The Corporate Governance Policies of Institutional Investors and its Implication in Korean firms

By

Tong- Wook Shim

THESIS

Submitted to

KDI School of Public Policy and Management

for the degree of

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ABSTRACT

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Since the Financial Crisis in Korea there have been numerous changes in corporate governance in both the private and public sectors. The increasing involvement of foreign investors in the restructuring process challenged Korean companies to further evolve their corporate governance systems. Corporate governance seeks to define the structural relationship among shareowners, the board and management. Ultimately corporate governance aims to raise transparency as well as the accountability of management to shareowners, while avoiding agency costs. Many studies have found a strong positive correlation between good corporate governance and companies' performance; good corporate governance, it is widely believed, lowers the cost of capital in the long run. Effective corporate governance implies several virtues including the maximization of profits (and reduction of corruption) that are seen as necessary elements of a healthy market. Many worldwide institutions, including the Organization for Economic Cooperation and Development (OECD), feel the need to outline principles of corporate governance.

Another recent social phenomenon is the institutionalization in the stock market. Institutional investors now hold between 50 to 60% of all shares; this rate is increasing as is the rate of international diversification. The California Public Employee's

Retirement System (CalPERS), a public fund, and the Teachers Insurance and Annuity Association –College Retirement Equity Fund TIAA-CREF, a private pension fund, manage over 400 billion dollars together in the US alone.[1] Korean firms and institutional investors have been increasingly pressured to reinforce and activate stronger corporate governance measures, given that foreign investors' share in the Korean stock market represents 36% of market value, as of February 2002. According to both the 1999 Korn/Ferry survey and a KSE survey, Korean corporate governance still lagged far behind international standards. Problems that were particularly acute included: the (lack of) independence of directors, the disparity between controlling rights' and ownership rights', and the negligence of institutional investors to take a more active role in protecting depositors rights. Such serious problems still persist, despite the financial crisis. Two recent surveys -- one from Standard and Poor's (S&P) and the other from Credit Lyonnais Securities Asia (CLSA) -- further confirm the lower degree of corporate governance in Korea, while pointing out the positive relation between corporate governance and ROE.

The paper suggests that the sustainable growth of the Korean stock market requires that 1) the government deregulate restrictions on pension funds stock investments and 2) institutional investors be required to prepare their own corporate governance guidelines and disclose them to the public. Ideally, individual investors should be able to entrust their money with institutional investors, while companies need to encourage stable patterns in equities sales by meeting the expectations of institutional investors. Such an improvement is not just a single act but rather requires systematic change.

[1] CalPERS, the largest U.S. public pension fund, manages over $160 billion USD in assets; TIAA-CREF, the largest

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This research is dedicated to my family; twins who just started their long journey in the public education system, my wife who urged to write a thesis rather than SRCs, and my parent who lovingly took care of my kids during such times. Also my heartfelt warmth goes out to my many comrades in POSCO; they allowed me to forget about my work duties and to concentrate on studies. Moreover, within my KDI family I cannot overemphasis vital role that certain professors played in dedicating their efforts on my behalf. Such persons include Professor Seung Joo Lee, Dr. Deuk-Keun Ahnn, my advising Professor Woo-Chan Kim, and Sang-Moon Hahm, who gave me academic passion. Dr Behling always provided me with a balanced point of view. Also I cannot forget many of my friends in the academic affairs department in the school. There are many friends who helped me finish this paper. Let me forward my appreciation to John who edited the paper, and thanks to O.K. Noh, who provided essential IT support. Finally, may I add that all thanks and praise are deserving of my Lord.

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private U.S. fund manages over $230 billion USD

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Ⅰ. INTRODUCTION

On Friday April 26 the Korean stock market (KOSPI) plunged under 900, recording a 43-point (4.7%) drop, the largest fall since the 911 accident. One reason for the fall was the decline of the U.S. market the previous day, but an even worse impact came from a murky stock transaction between the controlling shareholders and subsidiary of LG Chemicals. This transaction cooled down KOSPI, as rumors concerning a lack of transparency once again abounded. Investors responded to the shady deal with a 'walk on wall street' – the stock price of LG's major companies crashed by almost 20%; within a few short hours, 1.9 trillion KRW in market value evaporated due to poor corporate governance practices.

There has been extensive discussions on corporate governance in academic research and business areas since the 1980's, and it has taken over a century develop theories related to effective capital allocation. The recent bankruptcy of Enron has forced U.S. regulators, politicians, accountants, and the business community to reconsider the proper role of corporate governance.

It is widely agreed that corporations provide the best structure to create wealth for a majority of people. By splitting shares from major ownership to disperse risk, and separating ownership and management to increase efficiency, corporations have grown in both their size and effectiveness.[2]

But concentrating economic power in the hands of management caused various

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[2] According to Dean Robert Clark of Harvard Law School, the four characteristics essential to the vitality and appeal of the corporate form are: a. limited liability for investors, b. free transferability of investors interests, c. legal personality (entity-attributable powers, life span, and purpose), d. centralized management (Corporate Governance 2nd,2001.Robert A. G. Monks Nell Minow)

problems, including agency problems, moral hazards, conflicts of interest and social responsibilities. It was due to such reasons that the board system arose, aiming to control (or at least reduce) the problems associated with management 'abuses'. In recent years, solid corporate governance has been defined as the sharing of power of three main pillars -- shareowners, directors, and management.[3] Corporate governance, therefore, seeks to define a balanced relationship among these three participants, in the hopes of advancing the profitability and long-term survival of corporations. It is noteworthy that the ultimate purpose of corporate governance is the 'transparency' of management, coupled with 'accountability' to directors and shareholders. Even though these two important factors do not guarantee that a company will perform well, they at least indicate the direction that most companies seek to pursue in the future. We may also note that good corporate governance is enhanced both through the enhanced the transparency of management and the accountability of directors.

As Alan Greenspan commented at the Stern School of Business, any legislative and regulatory initiatives to strengthen the duties of CEO with respect to accounting and disclosure and to force selection of slates of directors who are patently independent of CEO influence and thereby significantly diminish the role of CEO could not be the overall solution. Because potentially this creates competing power centers within a corporation and thus dilute coherent control, in turn impairing effective governance.[4]

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[3] Berle & Means model was challenged by LLS&V research. Contrary to the model LLS&V found that only 1/3 of worldwide companies does fit to the separation ownership and management model. They argued the more important thing is the how to control the controlling shareholders who manage the company directly and how to protect minor shareholders.

[4] At his remarks on corporate governance on March 26,2002, even he expected legislative and regulatory move following the bankruptcy of Enron, he was certain that institutional investors' exertion far more control over corporation affairs than they appear to be willing to exercise would be better way under current CEO-dominant

Therefore what is needed is some structural balance between *effective management* and *transparency of management*; if such balance does not natural exist, intermediate adjustors are needed. Greenspan further asserted that institutional investors make a credible alternative to the concentration of power that many American CEOs possess.

Of course, even the definition of institutional investor varies from country to country, according to their various legal and financial regimes. Some define institutional investors as specialized financial institutions that manage savings collectively on behalf of small investors toward a specific objective in terms of acceptable risk, return maximization, and maturity of claims. One of the most important developments in financial markets in recent years has undoubtedly been the institutionalization of savings fueled through the growth of pension funds, life insurance companies, and mutual funds.[5] The volume of such investment instruments has dramatically risen in recent decades due to several factors, including: demographic influences (a larger base of aging people), greater wealth accumulation, as well as the development of more specialized and sophisticated financial instruments, as in derivatives.[6] Each type of institutional investor takes a different investment approach in terms of their portfolio,

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paradigm. (http://www.federalreserve.gov)

[5] Institutional Investors (Davis & Steil, 2001)

[6] Their claims valued at 100% of G-7 GDP and also account 30% of financial intermediation and 30% of household sector assets. These figure are much higher in countries such as the United States and United Kingdom, where institutional assets are almost twice GDP. Convergence of the rest of the G-7 on these levels would accordingly entail massive further expansion of institutional investment.(see Institutional Investors-Davis & Steil)

Twenty-five wonderful trends of the twentieth century (The greatest century that ever was: 25 Miraculous Trends of the Past 100 years, Stephen Moore and Julian L Simson)

Trends	Life expectancy	Per Capita GDP	Household asset	Poverty rate
1900-1920	47 yrs	$4,800 ('98dollars)	$ 6 trill (1945)	40% of US household
1995-1998	77 yrs	$31,500 (")	$ 41 trill	13% of US household

length of investment period; such decisions, of course, are mainly dependent on the characteristics of the clients they represent. But generally, with the exception of mostly mutual funds, they hold their assets long periods of time. It is for this precise reason we ought to be concerned with institutional investors – for they are quickly becoming the major shareholder in numerous corporations, and in turn hold the keys to maintain sustainable growth. Naturally, they have learned to expand their investment abroad as well, to lessen systematic market risks that cannot be avoided within any domestic market.

Although to date there seems to be no clear evidence to support the claim that institutional investors' activism increases the performance of corporations, their prominent market share and purpose of their activism deserves attention; it is therefore worthwhile to review their policies and principles regarding corporate governance, and to duly heed their views, when deemed necessary.[7] The financial crisis of 1997 resulted in a near total loss of confidence of both domestic and foreign investors in Korean financial markets. The government managed to successfully restore credibility through deregulation; foreign investment in the Korean stock market became quickly liberalized.[8]

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[7] While Nesbitt(1994)finds that companies targeted for monitoring by CalPERS outperform S&P index by 41% over subsequent five year period, Smith(1996) and Wahal (1996) finds successful market reaction on shareholder proposal but fails to to notice any improvement in firm's operating performance

[8] Starting in 1992,Korean government completely removed limits on foreign investors in Korean stock market in May 1998 ,except specific public companies, which still limited 40%

Market open schedule *(unit:%)*

Date	92.1.3	94.12.1	95.7.1	96.4.1	96.10.1	97.5.2	97.11.3	97.12.11	97.12.30	98.5.2
Total	10.00	12.00	15.00	18.00	20.00	23.00	26.00	50.00	55.00	100.00
Person	3.00	3.00	3.00	4.00	5.00	6.00	7.00	50.00	50.00	100.00

The goal of this thesis is to discuss the institutionalization of the Korean stock market, and to provide some ideas for better corporate governance to institutional investors and publicly traded companies. Part Ⅱ, THE GROWING POWER OF INSTITUTIONAL INVESTORS IN CORPORATE GOVERNANCE, describes the concept of corporate governance, the scope of institutional investors and the role they play, as well as their activism. In Part Ⅲ, CORPORATE GOVERNANCE POLICIES OF INSTITUTIONAL INVESTORS, the principles or policies of various institutional investors are reviewed, by comparing the various Korean institutional investors that exist. Part III also includes international perspectives concerning organizational principles and governmental legislations. Part Ⅳ, CORPORATE GOVERNANCE AND PERFORMANCE IN KOREAN COMPANIES, empirical tests are applied to help explain the relation between corporate governance and performance in the market or in the area of accounting. Unfortunately, a regression model could not be utilized in this research due to the lack of data available in the Korean market. But with valuable data from S & P and CLSA, we can garner some key ideas. Part Ⅴ concludes with improvement recommendations for Korean institutional investors and public companies.

Ⅱ. THE GROWING POWER OF INSTITUTIONAL INVESTORS IN CORPORATE GOVERNANCE

2-1 Corporate Governance

OECD Principles of Corporate Governance state that corporate governance includes a set of relationships between a company's management, its board, its shareholders and other stakeholders. OECD principles also provide the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance. CalPERS quotes the definition of corporate governance from Robert A.G Monks and Nell Minow, feeling that it represents the relationship among various participants in determining the direction and performance of corporations. The SCGOP("The Foundation for Corporate Governance Research for Pension Funds") Handbook states that corporate governance is concerned with the way companies are managed and managements are supervised. The SCGOP Handbook goes on to state that various parties in companies play their own specific roles; management and executive boards are responsible for managing the company; supervisors and non-executive boards regulate management boards; work councils can advise managements; while shareholders are responsible for appointing members of the supervisory and management boards, as well as auditors.[9]

There are differences of opinion as to what form of corporate governance is best

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[9] see preamble of OECD Principles of Corporate Governance : SG/CG(99)5

Also: see Corporate Governance Core Principles & Guideline (Apr.13,1998) of California Public Employee's Retirement System. And: the SCGOP Corporate Governance Handbook

for a company. The way in which publicly listed companies are managed varies from country to country because of differences in history and culture, in laws and regulation, in the pattern of ownership, and in the structure of capital markets. Much literature makes a distinction between Anglo-Saxon, German and Japanese models of corporate governance. The U.K. and U.S. that focus on shareholders' interests typify the Anglo-Saxon model. German and Japanese models, in contrast, focus on stakeholders' interests. Otherwise we differentiate such models as market-oriented or control-oriented. Europe usually applies a 'two-tier' board system that has a supervisory board *and* executive board, contrary to the one-tier board system used in Anglo-Saxon systems. Regardless of these differences, core principles on corporate governance nevertheless remain, as stipulated in OECD principles, The International Corporate Governance Network(ICGN) statements, and others.

