the list in 2001.

III. Capital Market Opening and Liberalization

— **New market-opening measures include the complete removal of investment ceilings and restrictions on foreign investment in bond and equity markets.**

- **Short-term market instruments (CDs and RPs) were opened to foreign investment.**
- **Money market was fully liberalized.**
- **Hostile takeovers by foreigners were allowed in 1988.**

— **Foreign Exchange Transaction Act of 1998**

- **The Korean government has taken significant steps to accelerate the liberalization of foreign exchange transactions.**
- **The primary objectives of this new act centered on fully liberalizing the capital account and developing the foreign exchange market.**

IV. Promotion of Foreign Direct Investment

— Foreign Investment Promotion Act (FIPA) of 1998

- **From a regulatory and administrative nature into a promotion and support-oriented system**
- **The previous positive list system for businesses open to foreign entry was changed to a negative system in may 1998.**
- **To increase investor convenience and to provide greater autonomy to local governments in attracting FDI**

IV. Promotion of Foreign Direct Investment (continued)

— Foreign Investment Promotion Act (FIPA) of 1998

- **Annual inflows of foreign direct investment (FDI) rose from US\$3.2 billion in 1996 to over US\$15billion in both 1999 and 2000.**
- **FDI rose considerably from 1.46% of GDP in 1997 to 3.42% of GDP in 2000.**
- **The rise in FDI was significant in the service sector including financial businesses.**

Table 1: Annual Foreign Direct Investment Trends

Units: US\$ million, %

	1995	1996	1997	1998	1999	2000	2001
Investment Amount	1,941	3,203	6,971	8,852	15,541	15,690	11,870
(Rate of increase)	(47.4)	(65.0)	(117.6)	(27.0)	(75.6)	(1.0)	(-24.4)

Note: Figures in parentheses are compared to the previous year

V. Promoting the development of capital markets

— Government debt market

- Introduction of primary dealers, electronic auction procedures, and other measures to make the market more liquid.
- Five different types of government bonds were consolidated into a single type in order to develop issues with sufficient size to enhance liquidity.
- National Debt Management Fund became the predominant issuer.

— Developing new instruments

- Asset-based securities market has been developed with 32 issues in 1999.
- Mortgage-backed securities were issued in 2000.

V. Promoting the development of capital markets (continued)

— Development of KOSDAQ stock market

- **KOSDAQ stock market was created in 1996 from the existing over-the-counter market to permit high-tech start-ups and SMEs to raise long-term funds.**
- **The KOSDAQ stock market has grown rapidly due to government support and keen interest in venture businesses.**

