

Issue: South Korea's Conglomerates

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Are business dynasties hindering economic progress?

Executive Summary

South Korea has rocketed from poverty to global economic leadership in the last half-century on the strength of massive conglomerates that specialize in electronics, telecommunications, autos and steel. These family-owned firms, called chaebols, include international brands such as Samsung, Hyundai and LG. While chaebols helped lift the country out of privation and continue to provide a massive global platform, many South Koreans now question their outsized influence and close ties to government. The economy has stagnated since the early 2010s, and political and business leaders have been jailed this year over corruption allegations. Some experts say chaebols must be reformed by curbing nepotism and insider dealing if South Korea is to restart its economy and cure many societal ills, including government corruption, income inequality and a lack of startups. Yet unraveling such complex government and business entanglements could be a decades-long process.

Among the key takeaways:

- South Korea ranks fifth globally as an exporter and 11th in gross domestic product.
- The country has the world's fourth-largest trade surplus; trade accounts for more than three-fourths of GDP.
- Economists say South Korea's dependence on exports, and on the chaebols that dominate its export trade, hold back the economy.

Full Report



Even as Samsung posted better-than-forecast earnings in July, an effigy of de facto chief Lee Jae-yong, who faces corruption charges, stood outside its headquarters. (Seong Joon Cho/Bloomberg via Getty Images)

The life of Bia Lee, a 25-year-old South Korean student, is dominated by a few looming brands. Her apartment, credit card and cellphone are products of [Samsung](#), where her father also works. She regularly visits [Lotte](#) department stores and eats Lotte candy. And she wants to buy a [Hyundai](#) auto. "It is the best car I can buy," Lee says. "And when I buy a Korean car, I feel like I am patriotic."

Americans who joke that [Amazon](#), [Apple](#) and [Google](#) have all but taken over their lives would likely be stunned by the influence that a few South Korean brands wield in their native land. Samsung is the most pervasive: a Korean could drive a Renault Samsung car, live in a Samsung apartment, use a Samsung Galaxy S8 smartphone, buy clothes from Samsung Outlets, take the children to a Samsung theme

park, get medical care at the Samsung Medical Center and pay for it all with a Samsung credit card. Samsung refines the oil used in South Koreans' cars and builds South Korean ships and power plants.

Lee says this ubiquity is normal: "People think products of a big company have better quality."

Samsung is one of a small number of immensely powerful, family-owned South Korean conglomerates known as chaebols ("chae" means wealth or property, "bol" is clan). These huge firms – which also include automaker Hyundai, electronics manufacturer [LG](#) and retailer Lotte – have dominated South Korea's economy since the country's economic revolution in the late 20th century and have helped make it the world's fifth-largest exporter with the 11th-largest gross domestic product (GDP).¹

But the chaebols' vast influence also is blamed for major political and business scandals, economic stagnation and lack of growth among startup companies. Between 2011 and 2014, just 0.01 percent of South Korea's small companies grew into midsized ones, according to a 2016 report by the Organisation for Economic Co-operation and Development (OECD).² As a consequence, many South Koreans are calling for reform of the conglomerates.

Even Lee, with her chaebol-dominated lifestyle, is concerned. "Many small businesses are falling prey to the tyranny of large enterprises," she says. "Everybody knows it, but we want the brand image."

Export Dependency

The chaebols powered South Korea's rise to global dominance in exports. Yet many economists say they now find Korea's export-dependent economic structure problematic.

After declining over the past two years, South Korea's exports are increasing again at record rates, rising 24.1 percent in April compared to the same month last year.³ The country maintains a trade surplus of more than \$98 billion, the fourth-largest in the world after China, Germany and Japan.⁴

Integrated circuits, cars, ships, refined petroleum, liquid crystal display (LCD) panels, auto parts, industrial machinery and telephones are the country's biggest exports by value.⁵

Chaebols produce most of those exports. These firms alone have had the accumulated capital needed to be involved in Korea's most profitable enterprises, according to Gyu-Chang Yu, a human resource management professor at Seoul's Hanyang University.

China, the United States, Vietnam and Hong Kong are the biggest customers for South Korean exports. China tops the list, accounting for almost 25 percent of the money South Korea earns from exports.

In 2016, trade accounted for 78 percent of South Korea's GDP. The average for all 35 member countries of the OECD, which encompasses the world's most prosperous economies, was 56 percent.⁶ The Korean economy is dependent on chaebol-produced exports, such as steel, electronics and cars, according to Seoul National University professor Sangin Park. The Korean government overhauled its economy through export-led industrialization policies starting in the 1960s, and that tactic has not changed today.