The first basic principle is regarding shareholder rights, and their timely access to financial information, voting rights, and their involvement in the process and approval of important matters. The second basic principle concerns takeover defenses to guarantee the continuity of a company (in exceptional situations) but not the continuity of management against shareholders' interests. A third core principle concerns management structure; independence of directors should be secured and conflicts of interest should be avoided. Last, transparency is widely seen as a vital principle of corporate governance. Transparency includes the disclosure of strategy, the rationalization of the decision making process within a company, as well as the remuneration of executives and non-executive directors. Shareholder rights, takeover defenses, management structure and transparency are basic principles, rather than a system onto themselves. Corporate governance seeks to heighten accountability to those

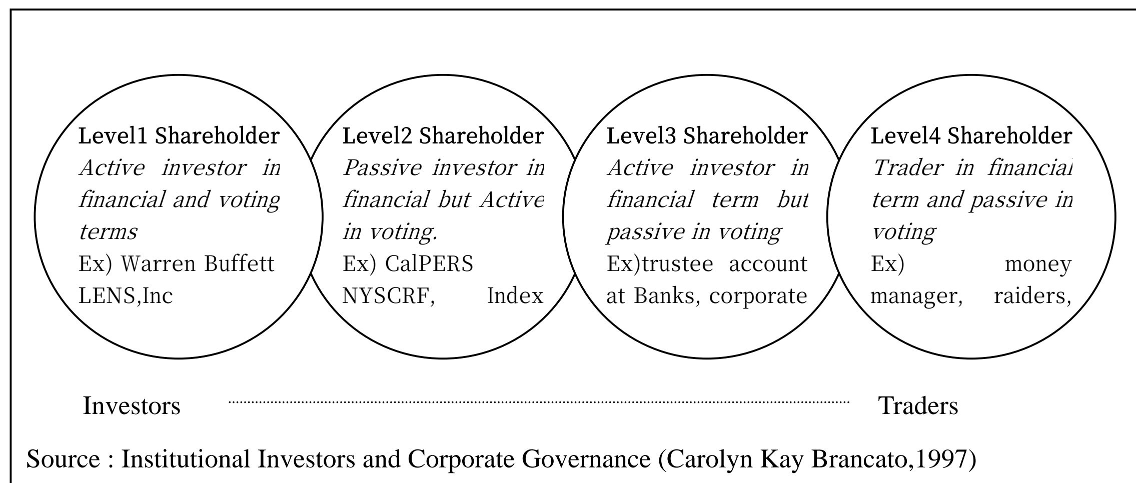
bearing the brunt of risk–bearing capital: shareholders.

2-2 The Scope of Institutional Investors and Investment Patterns

As mentioned before, the definition of institutional investors varies from country to country according to their specific market system, but mostly includes pension funds, insurance companies, mutual funds, banks, and trust companies. Each of these institutional investors has an investment pattern characterized by the needs of their customers.

Brancato suggested a spectrum by differentiating investors from traders, with investors at one end of the spectrum, and traders at the other.[10] Investors are those whose interest are more fully aligned with the success of the corporation, and traders are those whose interests are more narrowly focused on achieving rates of return over a more limited duration, regardless of the ultimate effect on the corporation.

Figure 2-1 : Level of Shareholder Participation



Source : Institutional Investors and Corporate Governance (Carolyn Kay Brancato,1997)

[10] Institutional Investors and Corporate Governance-Best practices for Increasing Corporate Value (Carolyn Kay Brancato,1997 The McGraw-Hill Companies Inc)

It is very important for corporate executives to understand investment characteristics, and the behavior of various shareholders along a spectrum when they make business decisions that effect shareholders. Such an understanding is the basis to build a mutually acceptable framework of reference regarding investment strategies and corporate governance. Both investors and traders play vital roles in markets; investors' interests are more aligned with the long-term intrinsic value of the firm, while traders occupy a critical place in the securities market by supplying liquidity to support sustained investment. Warren Buffett (and LENS Inc.) represents another type of investor called *relationship investors*; they are typically active investors, interested in strategic investments that gain them voting rights.[11] To these ends, relationship investors invest in only a small number of companies and become more involved developing in-depth relationships with their portfolio companies. Robert A.G. Monks and Nell Minow classify this as value investing. In a recent article, Monks suggests that 'global investors' offer a solution to the instinctive problems of most corporations; global investors are defined as investors that buy significant amounts of equities

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[11]Warren Buffett is chairperson of the board of Berkshire Hathaway Inc., and well known for making wise acquisitions of relatively small, well-run enterprises. A 1994 annual report of Berkshire Hathaway listed the company's ownership stake in American Express (5.5%), Capital Cities/ABC,Inc (13%), Coca Cola (7.8%), Federal Home Loan Mortgage (6.3%), Gannett Co.,Inc (4.9%), GEICO Corp (50.2%), and the like. By year's end (1994), the cost of all stocks purchased totaled $4.9 billion US, while market value reached an estimated $14 billion, for a book profit of $9.4 billion. Berkshire espouses that their `acquisition criteria' is to make large purchases that can demonstrate consistent earning power, in businesses earning good returns on equity while employing little or no debt, with management in place and governing a simple business plan

The LENS fund began in 1992 with the purpose of acting as an active money manager in what maybe regarded as the first 'corporate governance fund' (Institutional Investors and Corporate Governance, Brancato)

worldwide, and he believes that they practice responsible ownership wherever their bases are.[12] The focus of Monks global investors was in the arena of retirement funds and charitable foundations. Regardless of their investment behavior, the institutional investors include public pension funds, corporation pension funds, mutual funds, insurance companies, banks, and trusts.[13]

2-3 The Economic Clout of Institutional Investment

In recent decades, the field of institutional investment has mushroomed in global financial markets due to aging populations, greater wealth accumulation, and the sophistication of financial instruments, as previously mentioned. By mid-1995 U.S. institutional investors held assets worth $10.2 trillion -- nearly 22% of all U.S. financial assets. While their holdings in the equity markets have remained steady at approximately 50%, by the end of 1995, their ownership in the largest 1,000 U.S. corporations increased to 57.2%, up from 46.6 % in 1987.[14]

Growth in institutional investment during the past 25 years has been

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[12] In The Wealth of Nations (1776), Adam Smith identified four threats borne out in the modern corporation: infinite lifespan, limitless size, ever growing power, unlimited license

[13] In Korea, several laws mention institutional investors, as in the Banking Acts, Securities Transactions Act, and Corporate Tax law. Generally they include banks, securities companies, insurance companies, non-banking financial intermediaries and others (see The role of Institutional Investors in the Evolution of Corporate Governance in Korea, Lee Jae woong, Seo-gang Univ.)

[14] Institutional Investors (Brancato,1995) pp.20

Institutional Ownership in the 1,000 Corporation: 1987-1995

'87	'90	'92	'93	'94	'95
46.6%	49.5%	52.8%	55.8%	57.1%	57.2%

extraordinary. Total institutional investor assets nearly tripled in one decade, from $672.6 billion in 1970 to $1.9 trillion in 1980. The next decade brought more than a tripling of assets, to $6.3 trillion in 1990. There was an additional, staggered increase of more than 50% in next four years, to $9.6 trillion by the end of 1994. Then in a single year – during the stock market in boom of 1995 – institutional investments rose to $ 11.2 trillion by the year's end. The annual growth rate of institutional investors averaged 14.9% during the first half of the 1980s and then leveled off to 10.8% during second half of the 1980s. Aided by the boom in the stock market, assets grew 13.3% between1990 to 1993, slowed to 2.1% growth in 1994, then again boomed to 16.3% in 1995.[15] Table 2-2 shows that U.S. institutional investors continue to amass unparalleled amounts of financial assets while achieving robust growth. Total institutional investor assets grew 16.7% from 1996-1997; 13.7% from 1997-1998; and 14.3% from 1998 to the end of 1999. In 2000, the institutional investments rose marginally to $19.5 trillion from $19.3 trillion at the end of 1999. U.S. institutions continue to control nearly half of the U.S. equity market, although this amount has leveled off in recent years due to increased individual investing[16]. In Korea as well, total amount of institutional investors' assets has grown explosively, at an average of 33% per annum from 1992 to 1999 (except 1997, the year of the financial crisis). In 2000, Korean institutional investors total assets fell to $ 296.5 billion US, due to the slowing stock market. Table 2-1 compares the size of Korean institutional investor assets with three other prominent OECD countries.

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[15] Institutional Investors (Brancato,1995) pp.20

Institutional Investors Statistical Yearbook, OECD (2001 edition)

[16] The Conference Board (www.conference-boad/org) and OECD Statistical Yearbook 2001 edition

Table 2-1

Financial Assets of Institutional Investors Unit: US$ billion

	1992	1993	1994	1995	1996	1997	1998	1999	2000
Korea	161.4	189.4	220.2	266.4	284	169.2	326.4	375.9	296.5
Japan	3012.6	3628.5	4024.8	4322.7	3931	3517.7	4075.7	5039.8	na
UK	1207.2	1543.6	1522.1	1814.9	2225.5	2624.4	2889.9	3264.8	
US	8035.3	9051.7	9584.9	11239.5	12729.4	14842.2	16873.2	19279	19450.9

Source: Institutional Investors statistical yearbook, OECD 2001

Pension funds are the single largest category among institutional investors. Their growth was attributed to U.S. regulatory policy; corporate pension funds began under federal regulations established by the Employee Retirement Income Security Act (ERISA) of 1974.[17] By the first half of 1995, pension funds accounted for 48.1% of total institutional investor assets. Pension funds also registered the largest increases in size, from $860 billion in 1980 to $4.9 trillion by mid 1995.[18]

Pension funds still control the largest block of U.S. institutional assets; in 1999, they constituted 47.5% of all institutional investor assets. Within the pension fund category, state and local funds have grown most rapidly from $0.8 trillion in 1990 to $2.7 trillion in 1999 and they now account for 14.5% of total institutional investor assets - up from 13.0% in 1990. Meanwhile, open ended mutual funds have enjoyed staggering growth from $0.9 trillion in 1990 to $4.1 trillion in 1999 and they now account for 21.9% of all institutional investor assets - up from 14.5% in 1990[19].

State and local pension funds now devote 69.3% of their total assets to equities, up from 36.1% in 1990. This increase reflects a pervasive movement on the part of

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[17] ERISA pension funds are modeled on trust law, whereby a fiduciary must act for the exclusive benefit of pension plan participants and beneficiaries. By providing this framework for confidence, ERISA inspired the investment of vast sums in US corporate pension plans.(Institutional Investors 1997 Brancato)

[18] Institutional Investors (Brancato,1997)

[19] The Conference Board (www.conference-boad/org)

these public pension funds to diversify their portfolios into equities from their historically more conservative investments in the bond markets. In 1990, these public pension funds accounted for only 8.4% of the total equity market. But by the end of 1999, they accounted for 9.9% of total equities. By comparison, corporate pension funds actually lost ground as a percentage of total equity ownership: in 1990 they held 16.8% of total equities, which had declined to 13.2% by 1999. So pension fund occupied 23.1% of total equities. Even total public fund in Korea reached 571.7 trillion KRW basically the law prohibited the fund from investing in the stock without fitness to their purpose of establishment and public interests[20].

Of late, mutual funds have become more relevant in corporate governance matters, since they are amassing considerable amounts of equities by devoting a larger proportion of their assets to equities and enjoying considerable growth at the same time so that they command a larger proportion of the equity market. In 1990 they devoted 23% of their total assets to equities, representing only 6% of the total equity market, but by year-end 1999 they devoted 58.8% of their total assets to equities, representing 12.7% of the total equity market[21].

Institutional investors controlled 49.6% of the 1999 equity market, down slightly from 50.1% in 1998. Historically, institutional investors have accounted for greater and greater percentages of the equity market; for example in 1980 they accounted for only 33.9% of total equities, but by 1995 they accounted for 46.6% of total equities. Since then, institutional control of the equity market has been in the 48-50% range and

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[20] Summary of status of Funds (Public Funds) from Ministry of Planning and Budgeting of Korea,2002

The law for the management of Funds (Article 3-3)

[21] The Conference Board (www.conference-boad/org)

declined to 49.6% during 1999[22]. The fact that individuals have come into the marketplace at a more rapid pace during the past few years, and are less likely to vote their proxies on governance issues, actually reinforces the governance clout of the more organized and activist institutions. These pension fund institutions are under a fiduciary obligation to vote their proxies and therefore tend to exercise their governance oversight in their portfolio companies more extensively.

What need to be considered are not only the *amount of holding* but also *the amount of management*, since many institutions allocate a large portion of their assets to other institutions to manage on their behalf. As table 2-2 shows, pension funds manage less than 50% of the assets they hold (20.2%); further, it may be noted, investment & insurance companies manage a greater proportion of total assets, 24.5% & 27.3%, respectively. Therefore in regards to pension funds, companies need to focus on other intermediaries when they plan corporate strategies to attract institutional investors.

Turnover rates, which affect the stability of the stock market, are another vital aspect of institutional investments. Table 2-3 shows the average turn over rates of typical institutions. As expected, money managers recorded higher rates as compared with the turnover rates of public pension funds, which is the result of the higher level of funds they index. Managers of public pension funds trade less, since they are less inclined to believe that they cannot beat the market returns to cover their transactions costs.

