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State-led Capitalism Reconfiguring

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Abstract

This chapter of the *Oxford Handbook of Asian Business Systems* provides an overview of the institutional structure of the business system of South Korea. It explores the role of the state, the financial system, ownership and corporate governance, the internal structure of the firm (management), employment relations, education and skills formation, inter-company relations (networks), and social capital. Central to the Korean business system are the *chaebol*, major conglomerates controlled by families who usually own only a small fraction of their stock. The *chaebol* have been a major source of structural inertia, which the Korean state, formally very powerful, has been unable or unwilling to overcome to effect institutional changes expected by labour and the general public. This chapter contributes directly to the business systems and varieties of capitalism literature and identifies institutional contingencies for comparative and international social science research in general.

**Keywords:** South Korea, Asia, business systems, varieties of capitalism, institutions, business groups, *chaebol*, state, structural inertia, institutional change
Introduction
South Korea — formally the Republic of Korea, and in this chapter simply Korea — is one of Asia’s four 'Tiger' economies. Korea’s ‘miracle of the Han River’\(^2\) took the nation from among the world’s poorest in the early 1960s to OECD membership in 1996. Korean per capita GDP at purchasing-power parity has since surpassed that of the Southern European economies and is now within striking range of Korea’s developmental policy model and arch-rival, Japan.

The takeoff of modern economic growth in Korea is widely seen as the result of massive institutional change in 1961 following a military coup, as we will discuss in more detail. The state-led type of business system that emerged (Whitley 1999) survived in general outline until the Asian Financial Crisis of 1997/8, which drew the country and a number of its leading firms into bankruptcy. The impact on the Korean business system of this external shock, known in Korea as the 'IMF Crisis' because much of the pain was blamed on the International Monetary Fund’s restructuring plan, has since been subject to considerable debate.

This chapter presents a portrait of the Korean business system some fifteen years after the crisis. Like all country chapters in this handbook, it emphasizes the current shape of affairs over historical developments. It explores the role of the state, the financial system, ownership and corporate governance, firm-internal dynamics, employment relations, education and training systems, inter-firm relations, and social capital. It further identifies institutional complementarities in the present-day system and outlines the main dynamics of institutional change present in Korea. As will become apparent, post-crisis Korea has reconfigured in ways that are quite different from what many early observers had expected.

Role of the State
There is considerable agreement in the literature about the types of state Korea represented in the past. Korea under its first president, Syngman Rhee (1948-1960), is generally described as a predatory state, in which high levels of corruption enabled political and business leaders to enrich themselves at the expense of the general public (Amsden 1989; Eckert et al. 1990; Song 2003). While Korea lacks the abundant natural resources that are typical of predatory states, a functional substitute existed in the form of US aid money, which was intended to shore up South Korea as a bulwark against communism. Rhee used these resources to buy the loyalty of key actors in the political and economic arena. Economic performance during this period was poor, save for a brief outburst of growth following the end of the Korean War (1950-53). Following a popular uprising in 1960, Rhee left for exile in Hawaii.

After a one-year interregnum, the rules of the game changed fundamentally in 1961. Through a military coup on 16 May 1961, Major General Park Chung-hee became president, and the military took over the reins of the state. Concerned that public disorder and weak economic performance threatened the prospects of Korea’s survival as a nation, Park’s government constructed a developmental state on the Japanese model (Amsden 1989). From 1963 onward, this developmental state began to produce high levels of growth, taking Korea from one of the world's poorest countries in 1961 to OECD membership in 1996. Tempered from the 1980s by various efforts at liberalization, it survived in its general form until the 1997/8 Asian Crisis.

The characteristics of the Korean developmental path are well explored in the literature (Amsden 1989; Wade 1990; Kim, E.M. 1997; Woo-Cummings 1999). Broadly

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\(^1\) The others being Hong Kong, Singapore, and Taiwan.

\(^2\) The Han is the largest river of Seoul, the Korean capital.
speaking, the goal of Korean developmental policies was to develop the country by using administrative means to accelerate the progress of Korean industries from labour-intensive to capital-intensive, and ultimately to technology-intensive industries. Central planning of which industries and firms to promote fell under the auspices of the Korean Development Board, which reported directly to Park. Firms in targeted industries received preferential and subsidized access to finance, a scarce resource, and various other forms of help, including the licenses needed to expand. Capital controls prevented firms from squirrelling capital abroad, and barriers on imports and inward foreign direct investment prevented established international competition from driving budding Korean firms out of the market. At the same time, firms were required to meet ever-increasing export quotas if they wanted to stay in business. These export quotas were useful not only for earning foreign currency for their country, they also helped expose Korean companies to international competition, pushing them to improve their products, and provided a selection criterion by which government could establish which firms were well-run and thus worthy of further promotion.