"Because the traditional development policy was so successful, many people are afraid of sudden changes," said Korea University Law professor Hwang Lee.

Yu says the government has shown a "lack of innovation" to lessen its export-dependency. However, economic planners are also hindered by a relatively small domestic population to support the chaebols' huge output and few natural resources.

South Korea is grappling with tepid economic growth in recent years.⁷ Its GDP has grown an average of 3.5 percent annually in the current decade, down from 7.1 percent in the 1990s and 4.4 percent in the 2000s.⁸ The growth rate for the household debt-to-GDP ratio in Korea has climbed to the third highest worldwide, and 16 percent of job-seeking youth eat just one meal per day.⁹

Economists say one of the major causes of the sluggish growth is the government's slow response to the need for reducing export dependence. "Korea is also entering a state of stagnation because Korea depends on exports for growth," said Mauro Guillen, a management professor at the Wharton School at the University of Pennsylvania.¹⁰

Park adds, "The government-led chaebol-centered economic structure became a status quo which basically hinders the Korean economy from moving forward."

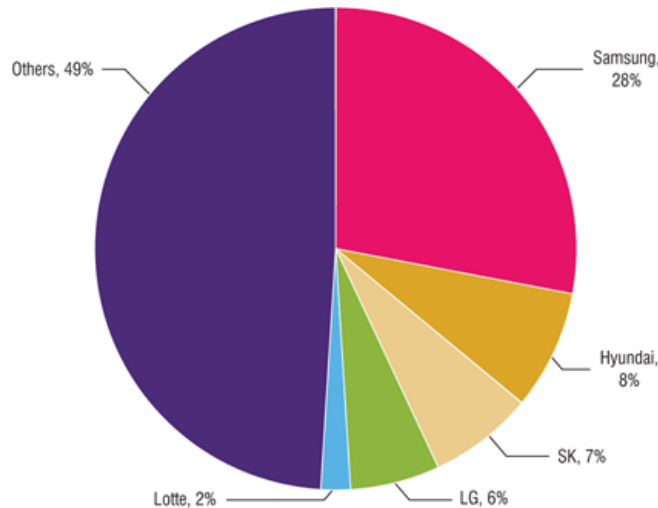
To lessen its dependence on exports, South Korea would need to boost domestic demand, but that will not be easy given the country's demographic and economic realities: Its growth rate is slowing and both young people and the elderly are struggling economically.¹¹

While South Korea was initially slow to embrace free-trade accords, it now participates in agreements with 16 countries and economic entities – including China, the United States, India, Canada, the European Union and the Association of Southeast Asian Nations.¹² The South Korean government pushed for the trade agreements, Park says, but chaebol leaders supported them. Lee says the manufacturing sector, largely dominated by chaebols, has particularly benefited from the accords.

President Trump has threatened to scrap the U.S.-Korea Free Trade Agreement, which took effect in 2012, but some experts, such as Harvard University economist Jeffrey A. Frankel, doubt that will happen. Frankel pointed to Trump's difficulty in making progress on his major campaign promises, such as building a border wall between the United States and Mexico, health care reform and renegotiating the North American Free Trade Agreement. Trump said after meeting South Korea's new president, Moon Jae-in, in July that the two countries are renegotiating the deal, but Moon denied that and said they should first create a task force to assess possible changes. ¹³

Chaebols Dominate Korean Stock Market

Five biggest made up half of benchmark index



Source: Peter Pae, "South Korea's Chaebol," Bloomberg Quick Take, March 24, 2017, <https://tinyurl.com/y8bwpl8m>.

The five largest chaebols in South Korea account for more than half of the country's benchmark Korea Composite Stock Price Index (KOSPI). Samsung alone accounts for more than one-fourth of the index.

The biggest chaebols, as measured by assets, are Samsung, Hyundai Motor, [SK Group](#), LG and Lotte. ¹⁴ These firms are known in the United States chiefly for electronics, home appliances or cars, but they provide a broad spectrum of services at home.

The chaebols' dominance of South Korea's economy is reflected in that fact that sales revenue earned by the top 10 chaebols account for 67.8 percent of the country's GDP, according to research by Park, the National University professor. Their assets equal nearly 110 percent of GDP, with Samsung's assets alone accounting for 42 percent.