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[22] The Conference Board (www.conference-boad/org) Possible reasons for the slowing and now stalled trend in institutional holdings of the total equity market are: The trend by institutional investors to invest in hedge funds and other "private market" equities; A strong increase in individual shareholdings prompted by recent bull markets and easier on-line stock purchasing outlets for individuals; . New initial public offerings (IPOs), which pump equities into the markets but are generally below minimum capitalization thresholds for institutional investors;

TABLE 2-2: Institutional Investor Holding versus Management(1994)

Institution	Assets Held	Assets Managed
Pension funds	47.4%	**20.2%**
Private trusteed	26.3	15.5
Private Insured	8.4	0.0
State & Local	12.6	4.7
External investment advisors	0.0	8.2
Investment companies	18.6	**24.5**
Insurance companies	20.0	**27.3**
Banks	11.9	19.4
Foundations	2.1	0.4
Total	100.0%	100.0%

Source: The Brancato Report on Institutional Investment, 3rd ed (Jan.1996)

TABLE 2-3: Average Turnover Rates and Equity Indexation (Sep.30, 1995)

Type	1993	1994	1995	Indexation
Corporate pension funds	33.2%	19.9%	24.8%	13.2%
Public pension fund	**13.3**	**20.9**	**20.7**	**66.8**
Mutual fund managers	48.2	50.5	42.3	-
Money managers	**56.7**	**55.7**	**59.2**	**1.0**
Insurance companies	53.6	44.7	46.4	4.2
Banks	**24.3**	**29.5**	**25.3**	**32.9**
Weighted average for All institutions	41.5%	43.6%	42.6%	14.9%

Source: The Brancato Report on Institutional Investment,3,ed 1 (Jan.1996)

2-4 Activism of Institutional Investors

During the early 1990's, the collapse of takeover bids helped boost activism by

removing them as an alternative means of corporate control. The U.S. shareholders' activist movement was further encouraged in the early 1990s by a SEC ruling that allowed coalition building, which enabled investors to collude more readily. Since that time pension funds such as CalPERS and the New York Employees Pension Fund (NYEPE) voted on resolutions that they may have previously ignored. Shareholder activists have tried to:

- challenge excessive executive compensation and takeover protection
- split the role of chairpersons and chief executives
- remove under performing chief executives[23]
- ensure that independent directors are elected to boards[24]
- ensure that new directors be appointed by non-executives.

There has been a lot of dispute on the effectiveness of active involvement of institutional investors with corporate management. Many wonder whether such involvement really improves the performance of a company in terms of market or accounting returns. Empirical testing has resulted in mixed results. On the positive side, Wahal (1996), Strickland et al (1996) found positive effects relative to gains in share prices. Conversely, Del Guercio and Hawkins (1999), Wahal (1994), Gillan and Starks (1995), M.P.Smith (1996) found that no statistically significant positive returns over the long term. But there does seem to have been positive results in the case of CalPERS involvement. CalPERS targeted inferior companies, and through corporate governance

[23] in the early 1990s, such examples include: IBM, Westinghouse, Kodak, Amex, and General Motors.

[24] CalPERS agreed to support Texaco management in a takeover bid as long as they accepted independent directors. Pressure by CalPERS and NYEPF also forced GM to accept a resolution to make more than half their directors independent. (Institutional Investors; Davis and Steil 2001)

reforms, improved the returns of such firms. Companies that successfully employ investors enjoy less stock price volatility and a lower cost of capital, enabling them to make in-depth investments necessary to achieve sustained growth. A full alignment of the interest of management, boards, and investors is the key to improving sustained corporate performance in order to maximize profits for the benefit of corporations and investors alike.

U.S. shareholder activism started in the 1930s with individual shareholder concern over corporate accountability. Many labor groups and shareholder groups like CIC, CII, ICCR, IRRC, ISS, and IRAA helped mobilize U.S institutional investors; such organizations allowed such investors to become more powerful, to gain more economic and political clout than they could otherwise achieve as a single large institution.[25] Brancato explains institutional investors activism as a series of developmental stages, as follows: ① pressing corporations to adopt shareholders resolution on 'social issues' ② opposing management when corporations institute certain anti takeover tactics ③ urging corporations to make structural changes in their boards of directors and voting procedures ④ analyzing the performance of corporations and their board of directors to identify under performing companies to be targeted for shareholder action and ⑤ turning to non financial aspects of corporate performance in order to understand the ability of certain operations to perform not only over a historic period but to generate a stream of future benefits.[26] The first stage

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[25] CIC: The Corporate Information Center (1969), CII: The Council of Institutional Investors (1984), ICCR: The Interfaith Center of Corporate Responsibility in New York, IRRC: The Investor Responsibility Research Center Inc. (1972), ISS: Institutional Shareholder Services, Inc. IRAA: The Investors' Rights Association of America (1994)

[26] Institutional Investors (pp 82)

(‘social issues’), she indicates, was the period from 1931 to 1970, where the movement initiated by Lewis Gilbert attempted to transform annual meetings from ‘perfunctory legal rituals to forums for discussion between management and shareholders. Later this ‘annoying gadflies’ movement was succeeded by Saul Alinsky, who lead a group called FIGHT, which pressured Kodak to hire and train black people. This kind of social activism also surfaced during the anti-Vietnam War of the late 1960s. Two cases involving Dow and GM in the 1970s typically represent this type of social activism. In one case involving DOW, U.S. courts overruled the SEC’s support of Dow that allowed management the right to engage in business decisions without the interference of shareholders. The court’s action launched the *social investing movement* by permitting social responsibility issues to be included among shareholder resolutions. By establishing the Public Policy Committee in 1970 (as proposed by four public interest lawyers), GM made a landmark case for the social responsibility movement.

The modern institutional investors movement was born in the 1980s in the U.S. when takeover waves began as two-tiered bidding.[27] While institutional investors were concerned that they might be in breach of their own fiduciary duties if they did not sell or tender their share to raiders, corporations responded to these raiders by instituting various anti takeover tactics, many of which protected management at the financial expense of shareholders, prompting institutional investors to become involved in corporate governance matters.[28] According to one news release from the Korean Stock

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[27] Raiders typically buy a block of shares making a bid for 51% of shares outstanding, at a higher price offered on the market; then, having gaining control, they would engage in a `mop up’ transaction for the remaining 49% of shares at a significantly lower ‘back end’ price.

[28] There are many takeover related provisions; anti-greenmail provisions, consider non-financial effects of mergers, fair price provisions, poison pills, supermajority vote to approve merger, classified board (staggering term),

Exchange, during the period of March 2001 to February 2002, only 80 institutional investors disclosed their exercising voting rights. 95% of their voting was favorable to any given proposal, especially if the agenda of elected board members were in 100% agreement. This may be the result of the relationships that exist between institutional investors and the businesses that they are affiliated with. Given the country's chaebol structure, it is common for bank and insurance companies to take deposits from companies and then lend the money back to them as a regular part of their operation. Mutual funds are not an exception to this case, either. This type of interdependence hinders Korean institutional investors from exercising independent voting rights.

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cumulative voting, confidential voting, dual class stock, Limited shareholder ability to act by written consent or to call a special meeting, unequal voting rights.

* Summary of corporate Governance Provision for 1,500 Companies Tracked by IRRC (Brancato pp 106)

Provision	1990	1993	1995
Advance notice requirement	N/A	N/A	657
Anti greenmail	84	93	90
Blank check preferred stock	N/A	N/A	1,275
Classified board	850	862	895
Confidential voting	48	139	176
Consider non financial effects of mergers	96	111	108
Cumulative voting	263	233	216
Dual class stock	112	122	124
Eliminate cumulative voting	131	150	156
Fair price	475	492	487
Golden parachutes	N/A	N/A	799
Limit right to call special meeting	355	424	466
Limit action by written consent	352	416	467
Poison pill	759	795	799
Supermajority vote to approve merger	252	269	267
Unequal voting rights	34	31	30

Pension funds, on the other hand, are legally free from these obstacles.[29]

As for major institutional players in terms of shareholder activism, there is The Investor's Right Association, CalPERS, TIAA-CREF, and Taft-Hartly union pension funds that is comprised of over 3,100 members totaling $300 billion in assets. Table 2-4 lists major of institutional investors -- so called global investors -- in terms of their managed assets.

Table 2-4: Global Investors Profile

Rank	Fund	Country	Assets(US$ billion)
1	Stichting Pensioenfonds ABP	Netherlands	159.9
2	California Public Employees' Retirement	US	133.5
3	Assoc. of Local Public Service Personnel	Japan	101.3
4	New York State Common Retirement Fund	US	99.7
5	General Motors Investment Management Corp	US	87.0
6	California State Teachers' Retirement	US	82.6
7	Alimanna Pensionsfonden(Board 1,2 &3)	Sweden	80.1
8	Florida State Board of Administration	US	77.5
9	Nat'l Public Service Personnel	Japan	75.6
10	New York State Teachers' Retirement System	US	71.1
11	Texas Teachers Retirement	US	69.5
12	Public School Personnel	Japan	67.1
13	Federal Retirement Thrift Investment Board	US	64.5
14	New Jersey Division of Investment	US	63.3
15	General Electric	US	58.7

Source : 1999 Pension & Investment/Intersec World 300 Pension Funds

U.S. institutional investors have increased their presence in foreign equity markets, not only in terms of their equity position, but also with regard to the level and intensity of their participation in international corporate governance. US pension funds

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[29] Parthiban David and Kochhar addressed three barriers to effective corporate governance facing institutional investors: relationship oriented barriers, barriers arising from government regulation, & information processing barriers (European Management Journal Vol 14 No5 pp457-466).

and mutual funds increased their equity holdings from $97.5 billion in 1990 to $ 281.7 billion in 1994 representing aggregate increase in pension funds assets invested in foreign equities from 3.1% in 1990 to 5.5% in 1994 and an increase in mutual fund assets from 1.7% in 1990 to 3.9% in 1994. Their investment increased from $ 17.7 billion in 1989 to $ 61.9 billion in 1993 then to $ 85.3 billion in 1994. The percentage of their portfolio invested in international equity also increased from 3.8% in 1989 to 7.7% in 1993 and to 10.5% in 1994[30]. Such international investment reduces systematic risks that cannot be avoided through domestic portfolio investments alone. ADR and GDR also contributed to this increase.

As of December 2001, 12,860 foreigners were registered as investors in the Korean stock market, an increase of 9.5% over the previous year. Among them, 38.9% were U.S. investors; of these U.S. investors, 62.7% are institutional investors. Most of these institutional investors represent investment companies (42.8%) – while a mere 6% represent pension funds. Including direct investment, foreign investors hold 36.6% of the total market value as of the end of 2001.[31] Foreign pension fund represent 10.1% of total market value -- larger than paltry Korean pension fund holdings (1.1%). Their 119.8% turnover rate was much lower than the average market turnover rate, which is 599%. But the foreigner turnover rate is still much higher than that of the U.S. market. This figure indicates the degree of market volatility and insufficiency of long-term investors.[32] Table 2-5 shows the aggregate volume of international equities held by 25 of the largest U.S. pension funds; we can note that the majority of their international

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[30] In 1999, the foreign holdings of TIAA-CREF amounted to more than $23billion in 32 different market. CalPERS holds $32 billion overseas. Hermes held more than $20 billion aboard.

[31] Excluding direct investment, they hold 34% of market value.

[32] 2001 Overview of foreign investors (Finance Supervisory Board,2002 Feb)

equity investments have increasingly involved large pension funds in recent years, from 27.9% of all international investments in 1996, to 65.8% in 1999.

Table 2-5: International Equities of the largest 25 U.S. Pension Funds

(Billion U$)

		1996	1998	1999
25 pension funds	amounts	110.8	181.1	265.6
	Percentage	27.9%	41.9%	65.8%
Total U.S. investors	amounts	397.7	432	403.7

Ⅲ. CORPOATE GOVERNANCE POLICIES OF INSTITUTIONAL INVESTORS

3-1 A Chronicle of Corporate Governance Policy and Guidelines

The Bank of England and London Stock Exchange initiated the first corporate governance code of the modern era in the U.K. in 1992. This spawned so many imitators -- more than 60 governance codes in 30 markets as well as numerous international codes.[33] In the U.S., the National Association of Corporate Directors Blue Ribbon Commission on Corporate Governance identified key

[33] Corporate Governance (Monks and Nell)

Some leading international codes include: Bosch Report (Australia) 1995, Cardon Report (Belgium) 1998, Dey Report (Canada) 1994, Vienot Report (France) 1994,1999, King Report (South Africa) 1994, Peters Committee (Netherland) 1997, Corporate Governance Forum of Japan 1998, The Governance of Spain Companies 1998, Swedish Academy Report 1994, German Panel on Corporate Governance 2000

guidelines for: director selection, evaluation, compensation; further, a complete board evaluation was established 1994 and the Business Round Table announced its *Statement on Corporate Governance* in September 1997.

In response to growing concerns over corporate governance in OECD countries, seemingly justified by the Asian financial crisis, OECD Ministers in 1998 asked the OECD to develop a set of corporate governance principles that could be useful to OECD Members and non-Member countries. In June 1998 the OECD established an Ad Hoc Task Force on Corporate Governance with representatives from all member governments and key international organizations, including the World Bank, as well as a number of private sector and labor representatives with special expertise in corporate governance. At their annual meeting, OECD ministers approved the Principles in May 1999, offering guidelines under five categories: shareholders' rights, the responsibilities of shareholders, the rights of stakeholders', disclosure and transparency, and the role and structure of the board. This code is intended as reference for the companies that wish to amend their governance practices. In July 1999, the International Corporate Governance Network (ICGN), an investors' group representing more than $6 trillion in assets, made a more forceful statement of global principles. The ICGN believes that it is in companies' best interests to adhere to such recommendation even in the absence of any domestic legal requirements. In the meantime CalPERS and TIAA-CREF settled their own guidelines in 1998. During the Corporate Governance Forum of Japan corporate governance guidelines were issued in May 1998; German too bowed to international pressure and produced their first-ever corporate governance code in January 2000. Korea set up a "Code of Best Practice for Corporate

Governance" in September 1999.

3-2 OECD Principles of Corporate Governance

In its preamble on corporate governance, the OECD clearly states that its guidelines are not binding and not intended to be a detailed prescription for national legislation. Nevertheless, their principles make a useful reference point for policy makers.[34]

The right of shareholders: regarding the protection of the basic rights of shareholders included in the corporate governance framework, OECD principles refer to: ownership registration, conveying or transferring shares, obtaining relevant information on a timely and regular basis, participating and voting in general shareholders meetings, electing members of the board, and sharing the profits of the corporation. OECD principles also mention shareholders' right to be involved in decisions concerning fundamental corporate changes; this entails respecting shareholders' proposals at general meetings. Further, OECD principles urge that market forces should guide corporate practices, and oppose anti take over devices that shield management from accountability.