Figure 1: Net Capital Inflows to Korea

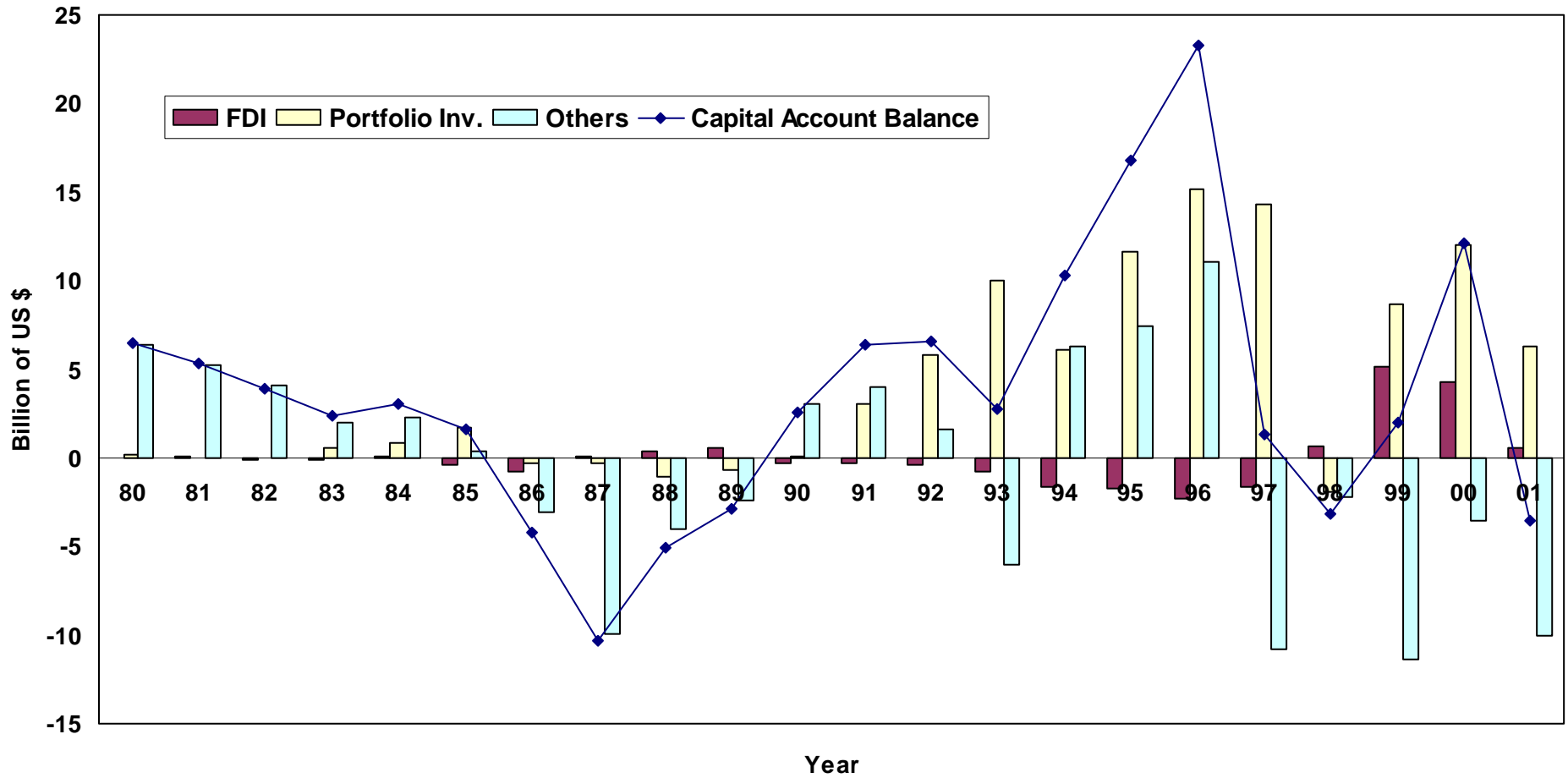