While the Korean model was Japanese-inspired, there were noteworthy differences to the post-war Japanese model. First, the Korean developmental state was much more top-down, especially in its early days. Business was not a partner, as in Japan, but a subservient tool. While general corruption levels in Korea remained (and remain) higher than in Japan (Transparency International 2012), enforcement of key economic policies was strict. Second, Korean strategy was built around the establishment of large family-led conglomerates, an organizational form that had been abolished in Japan by the Allied occupation. The Korean word for such conglomerates, chaebol, represents the Korean reading of the same Chinese characters used for the Japanese term, zaibatsu. Third, banks in Korea were state-owned, which gave the Korean state more direct influence over the allocation of capital.

While the role of the Korean state historically is thus fairly unambiguous, there is little agreement on what type of state Korea represents today. Following the Asian Crisis of 1997/8, the Korean state moved to deregulate the economy, leading some scholars to argue that Korea has transformed into a liberal regulatory state (Hundt 2005; Pirie 2005). Indeed, from 1998–2008, the OECD product-market regulation index dropped considerably. However, it remains above the OECD average and is far higher than that in regulatory states such as the United Kingdom or the United States. This implies that a full regulatory state has not (yet?) emerged.

Others have pointed to the expanding role of social insurance in Korea to suggest the emergence, at least temporarily, of a welfare state — though in the form of a 'developmental welfare state' that tends to be state-driven in a top-down manner (Mishra et al. 2004; Kwon and Holliday 2007; Lee and Ku 2007; Kim, E.M. 2010). OECD statistics (OECD 2012b) show that Korean public spending on social welfare indeed rose from 3.2 percent of GDP in 1995 to 7.6 percent in 2007 (latest year available). However, this was still far below the OECD average of 19.2 percent, and in the OECD, only Mexico spent less (7.2 percent). At the same time, the Gini coefficient in Korea has been trending up since the 1990s, as has relative poverty, which is the seventh highest in the OECD (OECD 2012a). This would suggest that, for now, Korea is at best a welfare state in the making.

Given the absence of a strong shift to another state type, and taking into account the constraining effect of path dependence, the most plausible categorization of the Korean state today is thus that it probably represents a reconfiguring developmental state (cf. Chu 2009; Kim, E.M. 2010). Certainly with the election of Lee Myung-bak to the presidency in 2007, growth re-emerged as a policy priority. This was evident, for instance, in Lee’s 7-4-7 plan, so called because it envisioned 7 percent average growth during his presidency, so as to reach US$40,000 per capita GDP and make Korea the 7th largest economy in the world. Economic and budgetary planning, functions that had been separated in 1998, were reunited in the new
Ministry of Strategy and Finance. While many of the original control structures, such as directed lending facilities, have been dismantled, functional equivalents seem to have developed. For instance, as we will note in the next section, long-term finance on preferential terms is still available to chaebol through the non-bank financial organizations they own. To the extent that the Korean state does not actively create structures benefiting the chaebol, it at least condones their presence. Whether this will change in the aftermath of the 2012 presidential elections, in which all candidates propose to enhance the welfare state, partially in response to a rapidly ageing population, and curb the power of the chaebol, remains to be seen.

Despite democratization from the 1980s onward, decision-making has remained top-down and centred on the president, with the large conglomerates representing the major non-state actor in economic policy-making. As a result of limited consultation and consensus-building, political strike actions are relatively common. Implementation of policies is generally good, with the World Bank rating government effectiveness as on a par with Taiwan and only surpassed among the economies in this handbook by Singapore, Hong Kong, and Japan (World Bank 2012b).