The equitable treatment of shareholders: This includes equal treatment within any class, cast voting by custodian or nominees for the beneficial owners of the shares, economical and easy access to voting, as well as prohibiting insider trading and abusive deals involving conflicts of interest.

The role of stakeholders in corporate governance: The rights of stakeholders

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[34] OECD Principles of Corporate Governance: Ad Hoc Task Force on Corporate Governance

ought to be protected by law and respected, and violations need be redressed effectively. This encourages active cooperation between corporations and stakeholders in creating sustainable wealth and jobs.

Disclosure and transparency: Timely and accurate disclosure should be made on all material matters; such information ought to be prepared in accordance under prudent regulations, and financial results ought to need be conducted by independent auditors.

The responsibilities of the board: The framework of any corporate governance policy should ensure the strategic guidance (and effective monitoring) of management by the board; additionally, board accountability needs to be aligned with the interests of the company and shareholders. The OECD principles describe compliance with laws as they pertain to the availability of information, the key functions of the board, the independence of directors (and sufficient number of non-executive board members), as well as the devotion of members.

The OECD principles are to be seen as minimum requirements applicable to various cultural settings. Each country and institution, of course, needs to amplify or modify such principles to meet their market characteristics.

3-3 Corporate Governance Policies of Institutional Investors

There is no ‘one-size-fits-all’ approach in policies or principles that binds either members or corporations. While institutional investors hardly expect that each company will adopt or embrace every aspect of their principles or guidelines, it is valuable to understand the basic philosophy of influential institutional investors in

regard to corporate governance. In this section, we will compare the corporate governance principles or guidelines of four organizations, which include: the Business Round Table ('BRT'), CalPERS (largest U.S. public fund), TIAA-CREF (largest private U.S. fund), and the Korean Code. As an association of chief executive officers, the BRT has made contributions for several years that have molded the evolution of corporate governance matters. They developed early concepts of corporate governance in the publication entitled "*The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation*" in January of 1978, their *Statement on Corporate Responsibility* in October 1981. Later, the Business Roundtable's released a statement on *Corporate Governance and American Competitiveness* in March of 1990, and another statement on corporate governance in September of 1997. In Korea the Committee on Corporate Governance was established as a non-governmental body in March 1999 to develop a code of best practices. The committee was composed of fourteen members from various business field including finance, accounting, law and the academia, along with an Advisory Group of thirteen law, securities, and financial specialists. The final draft was completed on September 22nd through a general meeting of the Committee and Advisory Group. Table 3-1 provides a detailed comparison of the four institutions' guidelines in respect to corporate governance.[35]

Regarding cumulative voting, whereas the BRT and TIAA-CREF are not concerned with directors that might represent specific groups of stockholders, the Code of Korea recognizes that cumulative voting is possible. This divergence stem from concerns of controlling shareholders that is more prevalent in Korea than that of U.S.

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[35] Mainly quoted from '*A Comparison of Board Guidelines and Best Practice in the US*' by Holly J. Gregory (November 1999)

These organizations share the same desire to protect shareholders wealth through the prevention of anti-takeover measures that tend to insulate the position of management. Although these institutions have similar general goals in mind, CalPERS supports the idea of electing board members on an annual election basis, while the TIAA-CREF does not. Instead, TIAA-CREF prefers to unify the CEO and chair (in contrast to the European two tier model), in which case they recommend (either formally or informally) the leader of outside directors. But such an outlook is not specified in the Korean code. Although neither CalPERS nor the TIAA-CREF put forth guidelines regarding the size of boards, one may assume that a smaller board is preferable. According to the Korn/Ferry survey, boards on average consist of 11 directors and the boards of larger companies, on average, consist of 16 directors. Most survey respondents believed that 12 is the most effective board size, with a mix of 3 inside directors and 9 outside directors.[36] As for the portion of outside directors on any given board, institutions support a substantial majority (of about 75%), while the Korea code decrees that a 50% outside participation rate is favorable.

One of the most relevant factors in corporate governance is the independence of directors. Maintaining the independence of directors is the key to any successful governance system. BRT, CalPERS, and TIAA-CREF all detail definitions of independence, while the Korean code does not. It is worth noting that these institutions define 'independence' as having an outside director who has not been an employee or officer of the company within the last 5 years; further, they state, outside directors

[36] The 1999 Korn/Ferry Survey is based on a study of more than 1,000 directors and chairmen of Fortune 500 listed companies. The survey also includes statistics on board composition and compensation taken from the proxy statements of 902 publicly held Fortune 500 listed companies.

should not be affiliated to even a non-profit entity, and cross directorship is prohibited. The BRT and TIAA-CREF are more flexible in their interpretation of independence clauses than CalPERS. TIAA-CREF allows arm's length regular transactions and individuals acting as supply service representatives. The Korean code is obscure in its definition of independence, since it merely requires companies to submit a 'letter of confirmation' that affirms their independence. The law should be ratified to provide a more specified definition of independence.

In the Korean code, the committee did not mention the CEO's evaluation, whereas other institutions separate CEO evaluations from those of directors. Generally, it is expected that the compensation of directors should be aligned with the interests of shareholders and be balanced in providing both long and short-term performance incentives. Each company has to have clear compensation criteria and disclose it. All of compared principles discuss the need for outside directors to meet in private, without the presence of the CEO or inside directors, so that they may evaluate the success (or lack thereof) and compensation of the CEO. Only CalPERS makes any mention of succession plans. Common committees associated with boards are the audit, compensation, evaluation and nomination committees, which are ideally composed of outside directors.

Table 3-1 : The Comparison of Corporate Governance principles

BRT Statement on Corporate Governance (Sept.1997)	CalPERS Corporate Governance Core Principles& Guidelines (Apr. 13,1998)	TIAA-CREF Policy Statement on Corporate Governance	Korea: Code of Best Practice for Corporate Governance (Sep.1999)
A.Shareholders Rights			
1.Each director represents the interests of all stockholders, not any single group of stockholders. Cumulative voting is generally not recommended for large publicly owned corporations * Korea Code… (continued) 8. Controlling shareholders should act in the best interest of the corporation and its shareholders 9. Acts of defending corporate control shall not involve sacrificing the profit of corporations and shareholders to maintain corporate control for only some shareholders or management. 10. The corporation shall, as determined by law, accept stock purchase requests from shareholders opposing material structural changes.	1.A majority of shareowners - amend the company's bylaws by shareowner proposal. - call special meetings - act by written consent 2.Every company should prohibit greenmail. 3.No board should enact nor amend a poison pill except with shareowner approval. 4.Every director should be elected annually 5.Proxies should be kept confidential from the company 6.Broker non-votes should be counted for quorum purposes only 7.Any shareowner proposal approved by a majority of proxies cast should be implemented by the board or explained the reason for not implemented. 8.Shareowner should have effective access to the director nomination process	1.Oppose the practice of cumulative voting in the election of directors. Meeting date is management's prerogative. Support equal access to a proxy statement without undue cost or other burdens on the corporation 2.Shareholders' approval to any action that alters the fundamental relationship between shareholders and the board. This includes anti-takeover measures. - changing corporation's domicile - opt out of coverage under state laws mandating anti-takeover protection. -oppose preferred stock as an anti-takeover program without approval 3. Not support mandated election of directors on an annual basis, or mandated directors' attendance in board meeting. 4.Can vote for alternative candidates or withhold vote from unopposed candidates. 5.Confidential voting, one vote for one common share, not combine disparate issues not to be presented by a single vote 6. Oppose any action to adopt super majority requirement that interfere with a shareholder's right to elect directors and ratify corporation action	1.In appointing directors cumulative voting system is recommended. 2.Receive all necessary information prior to exercising their rights, through which proper procedure. - right in profit sharing - right to attend and vote at general shareholders meeting 3.Sshareholders meetings may decide - articles of corporation - M&A and business transfers - Corporate disbanding & dissolution - Capital reduction and others 4.General shareholders meeting be made through transparent and fair proceeding: time, location, agenda 5.Ensure shareholders proposals 6.Exercising voting right either directly or indirectly 7.Equitable treatment of shareholders - one vote per share, somewhat restricted by law - sufficient, impartial information - protected from unfair insider trading and self dealing

BRT Statement on Corporate Governance (Sept.1997)	CalPERS Corporate Governance Core Principles& Guidelines (Apr. 13,1998)	TIAA-CREF Policy Statement on Corporate Governance	Korea: Code of Best Practice for Corporate Governance (Sep.1999)
B. Board of Directors 1. Missions			
1. The paramount duty of the board of directors is to the corporation's shareholders; the interests of other stakeholders are relevant as a derivative of duty to stockholders 2. A carefully planned agenda is important for effective board meetings, but it must be flexible enough to accommodate crises and unexpected developments. A CEO should be responsive to a director's request to add a specific subject to a future agenda. 3. The business of a corporation is managed under the direction of the board but the board delegates to management the authority and responsibility for managing the everyday affairs. The principle function are - select, regularly evaluate replace the CEO; determine management compensation; review succession planning; review and approve major strategies, objectives and plans; advise management on significant issues; oversee internal controls; risk management, financial reporting, and compliance; nominate directors.	1. A director's greatest virtue is the independence that allows him or her to challenge management decisions and evaluate corporate performance from a completely free and objective perspective. 2. The lead independent director will advise the Chair as to an appropriate schedule of the board meetings, seeking to ensure that the independent director can perform their duties responsibly while not interfering with the flow of company operations. 3. The lead independent director will provide the Chair with input as to the preparation of the agendas for the board and committee meetings.	1.The primary responsibility of the board of directors is to foster the long- term success of the corporation consistent with its fiduciary responsibility to the shareholders. 2. Support the primary authority of the board in such area as the selection of the CEO, review of the corporation's long-term strategy, and selection of nominees for election to the board. 3. Building long-term shareholder value is consistent with directors giving careful consideration to social responsibility issues and the common good of the community	1. The board shall make key management policy decisions and perform effective supervision of the directors and management. - setting business goal and strategies - approving business plans and budgets - supervising management and evaluating management performance - replacing the management and reviewing remuneration - monitoring major capital expenditure and corporate takeover - meditating the conflicting interest among directors, management and shareholders - ensuring integrity of the accounting and financial reporting system - supervising the compliance of statutes and ethic-related regulation -monitoring the effectiveness of governance practices - overseeing the process of information disclosure. 2. The board mandates its authority to the internal committee or the representative director

BRT Statement on Corporate Governance (Sept.1997)	CalPERS Corporate Governance Core Principles& Guidelines (Apr. 13,1998)	TIAA-CREF Policy Statement on Corporate Governance	Korea: Code of Best Practice for Corporate Governance (Sep.1999)
2. Board membership criteria			
1. Individuals who are highly experienced in their respective fields of endeavor and whose knowledge, background and judgment will be useful to the corporation. Director must have the ability and willingness to learn the corporation's business. 2.Each person must devote the time and attention necessary to fulfill the obligations of a director. Service on too many boards can interfere with an individual's ability to perform his or her responsibilities. But the BRT does not endorse a specific limitation on the number of directorship an individual may hold.	1. No director may also serve as a consultant or service provider to the company 2. The board considers the mix of directors characteristics, experiences, diverse perspectives and skills most appropriate for the company 3 .Each director should fit within the skill sets identified by the board -Core competencies: accounting or finance, international marketing, business or management experience, industry knowledge, customer base experience or perspective, crisis response, or leadership or strategic planning. 4. The board adopts guidelines that address the competing time commitments that are faced when director candidates serve on multiple boards. 5. To be re-nominated, the director must perform his duties as based on established criteria. Re-nomination on any other basis is neither expected nor guaranteed.	1. The board should be composed of qualified individuals who reflect diversity of experience, gender, race and age. Each director should be able and prepared to devote sufficient time and effort to his or her duties as a director.	1. Appointing competent professional directors and respect the appointed directors' term of office. -a vision for and a strategic perception of the corporate management, a level-headed and sound managerial judgment, an ability for managing and supervising the organization, a knowledge of law and finance, and some experience suitable for the corporation concerned.