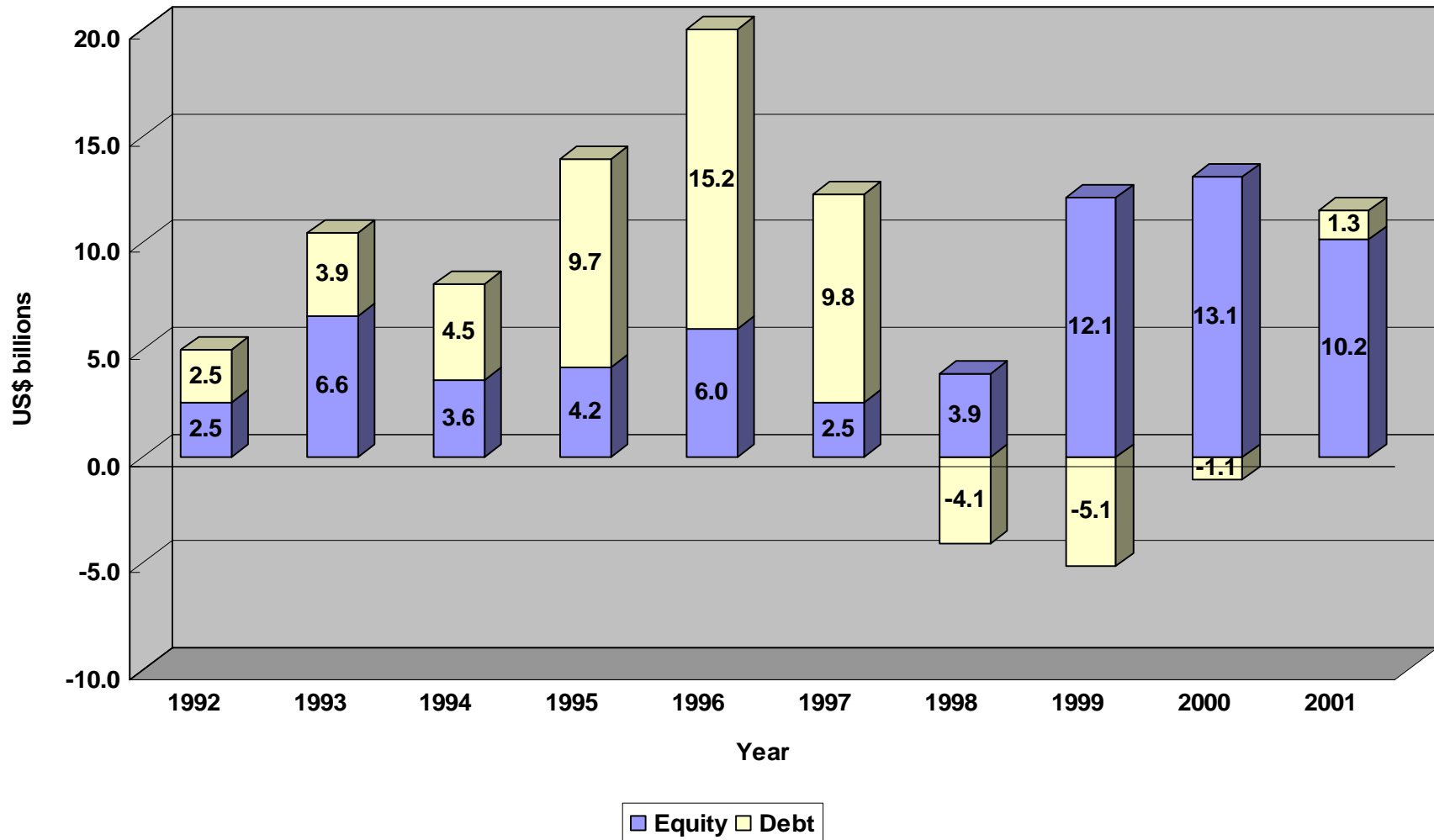