The chaebols' dominance has mostly stifled attempts by startup companies to be competitive, according to Katharine H.S. Moon, a political science professor at Wellesley College and a senior fellow at the Brookings Institution's Center for East Asia Policy Studies. However, some startups – including restaurant delivery app [Baedal Minjeok](#), apartment search app [Zig Bang](#) and home-delivery service [Coupang](#) – have become part of Koreans' daily lives. Each of those three startups has attracted tens of millions of dollars in investment money from [Goldman Sachs](#) and other major U.S. companies. ¹⁵ (Coupang has raised \$1.42 billion in equity funding.) ¹⁶

The best-known South Korean enterprise that began as a startup is the internet company [Kakao](#), now as omnipresent as Samsung and other chaebols. Kakao provides apps for mobile chatting, blogging, gaming and video and music sharing. It also operates a taxi service. It is not considered a chaebol because it is not family-owned.

Most small and midsized companies in South Korea struggle with lower revenue. Although these companies account for nearly 88 percent of total employment, they pay, on average, only 63 percent of what chaebols pay for similar work. ¹⁷ The small and midsized companies account for less than 38 percent of the country's exports. ¹⁸

Tech success stories aside, it is all but impossible for smaller firms to thrive, according to Wellesley's Moon, because "the economy is so top-heavy and dominated by chaebols." She says owners of smaller companies "run up against these towering figures ... and get eaten up."

The Source of Korea's Breakneck Growth

Chaebols and South Korea's government have relied heavily on each other since the administration of Park Chung-hee, who was president from 1963 to 1979. His policies enabled the chaebols' success through government contracts, legislative support and financial

benefits; in return, he demanded that chaebol leaders adhere to his priorities and directives.¹⁹

South Korea was one of the world's poorest countries at the start of Park's tenure, and his goal was to change that status. He cobbled together a group of businesses – some already successful, some that owed their success entirely to government support.²⁰ According to Moon, Park required these firms to pledge support for the goal of South Korea's economic development. The companies they created became today's chaebols, which Moon says still have the founders' grandchildren and great-grandchildren at the helm.



Harvard economist Jeffrey Frankel

Park aimed to make South Korea an aggressive exporter, starting with textiles and then moving to “higher rung” industries such as chemicals and steel, according to Harvard's Frankel. The plan worked: South Korean exports increased 1,340 percent between 1960 and 1970. Japan's exports over the same period, by comparison, increased 200 percent.²¹

Park's export model also relied on Japanese investment in Korean businesses and a decision by Japanese businesses to relocate certain manufacturing industries, such as textiles and heavy industry, to Korea.²² South Korea's success, wrote New York University professor Vivek Chibber, “was thus made possible by a combination of luck and genuine effort.”²³

Economists say few other countries matched South Korea's economic growth in the latter half of the 20th century. “It's been a very remarkable achievement,” says Frankel, who also directs the Program in International Finance and Macroeconomics at the National Bureau of Economic Research, a private nonprofit group in Cambridge, Mass.

South Korea is far more prosperous today than it was just a few decades ago. The population is the most educated in the OECD; nearly 70 percent ages 25 to 34 have a college degree, although the level falls to 18 percent for those 55 to 64.²⁴ Living conditions have been transformed. While an estimated 40 percent of South Koreans lived in absolute poverty in 1965, now nearly three-quarters of the population has a smartphone and the country has been called the “world capital of plastic surgery.”²⁵

The Government-Business Nexus

South Korea's exceptional growth has come at a cost. Its government and people depend on chaebols for ongoing economic growth. The chaebols, in turn, depend on the government for laws designed to aid their success.

Conservatives have dominated the country's politics, and those administrations generally have expanded the chaebols' power, allowing them to merge, enter previously restricted areas of commerce and engage in other unregulated practices. More liberal presidents, such as the recently elected Moon, try to restrain the conglomerates' power in order to protect smaller firms and consumers, Park of Seoul National University says.



Backers of President Park Geun-hye hold a banner with her and her father, former President Park Chung-hee, whose policies helped create the chaebols. (Jung Yeon-Je/AFP/Getty Images)

The consequences of the links between chaebols and business-friendly politicians were illustrated by the fall of conservative President Park Geun-hye. In a scandal that could force reforms of the chaebol system, Park – the daughter of Park Chung-hee – was impeached and removed from office earlier this year and is now on trial on charges of corruption and leaking confidential information as part of a complex influence-peddling scheme. She has denied the charges.²⁶ Top aides to Park and others have received prison sentences for related wrongdoings in Park’s administration.²⁷

Samsung’s de facto chief executive, Lee Jae-yong, has been charged with bribery and embezzlement, including bribes allegedly paid to Park. Prosecutors are demanding a 12-year prison term for Lee, which would be the longest term any chaebol executive has received.²⁸ This is the first time a chaebol leader has been arrested on corruption charges, although several have been imprisoned for embezzlement.²⁹

Charges in the Samsung case include allegations that Park shared confidential state information with Choi Soon-sil, a close friend. In 2015, Samsung allegedly paid \$36 million in bribes to phony charitable foundations operated by Choi in return for her influence to win government approval for a merger.³⁰

Reform Advocates Call for Change

The landmark corruption case has fueled demands for extensively reforming the chaebol system. Park of Seoul National University says the system concentrates too much power in the hands of a few stakeholders, those with familial ties to a chaebol or government leaders.