BRT Statement on Corporate Governance (Sept.1997)	CalPERS Corporate Governance Core Principles& Guidelines (Apr. 13,1998)	TIAA-CREF Policy Statement on Corporate Governance	Korea: Code of Best Practice for Corporate Governance (Sep.1999)
3. Selecting, Inviting and Orientating New Directors			
1.It's the board's responsibility to nominate directors. 2.Each nominating/governance committee should develop its own process for considering stockholders suggestions for board nominees. 3. The committee is responsible for reviewing possible candidates for board membership and to recommend a slate of nominees. Even the CEO is involved in the selection; responsibility for the selection of board remains that of board.	1.Shareowner should have effective access to the director nomination process 2.The Lead Independent Director will interview, along with the chair of the nominating committee, all candidates and make recommendations to the committee and the board.	1.Supports the primary authority of the board in such areas as selection of nominees for election to the board. 2.Not support shareholder resolutions requiring candidates for the board to be nominated by shareholders. 3. Each director represents all shareholders; TIAA-CREF opposes the nomination of specific representational directors.	1.It is advised that a committee be established and managed for the fair nomination of directors. 2.The director nomination committee should consist of at least one-half of outsider directors. There needs to be a review of the method of establishing a shareholders committee 3. cumulative voting systems could be adopted to reflect the opinion of shareholders when appointing directors.
4. Separation of Chairperson and CEO			
1.Each corporation should be free to choose its own leadership structure. 2.BRT believes that most corporations will continue to choose, and be well served by unifying the positions of chairperson and CEO for a single leader with single vision for the company and most members believe it results in a more effective organization	1.When selecting a new CEO, boards should reexamine the traditional combination of the CEO and chairperson position.	1. Ordinarily we would not support shareholder resolutions concerning separation of the positions of CEO and chairman.	Not covered
5.Leader Director			
Where positions are unified, it is desirable to have an understanding as to how non-executive leadership of the board would be provided, whether on an ongoing basis or transitional basis.	Where positions are unified, the board designates-formally (or informally) an independent director who acts in a lead capacity to coordinate the other independent directors.	With regard to companies that do not separate the positions of the Chairperson and the CEO, the board should consider the selection of one or more independent directors as lead directors.	Not covered

BRT Statement on Corporate Governance (Sept.1997)	CalPERS Corporate Governance Core Principles& Guidelines (Apr. 13,1998)	TIAA-CREF Policy Statement on Corporate Governance	Korea: Code of Best Practice for Corporate Governance (Sep.1999)
6. Board size			
1.Board of directors of most large publicly owned corporation range in size from 8 to 16 individuals. Optimal board size will vary from corporation to corporation and industry to industry. BRT suggests that smaller board are often more cohesive and work more effectively than large boards.	1.The board should periodically review its own size that is most effective toward future operations	Not covered	1.The number of directors shall be such that it allows the board to have fruitful discussions and to make appropriate, swift and prudent decision. For large public corporations, it is highly advised that the number of directors on the board be appropriate for effectively managing internal committees.
7. Mix of Inside and Outside Directors			
1.A Substantial majority of the directors of a large publicly owned corporation should be outside directors. 2.Inside directors will ordinarily include the CEO and may also include other officers whose positions or potential for succession make it appropriate for them to sit on the board	1.Substantial majority of the board consists of directors who are independent..	1.The board should be composed of a substantial majority of independent directors..	1.The number of outside directors shall be such that the board is able to maintain the particle independence. Particularly financial institution and large scale public corporations gradually increase the ratio of outside directors to cover half of the total number directors (minimum three outside directors)
8.Term and mandatory retirement			
1.BRT does not favor the establishment of term limits for directors, as this might lead to the loss of capable knowledge accumulated by directors. 2. The board should plan for its own continuity and succession and designation of new board members	.1.Every director should be elected annually.	1.Not support shareholder resolutions concerning… shareholder-mandated election of directors on an annual basis, or that director attend a specific percentage of board meetings unless the board to support such measures. 2.The board should establish a fixed retirement policy for directors	Not covered

BRT Statement on Corporate Governance (Sept.1997)	CalPERS Corporate Governance Core Principles& Guidelines (Apr. 13,1998)	TIAA-CREF Policy Statement on Corporate Governance	Korea: Code of Best Practice for Corporate Governance (Sep.1999)
9. Independence of Directors			
1.The degree of independence of an outside director may be affected by many factors - personal stature or business relationship with the corporation and with management. - legal, consulting, accounting other service - have an interest in a customer, supplier, or business partner of the corporation - at earlier point in his or her career have been an employee or officer of the company. 2.BRT believes that where such relationships exist, the board should be mindful of them and make a judgment regarding the director's independence based on individual circumstance rather than the mechanical application of rigid criteria 3. For certain functions, such as membership on an audit or compensation committee, more specific standards of independence should be used. The board should also periodically confirm that the composition of the committee meets the applicable requirements as well as any other criteria determined by the board	1.Each corporation should publish in their proxy statement the definition of independence adopted or relied upon by its board. *An independent director is one who* - has no been employed by the company in an executive capacity within the last five years.(1) - is not, and is not affiliated with an advisor, consultant to the company or a member of the company's senor management. - is not affiliated with a significant customer or supplier of the company. - have no personal service contracts with the company or a member of senior management. - is not affiliated with a not-for-profit entity that receive significant contribution from the company - within the last five years, has not had any business relationship with the companies for which the company required to make disclosure under regulation -is not employed by a public company at which an executive officer of the company serves as a director -has not had any of the relationships described above with any affiliate of the company -is not a member of the immediate family of any person described above	1.Independence means no present or former employment by the company or any significant financial or personal tie to the company or its management that could interfere with the director's loyalty to the shareholders. 2. An independent board is one that excludes people who regularly perform services for the company, if a disinterested observer would consider the relationship material. It does not matter if the service is performed on an individual basis or as a representative of an organization that is a professional advisor, consultant, or legal counsel to the company. 3. However we might consider a director independent if the person was involved in commercial transaction that were carried out at arm's length in the ordinary course of business, as long as the relationship didn't interfere with the individual's ability to exercise independent judgment.	1.Outside directors shall hold no interest that may hinder their independence from the corporation, management or controlling shareholders. The outsider director shall submit a letter of confirmation, which the corporation shall disclose, stating that he hold no interests affiliated with the corporation, management or controlling shareholder at the time of his consent to the appointment. (1) 2 years (Security and transaction act 191.12.3)

BRT Statement on Corporate Governance (Sept.1997)	CalPERS Corporate Governance Core Principles& Guidelines (Apr. 13,1998)	TIAA-CREF Policy Statement on Corporate Governance	Korea: Code of Best Practice for Corporate Governance (Sep.1999)
10. Evaluating board performance			
1.The board is responsible for its own evaluation from time to time. Such evaluations will provide the basis for the board's recommendation of the slate of directors to the stockholders. The Board also implicitly evaluates individual directors by endorsing re-nominations. While no particular approach to individual director evaluation is best for all companies at all times, each board should have a process, formal or informal, for discharging its responsibility to nominate good directors. 2. The board should from time to time review its own structure, governance principle, composition, agenda, processes and schedule to consider whether it is functioning well in view of its responsibility and the evolving situation of the corporation.	1.The board establishes performance criteria for itself and periodically reviews board performance against those criteria. 2. Each board should establish performance criteria , not only for itself (acting as a collective body) but also individual behavioral expectations for its directors. Minimally these criteria address the level of directors: attendance, preparedness, participation, and candor. 3.To be re-nominated, directors must perform their duties according to some established criteria. Re-nomination on any other basis should neither be expected nor guaranteed.	1.The board should have a mechanism to evaluate its performance and that of individual directors. At a minimum, there should be an annual review of performance by the board that measures results against appropriate criteria defined by the board.	1.To promote active performance of duties by the management, outside directors and the board, their activities shall undergo fair evaluation; based on such results, the matters of remuneration and reappointment shall be decided (9.0). 2.The activities of an outside director should be evaluated fairly, with remuneration being commensurate to the evaluation results. Activities and evaluation results of outside directors shall be disclosed.(9.2) 3.Activities of the board shall be evaluated fairly, the results of which shall be disclosed.(9.3)
10-1 Evaluation of CEO			
1.The performance of the CEO should be reviewed at least annually without the presence of the CEO and other inside directors. The board should have an understanding with the CEO with respect to the criteria on which he or she will be evaluated, and there should be a process for communicating the board's evaluation to the CEO.	1.The independent directors establish performance criteria and compensation incentives for the CEO, and regularly review the CEO's performance against those criteria, which minimally ensure that CEO's interests are aligned with the long term interest of shareowners, that the CEO is evaluated against comparable peer groups, that a significant portion of CEO's total compensation is at risk.	1.The evaluation of a corporation's chief executive officer is a critical board responsibility. A clear understanding between the board and the CEO regarding the corporation's expected performance and how that performance will be measured is very important.	Not covered

BRT Statement on Corporate Governance (Sept.1997)	CalPERS Corporate Governance Core Principles& Guidelines (Apr. 13,1998)	TIAA-CREF Policy Statement on Corporate Governance	Korea: Code of Best Practice for Corporate Governance (Sep.1999)
11. Compensating board members and management			
1.Board compensation should be competitive in view of industry practices and the extent of burdens placed on board members 2.Boards should consider aligning the interests of directors with those of the stockholders by including some form of equity, such as stocks grants or options as a portion of each director's compensation. 3.Some corporation may wish to establish a specific goal for equity ownership by directors, but it is not always desirable. 4. BRT believe that the focus should be on the appropriate level of total compensation, rather than the timing of payment 5.Compensation plans are appropriate and competitive and properly reflect the objectives and performance of management. Incentive plan should be designed to provide the proper balance between long and short-term performance incentives. Stock options and other equity oriented plans should be considered as a means for linking management interests to those of shareholders.	1.Director compensation is a combination of cash and stock in the company. The stock component is a significant portion of the total compensation.	1.All monetary arrangements with directors (for services outside normal board activities) should be approved by a board committee; the board committee should be composed of independent directors and should be reported in the proxy statement. 2.Board and its compensation committee should set executive compensation levels adequate to attract and retain qualified executives. These executives should be rewarded to the contribution they make in maximizing shareholder wealth. The 'pay for performance' system should reflect equitable treatment between the shareholders and corporate management. Key issues are -Determining what constitute 'excessive' executive compensation -Evaluating the soundness and reasonableness of the policies, standards, and processes for setting compensation levels. - Deciding what constitutes adequate disclosure of executive compensation to shareholder and public.	1.Business activities of the management shall be evaluated fairly, and the evaluation results shall be reflected appropriately in the remuneration. The board, within the limit approved by the general shareholders meeting, shall decide remuneration for the management. If a committee centered on outside directors is established within the board, then that committee may make the decision (9.1) 2. Calculation criteria for stock options shall always be disclosed in detail prior to any decision regarding it : such criteria be justified to accurately reflect results achieved through the management's efforts. 3. Also it would be best to place a ceiling on the criteria.

BRT Statement on Corporate Governance (Sept.1997)	CalPERS Corporate Governance Core Principles& Guidelines (Apr. 13,1998)	TIAA-CREF Policy Statement on Corporate Governance	Korea: Code of Best Practice for Corporate Governance (Sep.1999)
12. Outside directors meeting			
1.There should be an opportunity for he board to meet periodically, at least annually, outside the presence of the CEO and other inside directors. This may be a portion of a normally scheduled board meeting, and the CEO's annual performance evaluation is a good opportunity for such a meeting.	1.Independent directors meet periodically (at least once a year) alone, without meeting the CEO or other non-independent directors. 2. The lead independent director will develop an agenda and moderate the executive sessions of the board's independent directors, and act as the principal liaison between independent directors and the chair on sensitive issues.	1.The board should hold periodic executive sessions.	1.To raise the outside director's management supervision and supporting functions, a regular meeting participated by outside directors is only recommended, and management shall make every effort to make opportunities for regular discussions on managerial issues (4.5)
13. Succession planning			
Not covered	1.Board should have in place an effective CEO succession plan, and receive periodic reports from management on the development of other members of senior management.	Not covered	Not covered
14. Board access to senor management and materials			
1.Board members should have full access to senior management and to information about the corporation's operations. 2. Board members should receive information prior to board meeting so they will have an opportunity to reflect properly on the items. Board should ensure that adequate time is provided for full discussion.	1.All directors should have access to senior management. However the CEO, Chair or independent lead director may be designated as liaison between management and directors. 2.Although company management is responsible for the preparation of materials for the board, the Lead independent director may specifically request the inclusion of certain materials.	Not covered	1.The corporation shall provide, at the appropriate time, outside directors with information necessary to perform duties to allow accurate assessment of the corporation's managerial situation. Particularly when a board meeting is to be convened, information shall be provided beforehand so that the director may sufficiently review the agenda. Also the outside director may request information necessary for performing duties. (4.2)

BRT Statement on Corporate Governance (Sept.1997)	CalPERS Corporate Governance Core Principles& Guidelines (Apr. 13,1998)	TIAA-CREF Policy Statement on Corporate Governance	Korea: Code of Best Practice for Corporate Governance (Sep.1999)
C. Board Committee 1. Number, Structure of Committee			
1.It is recommended that each corporation have an audit committee, which is required under NYSE rules, a compensation/personnel committee, nominating/governance committee and that membership in this committee be limited to outside directors. 2. The board may wish to establish other committees such as an executive committee, a finance committee, social responsibility or public policy committee, or ad hoc committee.	1.Certain board committees consist entirely of independent directors. These include the committees who perform the following functions - Audit - Director nomination - Board Evaluation & Governance - CEO Evaluation and Management - Compensation - Compliance and Ethics	1.The board committee structure should include audit, compensation and nominating committees consisting entirely of independent directors. 2. Do not support shareholder resolutions concerning the formation of shareholder advisory committee. 3. Focus on good practice (e.g., board compensation committee composed entirely of independence directors; and a clear and convincing statement by compensation committee in proxy statement of the principles)	1.The board may, if necessary, establish internal committees that perform specific functions and roles, such as the Audit, Operation and Remuneration committees. 2.The committee's resolution on matters mandated by the board shall hold the same effect as board resolutions, and the committee shall report such resolutions to the board.

