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$15 billion 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, %

<table>
<thead>
<tr>
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<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Amount</td>
<td>1,941</td>
<td>3,203</td>
<td>6,971</td>
<td>8,852</td>
<td>15,541</td>
<td>15,690</td>
<td>11,870</td>
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<tr>
<td>(Rate of increase)</td>
<td>(47.4)</td>
<td>(65.0)</td>
<td>(117.6)</td>
<td>(27.0)</td>
<td>(75.6)</td>
<td>(1.0)</td>
<td>(-24.4)</td>
</tr>
</tbody>
</table>

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

Billion of US $

Year

FDI  Portfolio Inv.  Others  Capital Account Balance

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September, 2002
Figure 2: Composition of Portfolio Investment by Foreigners

US$ billions

Year


2.5 6.6 3.6 4.2 6.0 2.5 3.9 -4.1 -5.1 -1.1 10.2

Equity Debt
## Holdings by Foreigners in the KSE

<table>
<thead>
<tr>
<th>Year</th>
<th>Aggregate Market Value (billion won)</th>
<th>Held by Foreigners (billion won)</th>
<th>Ratio (%) (B/A)</th>
<th>No. of Listed Shares (10,000 shares)</th>
<th>Held by Foreigners (%) (D/C)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995. 12</td>
<td>141,151</td>
<td>16,723</td>
<td>11.85</td>
<td>760,941</td>
<td>76,231</td>
</tr>
<tr>
<td>1997. 12</td>
<td>70,989</td>
<td>10,358</td>
<td>14.59</td>
<td>903,075</td>
<td>81,979</td>
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<td>1998. 12</td>
<td>137,799</td>
<td>25,640</td>
<td>18.61</td>
<td>1,144,367</td>
<td>120,460</td>
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<td>1999. 12</td>
<td>349,504</td>
<td>76,591</td>
<td>21.91</td>
<td>1,732,580</td>
<td>213,688</td>
</tr>
<tr>
<td>2000. 12</td>
<td>188,042</td>
<td>56,559</td>
<td>30.08</td>
<td>1,963,867</td>
<td>273,107</td>
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<tr>
<td>2001. 12</td>
<td>255,850</td>
<td>93,698</td>
<td>36.62</td>
<td>1,957,830</td>
<td>286,922</td>
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<tr>
<td>2002. 7</td>
<td>289,273</td>
<td>100,941</td>
<td>34.89</td>
<td>2,547,786</td>
<td>299,700</td>
</tr>
</tbody>
</table>

Note: End of Month
「Stock」, Korea Stock Exchange.
Korea Stock Exchange’s Stock Holding by Foreigners

Billion won

Month

Holding by Foreigners  Aggregate Market Value  Ratio


16,723  15,222  10,358  25,640  21.91%  188,041  93,698  100,941

141,151  117,370  70,989  137,798  14.59%  349,504  56,559  349,504

11.85%  12.97%  14.59%  25,640  21.91%  188,041  36.62%  34.89%

349,504  56,559  137,798  117,370  11.85%  255,850  36.62%  34.89%

# Holdings by Foreigners in the KOSDAQ Stock Market

<table>
<thead>
<tr>
<th>Month</th>
<th>Market Value (billion won)</th>
<th>Number of Listed Shares (10,000 shares)</th>
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<tr>
<td></td>
<td>Aggregate Market Value (A)</td>
<td>Held by Foreigners (B)</td>
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<tr>
<td>1997. 12</td>
<td>7,069</td>
<td>319</td>
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<td>1998. 12</td>
<td>7,892</td>
<td>269</td>
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<tr>
<td>1999. 12</td>
<td>106,281</td>
<td>7,964</td>
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<tr>
<td>2000. 12</td>
<td>29,016</td>
<td>2,034</td>
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<tr>
<td>2001. 12</td>
<td>51,818</td>
<td>5,371</td>
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<tr>
<td>2002. 7</td>
<td>47,501</td>
<td>5,057</td>
</tr>
</tbody>
</table>

Note: End of month

Stock, Korea Stock Exchange.


KOSDAQ Stock Market's website, [http://www.kosdaq.co.kr/](http://www.kosdaq.co.kr/)