“The market economy and political democracy is based on pluralism, but the concretion of economic power means there is no pluralism,” says Park, who also directs his university’s Research Center for Market and Government.

Reform advocates say the chaebols’ ownership structure needs to be simplified and purged of nepotism. In most chaebols, a single family is the majority stakeholder in a holding company that in turn is the majority stakeholder in dozens of affiliated companies. Those affiliates are often run by other family members, whose priority is making money for the family rather than making smart business decisions.

LG’s chairman, for example, is the grandson of the company’s founder, Koo In-Hwe. The Koo family owns 48 percent of the company.³¹ LG owns one-third of the shares of each of its affiliated companies, giving the Koo family huge sway over those companies.³² “In the cultlike corporate culture of the chaebol, only the so-called owner chairman can decide on multibillion-dollar investments,” wrote New York Times Korea correspondent Choe Sang-Hun, who won a Pulitzer Prize for his Korea reporting in 2000.³³

Top executives at the conglomerates often arrange for their children to inherit management rights, overlooking more qualified non-family candidates.³⁴

Similarly, chaebols borrow money from each other and use their affiliates as suppliers even if an outside supplier offers a better product. The fire-prone lithium-ion batteries inside Samsung's Galaxy Note 7 smartphones, for example, were made by a Samsung subsidiary.³⁵

"You have a disadvantage as an innovator" when suppliers are affiliate companies, Park says. "The organization and the business structure of the Samsung Group is a disadvantage for Samsung Electronics to be a fast mover."

The interdependence among chaebol affiliates – for example, LG Electronics uses LG Display for its tablet, television and phone screens – also prevents smaller companies from growing, critics of the conglomerates say. South Korea's current government policies "discourage the expansion" of small and medium-sized businesses, the OECD said in a 2014 report.³⁶

Reform Potential Is Uncertain

Reform will not be easy given that family ties connect the highest rungs of South Korean society, says Wellesley's Moon. Politicians who call for reforming chaebols could make enemies of in-laws, friends or siblings. "I don't think [the new president] can deeply reform the chaebol system because it is so engrained in the economic, social and political structure," Moon says.



Katharine H.S. Moon

Previous efforts to reform the chaebols largely failed due to opposition by pro-business politicians. "The organized resistances have shown significant powers and have been very effective," says Sung Ick Cho, an associate fellow at the Korea Development Institute, a Sejong-based think tank.

To make their case for limiting reform, chaebol leaders and conservative lawmakers assert that proposals to regulate chaebols would damage South Korea's economy.³⁷ But Park, the Seoul National University professor, says such consequences would be manageable.

"The Korean government has some very sound financial resources," he says. "It can use fiscal policy to help the temporary shock of the reform."

And Park says the economy would improve in the long run if real reform occurred. "The Korean economy is hitting the limit because it is based on the chaebol," Park says. "We need new innovation and new energy and it should come from structural reform of the economy."

While economists doubt the government will enact extensive reforms, Korea University's Lee says even minor changes still would be a win.

"For now, the current government seems to design soft but lasting reforms that may change chaebols' conduct as well as change the government's interface with them," says Lee, who also directs his university's Innovation, Competition and Regulation Law Center. "If this is the case, we may not see drastic reforms, but its potential would be huge."

About the Author

Rachel Premack is a journalist based in Seoul. She writes about the intersection of economics and culture in South Korea. Her work has appeared in The Washington Post, Foreign Policy, Time, Quartz and other outlets.

Chronology

1910–1987

From colonialism to development.

1910

Neighboring Japan annexes the Korean Peninsula.

1945

Japan surrenders in World War II and its colonial rule in Korea ends. The Soviet Union and United States split the country in two, with the Soviet Union dominating the northern half and the United States the southern. They determine that the two Koreas should be reunited after four years and enjoy independent rule.

1950–1953

The Korean War begins when the North invades the South, then concludes in a stalemate, with no peace treaty signed. The estimates of total casualties, including military and civilians, range from 1.2 million to 5 million. South Korean President Syngman Rhee rules autocratically for the rest of the 1950s as the economy struggles. In the North, Communist strongman Kim Il-sung creates a Stalinist state.