BRT Statement on Corporate Governance (Sept.1997)	CalPERS Corporate Governance Core Principles& Guidelines (Apr. 13,1998)	TIAA-CREF Policy Statement on Corporate Governance	Korea: Code of Best Practice for Corporate Governance (Sep.1999)
D. Disclosure			
1.It is important that each board consider its policies and practices on corporate governance matters. Whether or not a board will formalize its board practices in written form will vary depending on the particular circumstances.	1.The board ought to adopt a written statement of its own governance principles and regularly re-evaluate them.	Not covered	1.In its annual report, a public corporation shall explain the difference between its corporate governance and this code, and the reasons for such; any plan to make future changes shall also be explained. 2.Annual report shall include the following information (5.2.2) 3. Major items concerning governance for disclosure are; the adoption of a cumulative voting system; information on the composition of the board, along with outside directors and their independence; the composition, rights, and activities of the board's internal committee; and the activities of directors and the board.(5.2.3)

3-4 Corporate Governance Practices in Korea

As discussed earlier, there is no such thing as a 'one size fits all' policy. Most institutional investors recognize situational differences in corporate governance systems. A balanced analysis of corporate governance practices of Korean companies requires an understanding of Korea's legal system, commercial act, security and transaction act, as well as its code of best practices described in the previous section. In Korea, corporate governance did not begin in earnest until 1996, and was largely prompted by the financial crisis of 1997~1998. As a result, major reform is now in progress. To enhance transparency, the government has introduced significant changes in financial accounting standards (December 1998) to bring them into conformity with internationally accepted accounting principles. Additionally, The Fair Trade Commission mandated that the 30 largest chaebols produce combined financial statements from the fiscal year beginning on or after January 1999. Given that the financial crisis highlighted the deficiencies in the disclosure system of the securities market, the government improved disclosure systems by legislating the need for quarterly reports, electronic filing systems, allowing more class action lawsuits, and meeting out more severe penalties in the case of violations.[37] In regard to a direct corporate governance system, the government obliged publicly traded companies to elect outside directors in 1998. In 1999 the Code of Best Practices was announced (which was framed by a corporate governance committee composed of various field professionals). Then in December (1999) the government introduced an audit committee and other committees in the board. The Korean Stock Exchanges gives out annual awards to corporations that achieve corporate governance milestones in order to induce voluntary improvement. Many large publicly owned

[37] Corporate Governance in Asia: A Comparative Perspective(2001) : Corporate governance in Korea by Il Chong Nam, Joon-Kyung Kim, Yeongjae Kang, Sung Wook Joh, Jun-Il Kim

companied started to improve their governance systems after they were mandated to do so by the government. The Korea Stock Exchange announced its own survey regarding the improvement of corporate governance of listed companies.[38] This survey may be compared with the 1999 Korn/Ferry survey to see how wide a gap exists between Korea and other national standards. Table 3-2 lists the details.

Through a close look at Table 3-2, one may note that there is still a gap between the practices of the U.S. versus those of Korea. The average portion of outside directors on boards in large Korean companies is 58%, compared 82% in U.S. U.S companies believe that supervisory functions over management are the most important duty of board members, while Korean companies emphasize the professional knowledge of the members. According to the law, Korean companies keep term limits on board membership, but in the U.S., age limits are common. Most U.S. companies compensate its members though stock options; only a limited number of Korean companies have yet adopted such incentive packages. With the exception of audit committees, other committees (compensation, evaluation & nomination) are neither legally mandated, nor are they the social norm. Nevertheless, there are rising sentiments in society, symbolized by the People's Solidarity for Participatory Democracy (PSPD) organization, for more active involvement in corporate governance issues. CEOs are also considered influential in both Korea and the U.S. Evaluation and succession systems for board members are not popular in U.S., yet are seen as important objectives that need to be introduced in near future. Perhaps the biggest gap in corporate governance between Korea and the U.S. is the absence of meetings held only by outsider directors.

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[38] Korea Stock Exchange press release on December 7th, 2001

The Korea Stock Exchange carried out a survey between March to August (2001) on matters related to corporate governance issues, through a questionnaire to every listed company. Some data is based on 2001 March data

Table 3-2 : The Comparison of Korea Stock Exchange and 1999 Korn/Ferry Survey

Items	Legal system	KSC survey	1999Korn/Ferry Survey
1.Number of Outside directors	- No less than 25% of total directors (Minimum 1 person) - No less than 50% of total directors (minimum 3 persons) in case total asset is over 2 trillion won	- 2.37 outside director (1,222persons/515companies) - 35% (1,222people/3458directors) - 6.01 outside directors (405 people/67 companies) - 58% (405 people/ 698 people)	Boards consist of, on average, of 2 inside directors (including CEO, who frequently serves as chairperson) and 9 outside directors : 82 % (substantial majority) The largest boards average 3 inside directors and 13 outside directors. : 81% (substantial majority) Most respondents believe that 12 is the most effective board size, with a mix of 3 inside directors and 9 outside directors.
b. Quality/ Occupation of outside directors	- Not allowed present professors.	Criteria for good outside directors Special knowledge 69.2% Management ability 10.1% Background of outside directors surveyed Management: (30%), Finance (16%), Professor & Research (20%), Lawyer (9%), Accountant (8%)	Criteria for a good outside directors -willing to challenge to management(95%) -special expertise regarding the company(67%) -available outside meeting (57%) -expertise on global business issues(41%) -understanding firm's key tech and process (33%)
c. Tenure of directors	- may not exceed 3 years (Commercial Act Article 383)	1 year : 8.99% 2 year : 13.27% 3 Year : 77.74%	8% have term limits 77% have age limits 54% have asked directors to resign or not stand for re –election (up from 53%)
D .Multiple Directorship	- Less than 3 companies (Code for Security and Transaction 37.6.3)	Two companies : 5.79%	22% limit the number of other boards on which the CEO may serve : 3% limits the number of other boards on which directors may serve.
e. Ages of directors	-	40's : 17.63% 50's : 40.46% 60's : 33.01%	Not covered
f. Compensation of out side directors	-	Generally satisfied with $ 16,000 yearly payment	Average total director compensation, exclusive of stock, is $ 41,949. 84% compensate with some stock 98% provide additional compensation for service on a committee.

Items	Legal system	KSC survey	1999Korn/Ferry Survey
g. Committee	- The board of directors may establish committee within the board. - The board of directors may delegate to the committee its power other than the matters set for the… - The committee shall be composed of no less than two directors, in case Audit committee not less than three directors. (Commercial Act Article 393-2) - listed companies with not less than 2 trillion won assets must establish an audit committee (Code of S&T 84.24) 73% of audit committee members are outside directors. 71% that chair audit committees are outside directors.	- Only 20.7% of the surveyed companies established committee in the board. - 12.1% of the companies established an audit committee, as obliged by the law. Only 10 non-obligated companies have an audit committee.	- 100% have audit committee - 99% have compensation committees - 74% have nominating committees - 56% have corporate governance committee, which usually absorb the function of nominating committees - 40% have finance committees Generally, audit, compensation and nominating committees are comprised exclusively of outside directors.
h. Board meeting	-	- Average 18 meetings per year (1.5 per month)	- Boards average 8 meetings per tear (same as last 5 years) . Chairperson averages 160 hours of work . Outside directors 157 hours per year - 69% report that their outside directors meet in executive sessions other than for compensation matters, without the CEO present Such meetings take place on average 3 times per year.
i. Effectiveness	-	- Responded that outside directors enhance management transparency (59.7%) and professionalism (22.0%)	-Rep of the interest of shareholders (92%) -Advising major decision (89%) -Evaluating performance of top management(78%) - Identifying possible critical threat -Monitoring and evaluating strategy implementation (67%) -Shaping long-term strategy (66%) -Planning for top management succession (61%)

Items	Legal system	KSC survey	1999Korn/Ferry Survey
j .Multiple Directorship	-	- 76% of controlling shareholders exercise their influence in outside director elections	According to director, the CEO/Chairperson retains the most influence in determining who is named to the board, whereas according to CEO/Chairperson the nominating committee has the most influence in naming directors to the board. . 74% have a nominating committee, which consists of 3 outside directors and no inside directors.
k. Separation of chairperson and CEO	-	- not covered	9% have a non-executive chairperson who is not a current or former employee 88% are not considering a non executive chairperson
l. Lead director	-	- not covered	- 30% have a lead director - 66.5% have no plan to name a lead director
m. principles	-	- 77.1% stipulated the board operational regulation	-65% report having written board guidelines
n. Evaluation	-	- not covered	-20% formally evaluate individual directors, 73% believe that they should do so. - 375 evaluate the board's performance on a regular basis, another 105 of boards are considering instituting board evaluations. - 75% report that they evaluate the CEO, and that this practice has proven effective or very effective.

Items	Legal system	KSC survey	1999Korn/Ferry Survey
o. Information	- Outside directors may be advised by outside professionals at the company's expense on the board's decision.(Security and transaction Act Article 191.16.5)	-52% report that they have a contact point with an outside director; only 9% reported that they supply regular management information to outside directors. -10% reported that outside directors can get advice from outside professionals at the company's expense	-75% receive company performance benchmark information on a regular basis
p. CEO	-	No covered	-79% report that they do not have a management succession committee and many respondents are critical of their companies management succession process
q. Executive compensation	-	Not covered	50% of respondents believe executive compensation is 'just right' 23% believe it is 'generally in line with economic conditions' and 26% of inside directors and 30% of outside directors believe it is too high.

Ⅳ. CORPORATE GOVERNANCE AND THE PERFORMANCE OF KOREAN COMPANIES

4-1 Two Institutions' Evaluations of Corporate Governance

It is quite difficult to evaluate the corporate governance of corporations in absolute terms, as most institutions take a more flexible position in applying its 'principles' by allowing cultural, economic, political differences. Nevertheless many financial organizations such as S & P and CLSA announce their research regarding corporate governance findings on worldwide companies. S & P is currently conducting a major survey of 1,600 companies around the globe to complement its other corporate products and services. Based on the extent to which a company adopts and conform to the codes and guidelines of good corporate governance practices, they are awarded a Corporate Governance Score ('CGS'); CGS-10 being the highest possible score, CGS-1 the lowest. Their first report consisted of 350 of Latin America and Asian's most liquid and largest companies, taken from the Standard & Poor's IFCI Index. This survey focuses on transparency and disclosure, and is broken into three major categories: ownership structure and investors' relations, financial transparency and information disclosure, and board and management structures and processes. A total of 98 attributes comprise the three categories. Given the comprehensiveness of the study, it represents one of the leading indicators of governance standards.[39] In their first release the 47 Korean companies included did not fare particularly well with CG scores between 1~7; these

[39] Standard & Poor's Transparency and Disclosure Survey for International Investors (http://www.stadardpoor.com)

The inclusion of each attribute is scored on a binary basis representing 'yes' (included) or 'no' (not included) answer to ensure objectivity. Each 'yes' answer is equal to one point. Companies are ranked in order, according to deciles. An overall ranking reflects the total number of the 98 possible attributes included in a company's annual report and accounts.

results seem a little disappointing considering Korea's attempt to reform corporate practices over the past years. However the report did not cover overall disclosures nor did it cover any IR activities -- just annual reports and accounts.

Another major report from the CLSA, humorously entitled "*Saints and Sinners Who Got Religion*", was released in April 2001. It released its `CG Watch' providing results on corporate governance practices across emerging markets. This report confirmed a correlation between high (or improving) corporate governance (CG) and stock performance. A key reason behind these findings is that CG is tends to strive to improve the quality of management, and investors, not constrained to particular markets, can avoid stocks and markets where CG is poor. This results in corporate governance in itself becoming an investment criterion.[40] With these two evaluation results, it would be interesting to find the relation between accounting returns and the extent to which they adopted the guidelines or codes concerning corporate governance. Stock market returns are a suitable method to measure accounting returns because market value represents realized values (profit). This paper, however, uses accounting returns, because as Professor Joh argues in Corporate Governance and Firm Profitability: Evidence from Korea Before The Economic Crisis, accounting returns better gauge market performance in emerging markets, given that emerging markets are more prone to market distortions and inefficiencies. Also, she points out, because accounting returns are more direct indicators with regards to the prediction of bankruptcies.[41]

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[40] In their survey of April 2001, they selected 495 companies from 25 global emerging markets covering Asia, Eastern Europe, South Africa and Latin America. They updated previous survey questionnaires & it was composed of 57 main issues divided into seven key criteria, including: management discipline, transparency, independence, accountability, responsibility, fairness and social responsibility. They compared the weighted rating points with ROE, PB, ROCE, EVA™/IC to seek correlations. CLSA continues its corporate governance focus its latest report: *CLSA Emerging Market Press,* released on April 8th 2002.

[41] Corporate Governance and Firm Profitability: Evidence from Korea Before The Economic Crisis (Sung Wook Joh, Dec.2001)

4-2 Corporate Governance Scores and Performance

This paper assumes that foreign investors in the Korean stock market are institutional investors and advocators of shareholder activism, and that they are likely to invest in companies that have a good track record on corporate governance. Moreover, this means that foreign investors should prefer companies that received high CGS scores, which in turn ought to generate higher market performance and account returns.[42] This paper monitors a sample of 53 Korean companies used in either the S&P CGS survey or CLSA's survey, which received their own CGS. It was therefore necessary to find each company's foreign investor stockownership rate, and accounting returns that matched the period (2001) of the CLSA and S&P surveys. From this analysis we can find the extent to which good corporate governance effects companies' accounting performance. But due to an unfortunate lack of data, the results of the analysis will be limited. With such limits, this work is intended merely as a starting point for further analysis.[43] This analysis, nevertheless, mirrored the results of the S & P and CLSA surveys; despite the distinct characteristics of each of these two surveys, a relationship between CG and performance does seem to exist.[44] Figure 4-1 shows the relation between the S&P and CLSA survey scores. The points range almost entirely within the 40% to 60% axis, which means that the general corporate governance of Korean companies still lags far behind that of international standards. An exceptional case is Korea Telecom (KT), which received the highest score in the S&P

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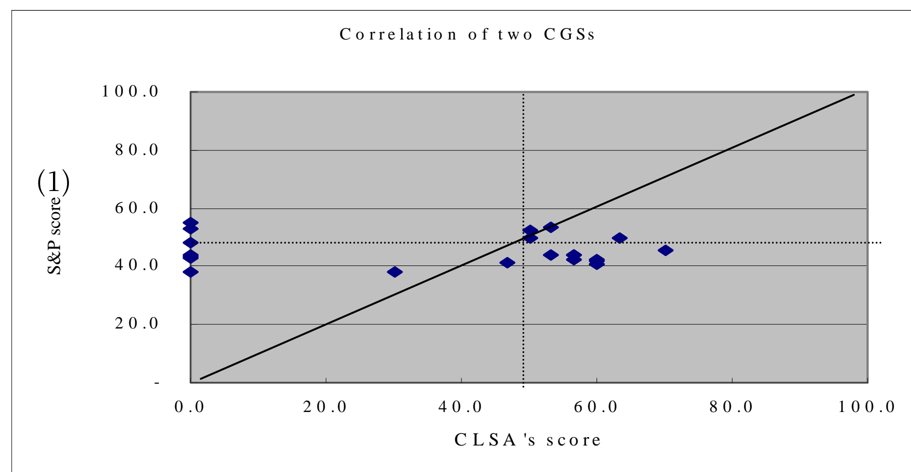
[42] I modified the CGS of S&P surveys by averaging sub category scores and multiplying them by 10 to compare to the CLSA's scores.