Figure 2: Composition of Portfolio Investment by Foreigners



Holdings by Foreigners in the KSE

	Market Value (billion won)			Number of Shares (10,000 shares)		
	Aggregate Market Value (A)	Held by Foreigners (B)	Ratio (%) (B/A)	No. of Listed Shares (C)	Held by Foreigners (D)	Ratio (%) (D/C)
1995. 12	141,151	16,723	11.85	760,941	76,231	10.02
1996. 12	117,370	15,222	12.97	859,838	98,929	11.51
1997. 12	70,989	10,358	14.59	903,075	81,979	9.08
1998. 12	137,799	25,640	18.61	1,144,367	120,460	10.53
1999. 12	349,504	76,591	21.91	1,732,580	213,688	12.33
2000. 12	188,042	56,559	30.08	1,963,867	273,107	13.91
2001. 12	255,850	93,698	36.62	1,957,830	286,922	14.66
2002. 7	289,273	100,941	34.89	2,547,786	299,700	11.76

Note: End of Month

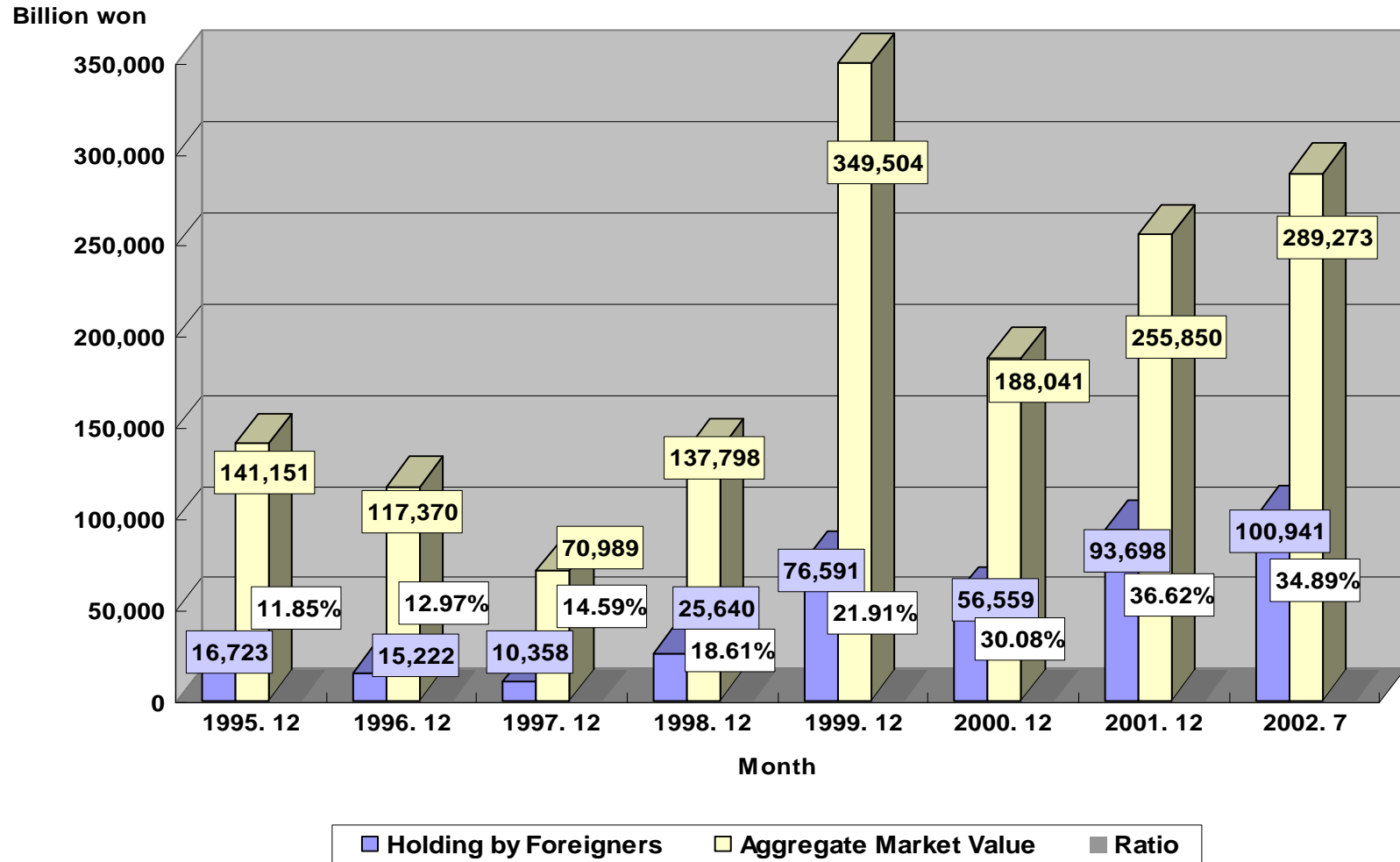
Source: 『Monthly Review』, Securities Supervisory Board.

『Stock』, Korea Stock Exchange.

『Monthly Financial Statistics Bulletin』, Financial Supervisory Service.

Financial Supervisory Service's Website, <http://www.fss.or.kr/kor/koreanIndex.html>.

Korea Stock Exchange's Stock Holding by Foreigners



Holdings by Foreigners in the KOSDAQ Stock Market

Month	Market Value (billion won)			Number of Listed Shares (10,000 shares)		
	Aggregate Market Value (A)	Held by Foreigners (B)	Ratio (%) (B/A)	Total Listed Shares (C)	Held by Foreigners (D)	Ratio (%) (D/C)
1997. 12	7,069	319	4.51	71,948	1,791	2.49
1998. 12	7,892	269	3.41	116,712	2,665	2.28
1999. 12	106,281	7,964	7.49	408,988	16,590	4.06
2000. 12	29,016	2,034	7.01	704,884	33,818	4.80
2001. 12	51,818	5,371	10.37	841,407	42,658	5.07
2002. 7	47,501	5,057	10.65	981,555	43,146	4.40

Note: End of month

Source: *Monthly Review*, Securities Supervisory Board.

Stock, Korea Stock Exchange.

Monthly Financial Statistics Bulletin, Financial Supervisory Service.

KOSDAQ Stock Market's website, <http://www.kosdaq.co.kr/>

Holdings by Foreigners in KOSDAQ Stock Market