- 1963** After seizing power in a military coup two years earlier, Park Chung-hee is elected president. During his 18-year rule, South Korea's economy is revolutionized at a deep cost to human rights.
- 1972** Under Park Chung-hee's direction, a young company, POSCO, opens its first modern steel plant. Skepticism abounds that South Korea should develop domestic heavy industries. POSCO is now the fifth-largest steel producer in the world.
- 1981** South Korea receives its last significant aid package from Japan, just under \$800 million in 2010 U.S. dollars. Six years later, it begins granting development assistance to others.
- 1987** Ending decades of military dictatorships and crushed democracy movements, a democratic government is established in South Korea. The constitution, still in force today, provides for a free press, direct election of presidents and, among other rights, habeas corpus.
- 1997–present** **Crises and corruption charges amid global dominance.**
- 1997** South Korea is among the hardest hit by the Asian financial crisis. Its national debt-to-GDP ratio nearly doubles, its currency tumbles in value and its stock markets experience record drops.
- 1998** Some chaebols and several affiliated firms go under as a result of the financial crisis. Daewoo, once a major force in buses, cars, shipbuilding, electronics and hotels, declares bankruptcy and splits into three smaller firms. Samsung Motors sells 80 percent of its stock to French automaker Renault.
- 1999–2000** Gross domestic product grows by 11.3 percent in 1999 and another 8.9 percent in 2000, marking a return to a flourishing economy.
- 2010** South Korea joins the Organisation for Economic Co-operation and Development's Development Assistance Committee, a consortium of the world's biggest aid donors. South Korea is the first country to go from being a recipient of committee aid to a donating member.
- 2012** South Korea becomes the first newly industrialized country to join the "20–50 club" – countries with a population of more than 50 million that have a per capita income of more than \$20,000. The other six are the United States, Germany, France, the United Kingdom, Italy and Japan.
- 2016** Approval ratings for President Park Geun-hye, who is Park Chung-hee's daughter, fall to 4 percent in late November. Details concerning allegations of influence peddling involving Park and confidante Choi Soon-sil emerge, prompting hundreds of thousands of Koreans to turn out for weekly protests demanding the imprisonment of Park, Choi and several chaebol leaders.
- 2017** Lee Jae-yong, the de facto head of Samsung Group and third-wealthiest person in Korea, is arrested in February. Samsung allegedly paid \$36 million in bribes in 2015 to fraudulent charities operated by Choi. Park is arrested a month later. Moon Jae-in is elected president in May, the first liberal to win a presidential election in South Korea since 2002.

Resources for Further Study

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Books

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The Next Step

Generation Gap

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Organizations

Korea Development Institute

263 (Bangok-dong, Korea Development Institute), Namsejong-ro, Sejong-si 30149, Korea
+044-550-4114

www.kdi.re.kr/kdi_eng/main/main.jsp

South Korean economic think tank with numerous areas of expertise, including macroeconomic policy, public finance, the industry and service economy and North Korea's economy.

Korea Fair Trade Commission

95 Dasom-3ro, Sejong 30108, Korea
+82-44-200-4326

www.ftc.go.kr/eng/index.jsp

South Korean government commission formed in 1980 that independently "formulates and administers competition policies, and deliberates, decides, and handles antitrust cases."

Korea Foundation

Mirae Asset Center 1 Building West Tower, 67 Suha-dong, Jung-gu, Seoul, Korea
+82-2-2151-6520

<http://en.kf.or.kr/?menu=3722>

Cultural organization founded in 1991 to promote goodwill between South Korea and the overseas community through exchange programs, fellowships and cultural activities.

Organisation for Economic Co-operation and Development

1776 I St., N.W., Suite 450, Washington, DC 20006
1-202-785-6323

www.oecd.org/unitedstates/

Intergovernmental economic organization with 35 member countries that was founded in 1960 to promote world trade and the market economy.

Statistics Korea

Government Complex - Daejeon, 189 Cheongsa-ro, Seo-gu, Daejeon 35208, Korea
+82-2-2012-9114

<http://kostat.go.kr/portal/eng/index.action>

National statistics agency with comprehensive website detailing population, housing, business trends, agriculture, national wealth, time use and other pertinent data.

World Bank

1818 H St., N.W., Washington, DC 20433
1-202-473-1000

<http://worldbank.org>

An international financial institution with 189 member countries dedicated to ending poverty and promoting prosperity.

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