[43] Recent research by Black, Jang and Kim shows that a moderate improvement in corporate governance results in an increase of market capitalization (Does Corporate Governance matters? Evidence from the Korean Market, 2002)

[44] CLSA is partly subjective and comprehensive survey performed by equity analysts, while the S & P survey is somewhat objective, directly analyzed, but narrow focused on disclosures.

survey (70%), but a rather low score with the CLSA (45.5%). The government ownership of KT resulted in the under evaluation due to the weak political and regulatory environment. Regarding the relation between the two surveys, one research paper found that subjective measure reported by the CLSA is consistent with the objective measure reported by the S&P analyzing 130 companies covering all over the emerging market (not only Korean companies).[45]

Figure 4-1



Latin America and South Africa companies received higher scores than those of other countries. The report indicated that companies listed on advanced stock markets such as the New York and London stock markets required more strict disclosure and transparency. It seems that Korean companies received lower scores due to lower macro determinants. Markets with low macro CGSs are seen to be susceptible to substantial falls in ratings that cause investors to avoid them. The macro factors which the CLSA survey listed include (1) clear, transparent and comprehensive rules and regulations (2) committed and effective enforcement of rules and regulations (3) political and regulatory environment affecting CG and ability of corporations to maximize value without arbitrary restrictions (4) adoption of international Generally Accepted

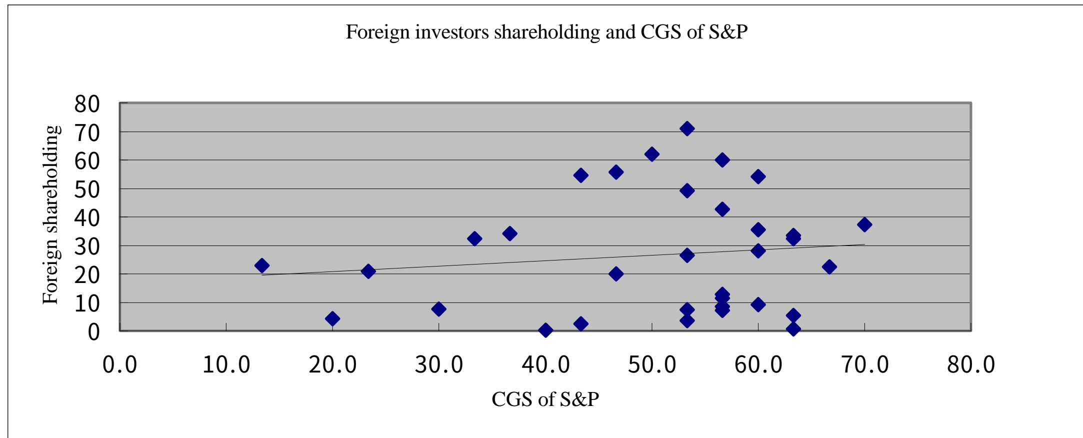
[45] The author of the paper preferred not to be quoted

Accounting Principles (5) in situational mechanisms to promote awareness and a culture of good governance. Korea received only 3.8 out of 10 points, putting them 16th among 25 countries. Among the five factors, Korea fared the worst in regards to enforcement & regulation, political regulatory environment and Institutional mechanisms, and CG culture. It was reported that Korea recognizes the importance of a legal system and regulations, and has improved them a lot in recent years; still, the report pointed out, cultural problems such as corruption and political interference remain as major stumbling blocks to Korea's corporate governance.

From the following figures we can see the somewhat positive relationship between both institution's CGSs and foreign investors share ownership, as well as a positive correlations between ROE and CGS. Given the marginal investment of foreign investors in KOSDAQ, this paper disregarded KOSDAQ-registered companies in the analysis of S&P's CGS survey, and disregarded foreign direct invested companies. Figure 4-2 shows the relation between the portion of foreign investors shareholding in the selected Korean companies listed on the stock market and the CGS of S&P ratings of those companies. Putting aside the situational differences of each survey, Figure 4-2 still suggests that foreign investors in the Korean market -- whom are mainly interested in mutual funds high turnover rates --consider corporate governance in their investment decisions or that foreign investor improved the corporate governance of Korean companies.[46]

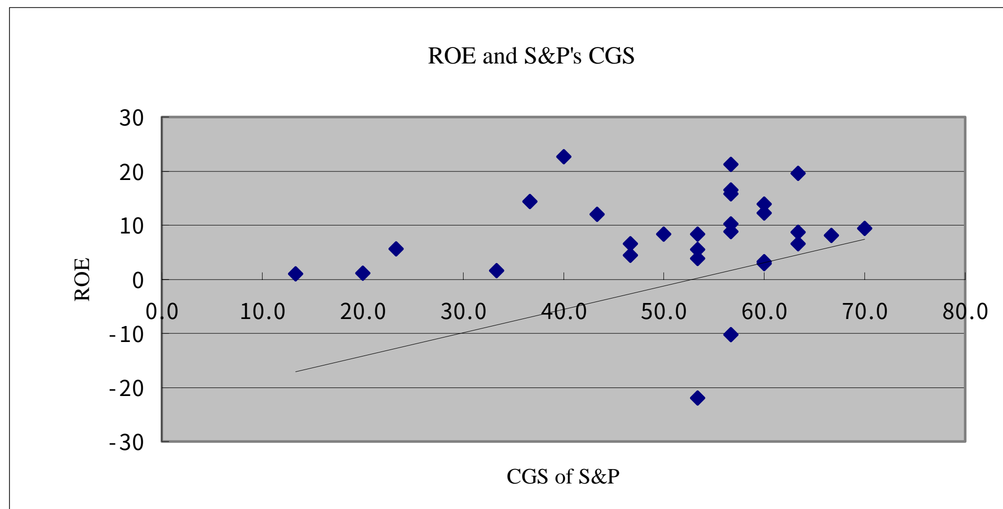
[46] Some institutional investors select poor corporate governance company and improve its governance system. But in here we simply think that they invest in good governance companies.

Figure 4-2



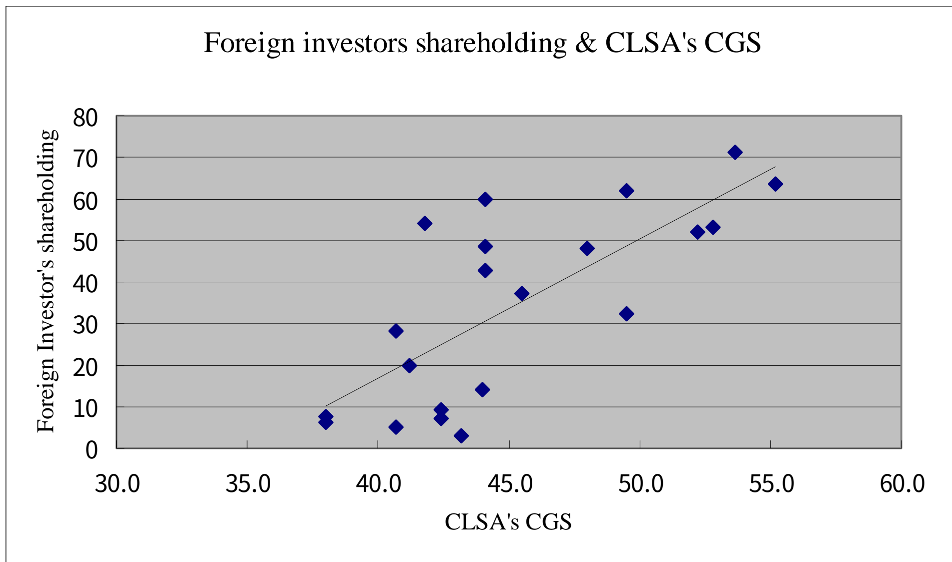
Again in Figure 4-3 we can find a positive correlation between ROE and the CGS of S&P; the KOSDAQ registered companies and some companies such as SKC are exceptional due to their specific IT industry's business slowdown.

Figure 4-3



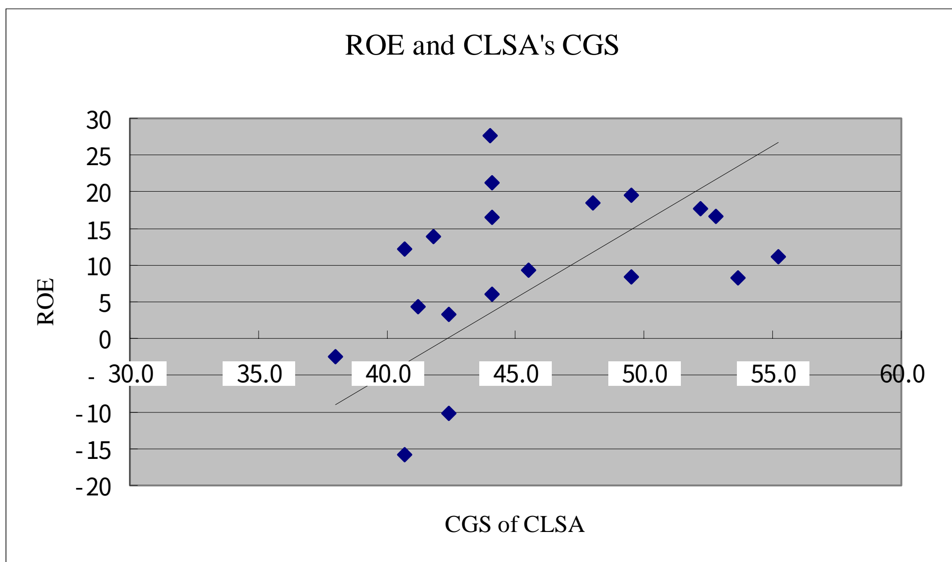
The following two figures indicate positive correlations between the CGS of CLSA and foreign investors shareholder concentrations; this parallel between foreign shareholdings and CLSA's CGS becomes quite evident in figure 4-4.

Figure 4-4



A strong correlation between CG and financial performance does seem to exist; Korean companies that received low CG score underlie such a correlation in Figure 4-5., despite the limited number of companies involved in the analysis.

Figure 4-5



4-3 The Weakness of Korean Corporate Governance According to the Two Surveys.

As it has already been pointed out, there clearly exist some correlations among corporate governance, the preference of foreign investors, and financial performance. No matter which way causality is viewed among these variables, it is worth trying to figure out what weaknesses exist with regard to corporate governance in Korea. In the S&P report, the average score (out of 10) for ownership structure and investor relations was 4.77; regarding financial transparency and information disclosure, the average score was 6.39; for board and management structure and processes, 4.23. Korea's disclosure system received a higher score since the system was overhauled quite a while ago; lower scores in ownership structure and board and management structure and processes were received.

It is natural that Korean companies would receive lower scores in regard to ownership structure. The S&P stated that a company's actual ownership structure should be transparent, and not obscured by cross-holdings, management controlled corporate holdings, nominee holdings, and the like. Although Korean companies are legally required to disclose shareholdings of over 5% with the Financial Supervisory Service (FSS) and KSE (KIND system), they are reluctant to share such information in their annual reports; further, the 5% rule conceals the fact that cross-holdings blur the true influence that controlling shareholders enjoy. According to a KSE report, controlling shareholders in the 10 largest conglomerates average 31.84% of outstanding shares.[47] In other words, regardless of the 5% rule, more detailed disclosures in regards to major shareholders is still to identify substantial, majority holders -- including

[47] Korea stock Exchange news release, Jan.29th 2001

indirect ownership and in cases that voting control is needed. Secondly, Korea was handicapped due to the concentration and influence of share ownership, which is a far more serious problem than managerial issues. Its criteria of is that the concentration of interests and influence of controlling shareholders of the parent company on the independent board action should not occur through block holdings of key operating subsidiaries and through the effective control of key customers and supplier. In the Korean marketplace, however, some companies have affiliations (shareholdings) amongst major suppliers and customers in order to prevent takeovers. This may be viewed as a good strategy that facilitates stable management, unless these large block holders fail to respect the interests of other stakeholders or marginalize the independence of the board.

Korea's board structure and process is the area of CG that requires the most reform. One of the many problematic issues in this area is the independence of non-employed directors, as well as the matter of board and executive compensation, evaluation and succession policies. A significant portion of the board need be truly independent (through the appointment of so-called outside directors) to ensure the long-term interests of all shareholders and the interests of other stakeholders as well. But the Korean board system has made little progress, despite the fact that even the government adopted an outside director system several years ago. In the corporate sector outside directors do not represent a substantial majority and are not truly independent. With the exception of some banks, most of Korean companies have far less than a 75% proportion of outside board directors. Only 36% of the companies legally obliged to do so maintain more than a 50% proportion of outside board directors.[48] An even more

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[48] Only three banks (The First Bank (94%), Shinhan Bank (89%) ,and Kookmin bank (83%)) have an outside board directorship exceeding 75%. Among 67 companies legally obliged to have outside directors, 43 companies -- including Samsung Electronics – maintain a 50% proportion of outside directors (Korea Stock Exchange report,

pressing matter is not merely the lack of outside directors, but rather their lack of real independence from the CEO or controlling shareholders. The passive exercise of shareholders' rights only further exacerbates abuses created from the CEO (and controlling shareholders) possessing unyielding powers. As Alan Greenspan remarked, an effective way to secure the independence of the board and to restrain a powerful CEO is through the activism of institutional investors. Nevertheless it is the Korean norm for institutional investors not to actively exercise their shareholder's right even though have legal entitlement to do so. Enlarging the investment level into stock market pension funds, therefore, would be a vital first step to build activism among institutional investors.[49] In tangent with these pursuits corporate governance guidelines need to be further developed and advanced. Korean institutional investors are yet to attempt to assert any influence. Another serious problem is the lack of any effective evaluation system of directors. In contrast to evaluation systems set in place to evaluate operating performance, Koreans appear less inclined, perhaps due to cultural factors which focus on harmony and respect for elders, to apply such principles towards board members. Further, the succession plans of a company like GE seem extravagant (and perhaps misguided) in the eyes of many Koreans.

The second report was the CLSA's CG watch titled "*Saints & Sinners Who Got Religion*". Their results proved to be similar to those of the S&P report. By analyzing

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2001).

[49] According to the KCIF report, large fluctuations of stock price in Korea may be attributed to lower levels of stock investments in pension funds. Korea's pension stock investment ratio is the lowest level amongst other advanced countries

	US	Australia	Hong Kong	Taiwan	Korea
- Pension fund assets to GDP	95%	78%	16%	4%	13%
- Stock investment to assets	64%	45%	51%	32%	9%

(The Daily Economic Newspaper, 2002.5.14)

the binary ("yes" or "no") results to each question we may decipher some of Korea's weaker points regarding corporate governance as viewed from a western (U.S.) point of view. To these ends, this paper first lists the questions in which Korea scored less than 20%.[50] Generally we find that there were problems in the corporate governance system, financial targets for next 3-5 years, directors' independence from management, as well as nominating and remuneration committees chaired by independent directors. Also, questions (4 of them) related to evaluations scored almost zero.

Ⅴ. CONCLUTION

5-1 Korean Institutional Investors' Role in Corporate Governance Policies

Korean institutional investors are different from those of western countries in terms of their historical background. From the 1960's through the 80's, the role of such investors in capital markets was limited, due to the strong role that the government played in capital allocation. Investment trust companies had to buy huge amounts of stocks to support the stock market under the auspice of the government, which later became a regular market distortion. Banks straddled with a large portfolio of non-

[50] The below questions received scores lower than 20%

- Explicit public statement placing a priority on CG (4.2%)
- Ensuring debt is manageable, used only for projects with adequate returns(4,2%)
- Clear and informative results disclosure (0%)
- Accessibility if investors to senior management (12.5%)
- Chairperson who is independent from management (8.3%)
- Acting effectively against individuals who have transgressed (0%)
- Record on taking measures in cases of mismanagement (0%)
- Measures to protect minority interest (0%),
- Guiding market expectations on fundamentals (8.3%)

performing loan also came to expect the help of the government, which further emasculated active involvement in the market. In a similar manner, other institutional investors insurance companies and pension funds have faced tight resources until now due to investment regulations in the stock market. Efforts to restructure the financial environment have aimed at securing sound business practices. It is now also the right time to change historical investment habits, as well. In order for this to occur, investment policies that include corporate governance principles must first be revised or setup, with the help of the OECD, the Korean Corporate Governance Committee, or the like. Through clearer investment policies institutional investors will be better enabled to meet long-term investment targets, by investing in companies in which may become 'investors' in a deeper sense, with a greater sense of commitment, rather than simply 'traders' or 'walk the wall street' type investors. This in turn ought to reduce the volatility of the Korean stock market.[51] Of course, governmental revisions of the legal system are needed, to ease restrictions in institutional stock investments. In particular, they ought to raise the stock investment portion of public pension funds that are free from business connections with other invested companies, as this has acted as a severe restriction to any form of institutional investors' activism. Major institutional investors also need to better utilize their potential influence by adopting stricter corporate governance policies and exercising their proxies actively according to those policies; this would likely lead to long-term profit by lowering the cost of capital, as business strategies become more aligned with investors' interests. Despite the lack of data in this paper, Section 4 revealed that stronger corporate governance fuels stronger performance. Joh (2001) and Kim (2002) also suggest that a good corporate governance system

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[51] The *shadow voting system* is attributed to the passive activism of Korean institutional investors (Sung Sook Joh, 2001)

contributes to better performing markets and better accounting returns terms as well.

5-2 Improvement of Corporate Governance Practices in Korea

As Section 3 of this paper states, Korean companies still lag far behind U.S. companies in terms of corporate governance systems, even after improvements carried out after the financial crisis. Given the rapid involvement of foreign institutional investors in Korea's market, Korean institutional investors (and companies affiliated with them) need to reform their CG practices; this means striving harder to secure their investment strategies by getting more involved in the management of their invested companies. These concerns should be (and will likely be) on achieving arm's length deals between the management and the company, while avoiding window dressing and any management position that is too costly from the shareholders' point of view.

Korean companies have to increase the minimum portion of outside directors from the legally mandated 50% to a more substantial portion of about 75%. And they ought to compose evaluation and compensation committees – consisting of only outside directors – to introduce more effective incentive pay packages. Audit committees and nominations should be chaired by outside directors. IT technology can be used to adopt confidential internet voting systems.

More importantly, Korean companies have to create a board atmosphere which seriously addresses, discusses, and debates critical business decisions; rubber-stamping will no longer suffice in today's competitive age, nor will short and `amicable' board meetings based on merely hierarchy and rank (in which younger members or new employees quake in their boots at the prospect of offering any dissenting advice). To achieve this supervisory function of the board, various units within the company also need to strive better to support board members with useful data; such data could include

managerial information, market research, technical trends, and the like. Moreover, Korean companies have to remove the disparity between controlling rights and ownership rights.[52]

This paper merely offers a general overview of institutional investors in Korea; although it may be a poor excuse indeed, may I also add that there is only a small portion of long term 'investors' regarded as Korean institutional investors, and that there always seem to be a lack of systematic financial reporting, making it nearly impossible to engage in any meaningful comparison with the U.K. or U.S. Nevertheless, I accept all full blame for all the faulty reasoning that surely must exist in certain sections of this paper. Let me finally add, however, that I firmly believe that the activism of Korean institutional investors is not far away, and I therefore expect more scholarly work will be achieved in this area in the not so distant future.

[52] SW Joh defined poor CG as a high disparity between controlling rights and ownership rights, and the expropriation of the firm's resources in the business group

APPENDIX A : The List of CGS from S&P,CLSA and ROE

Company Name	Ownership Structure and Investor Relations (S&P)	Financial Transparency and Information Disclosure	Board and Management Structure and Processes	Total points of S&P (98)	CLSA's CGS	Total market value (Dec.31,2001)	Foreign investors shareholding (Dec.31,2001)	ROA for 2001	ROE for 2001 (for Sec co. Mar,2001)	ROIC for 2001
ANAM SEMICONDUCTOR INC	5	6	5	53.3		4,507	49.15	-14.57	-21.91	-4.38
CHEIL JEDANG CORP	5	6	3	46.7	41.2	8,030	19.9	1.89	4.39	7.88
CHO HUNG BANK	2	6	4	40.0		12,902	0.3		22.62	na
DACOM CORP	6	7	4	56.7	42.4	7,182	7.2	-3.07	-10.24	4.49
DAISHIN SECURITIES CO	6	7	5	60.0		5,860	35.58		2.88	na
DONG A PHARMACEUTICAL CO LTD	5	7	5	56.7		1,193	12.9	6.69	15.85	14.28
DONGWON SECURITIES CO LTD	5	7	5	56.7		3,541	11.4	na	10.26	na
GOOD MORNING SECURITIES	4	7	3	46.7		7,792	55.7		6.51	na
H & CB(Kukmin)	6	7	3	53.3	53.7	158,203	71.1		8.31	na
HYNIX SEMICONDUTOR INC	2	5	2	30.0	38.0	13,535	7.7	-33.93	-88.22	-16.38
HYUNDAI ENGR & CONSTR CO	6	4	3	43.3		2,182	2.4	-12.18	-100	-5.54
HYUNDAI MOTOR CO LTD	5	7	6	60.0	41.8	38,437	54.21	6.19	13.94	19.91
HYUNDAI SECURITIES CO LTD	2	4	1	23.3		6,228	20.92		5.57	na
KEPCO-KOREA ELEC POWER CORP	5	7	4	53.3		119,058	26.5	3.08	5.49	3.98
KOREA EXCHANGE BANK	3	6	2	36.7		21,258	34.1		14.41	na
KOREA TELECOM	7	8	6	70.0	45.5	165,778	37.2	4.71	9.36	15.16
KTB NETWORK	6	5	5	53.3		2,442	7.4		3.81	na
LG ELECTRONICS INC	5	7	6	60.0	40.7	20,114	28.1	4.32	12.26	13.63
LG INVESTMENT & SECURITIES	7	7	5	63.3		8,898	5.3		8.74	na
MIRAE CORP	4	7	5	53.3		2,037	3.5	-28.59	-36.09	-19.29

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Company Name	Ownership Structure and Investor Relations (S&P)	Financial Transparency and Information Disclosure	Board and Management Structure and Processes	Total points of S&P (98)	CLSA's CGS	Total market value (Dec.31,2001)	Foreign investors shareholding (Dec.31,2001)	ROA for 2001	ROE for 2001 (for Sec co. Mar,2001)	ROIC for 2001
POSCO	3	7	5	50.0	49.5	87,797	62	4.63	8.35	11.17
SAMSUNG CORP	1	2	1	13.3		8,553	22.9	0.37	0.99	11.55
SAMSUNG ELECTRO-MECHANICS CO	5	7	7	63.3		29,450	33.5	3.29	6.62	0.89
SAMSUNG ELECTRONICS CO LTD	6	7	4	56.7	44.1	449,325	59.9	10.75	16.52	8.17
SAMSUNG FINE CHEMICAL CO LTD	6	7	4	56.7		2,559	8.5	5.38	8.77	6.96
SAMSUNG FIRE & MARINE INS	4	5	4	43.3		14,223	54.5	1.26	11.98	na
SAMSUNG HEAVY INDUSTRIES CO	5	7	6	60.0	42.4	13,291	9.3	1.01	3.26	6.53
SAMSUNG SDI CO LTD	5	7	5	56.7	44.1	25,296	42.7	13.57	21.28	20.68
SAMSUNG SECURITIES CO LTD	7	7	6	66.7		22,592	22.5		8.07	na
SK CORP	1	7	2	33.3		15,110	32.3	0.62	1.56	3.79
SK TELECOM CO LTD	7	7	5	63.3	49.5	147,101	32.3	11.58	19.57	47.38
SKC CO LTD	6	8	5	63.3		916	0.7	-8.26	-30.82	8.34
TRIGEM COMPUTER INC	1	4	1	20.0		1,684	4.3	0.49	1.18	0.65
CYBERTEK HOLDINGS INC	4	6	3	43.3		749	1.6	-3.05	-4.39	-4.87
DAUM COMMUNICATION CORP	6	6	5	56.7		2,705	28.5	-22.85	-46.85	1.99
HANARO TELECOM CO LTD	6	7	5	60.0	40.7	7,788	5.2	-7.04	-15.75	-6.9
HANDYSOFT CORP	4	7	5	53.3		2,246	2.6	1.19	1.28	0.78
KT FREETEL CO LTD	5	7	4	53.3	44.0	53,997	14.2	8.82	27.59	18.29
LOCUS CORP	5	6	5	53.3		1,532	20	-16.64	-21.84	-15.65
MACROGEN CO LTD	6	6	5	56.7		873	1.1	0.54	-12.21	-32.75

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Company Name	Ownership Structure and Investor Relations (S&P)	Financial Transparency and Information Disclosure	Board and Management Structure and Processes	Total points of S&P (98)	CLSA's CGS	Total market value (Dec.31,2001)	Foreign investors shareholding (Dec.31,2001)	ROA for 2001	ROE for 2001 (for Sec co. Mar,2001)	ROIC for 2001
MPLUS TECH INC	5	6	4	50.0		521	23.8	-29.47	-61.61	-46.36
SEROME TECHNOLOGY INC	5	7	5	56.7		4,908	2.5	-27.54	-30.69	-52.5
TELSON ELECTRONICS CO LTD	6	7	5	60.0		1,327	22.6	-9.87	-25.67	-11.34
HITE				0.0	55.2	5,183	63.5		11.17	14.67
KORAM				0.0	52.8	12,443	53.2		16.62	na
HANA BANK	5	7	3	50.0	52.2	7,349	52		17.64	na
Shinsegae				0.0	48.0	10,142	48		18.51	14.94
Shinhan bank				0.0	44.1	na	48.6		6.07	na
LG Telecom				0.0	43.2	9,515	2.9		30.42	16.15
Cheil Communication				0.0	42.8					
SEMCO				0.0	38.3					
HYUNDAI Heavy Ind					38.0	21,394	6.3		-2.51	11.02
Average	4.77	6.39	4.23							
Source : S&P, CLSA, KIS										

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