**Financial System**

While the Korean financial system has undergone significant changes in recent years, it remains dominated by indirect finance (Tsutsumi, Jones, and Cargill 2010). In the heyday of Korean industrial policy, banks were state-owned vehicles for funnelling capital to targeted conglomerates. Banks operated in a system that would keep firms supplied with preferential loans — and more generally, alive — as long as they met industrial policy targets or, in later years, if they were well-connected or 'too big to fail'. The long-term availability of cheap debt, paired with a desire by chaebol owners not to dilute their controlling stakes, led conglomerates to expand on leverage, rather than by raising equity. This general pattern survived liberalization and privatization in the banking sector in the 1980s, not least because the liberalization process opened the door to chaebol ownership of non-bank financial institutions such as insurance and securities houses. These non-bank financial institutions grew to contribute about half of all loans in the economy prior to the 1997/98 Asian financial crisis (Hahm 2008). By the time of the crisis, the average debt/equity ratio of the chaebol was about 450 percent for all conglomerates (Lim 2012) and 600 percent for the top-30 conglomerates (Hao, Hunter, and Yang 2001). The average debt/equity ratio for listed non-conglomerates was about 300 percent (Lim 2012).

The Asian financial crisis necessitated a re-nationalization and restructuring of banks. While some banks still remain in state hands, most were re-privatized in the following years, often through sales to foreign investors. The Korean government further required the chaebol to reduce their dependence on bank loans by capping debt/equity ratios at 200 percent (Lee, Park, and Shin 2009).

While these changes, egged on by the International Monetary Fund (IMF), could have led to a shift towards a more market-oriented and equity-based system, indirect finance continues to dominate. Between 1988 and 2009, the ratio of bank credit to the private sector over GDP expanded from about 0.45 to 1.1. During the same period, the ratio of stock market valuation over GDP increased from about 0.15 to about 0.6 (Bank for International Settlements 2010). These are about the same levels as for Japan, a bank-led system with respective 2009 levels at 1.05 and 0.55.

Helpful for the ability of the chaebol to obtain loans is their continued ownership of non-bank financial institutions, which by 2005 were estimated to account for about 30 percent of loans in the entire economy (Hahm 2008). Given their ownership control by chaebol, it is likely that non-bank financial institutions are the main source of loans for the
chaebol and that the loans received are on preferential terms and patient in nature. In addition, as the next section will show, the state of corporate governance in Korea is such that impatient capital — in essence, minority shareholders — has limited influence on managerial decision-making.

Ownership and Corporate Governance
Family ownership and control have been key characteristics of the Korean business landscape. Of the 200 largest listed firms in Korea in 2008, 159 published sufficient data to trace ultimate ownership. Of these, between 35.8 and 54.5 percent (depending on the threshold applied for ultimate control) were family-controlled\(^3\) (Carney and Child 2012). These levels represent a marked increase from 1996 levels of between 26.3 and 51.8 percent (Carney and Child 2012).

A common tool for maintaining family control of listed firms is pyramidal share ownership. In this pattern, the largest shareholder holds a controlling share in one firm, which in turn holds a controlling stake in another. This makes it possible for the largest shareholder to retain control of the latter firm without possessing a controlling ownership stake. Of the 159 firms already mentioned, 50.6 percent were part of pyramids in 2008, up from 36.1 percent in 1996, with cross-shareholdings in these pyramids exceeding 5 percent (Carney and Child 2012). As a result, “the typical large control holder has ten ultimate votes for each 7.8 shares held” (Carney and Child 2012: 30).

The same patterns apply for the country’s leading conglomerates, the chaebol, but in more pronounced form. Family control is the norm among this group, even though consolidated ownership stakes are considerably below controlling levels. For instance, for a group of 47 chaebol with on average 23 member firms, the 'owner family' on average held only 21 percent of the cash-flow rights during the period 1998-2004 but retained up to 68 percent of voting rights through measures such as pyramids (Almeida et al. 2011). The Korea Fair Trade Commission reported for 2008, the latest year for which it published such data, that the owner families of the 28 leading privately-owned conglomerates held on average 14.2 percent of the stock, but had 49.3 percent of the voting rights (Korea Fair Trade Commission 2008). The most extreme case was the SK chaebol, with the owner family holding 2.2 percent of stock, while retaining 37.3 percent of the voting rights.

This divergence between ownership and control creates enormous potential for abuse by the controlling family. Well-documented (e.g., Bae, Kang, and Kim 2002; Claessens and Fan 2002; Baek, Kang, and Lee 2006; Kim and Yi 2006) is a phenomenon known as ‘tunnelling’, which involves the transfer of funds from firms in which the controlling shareholder has low cash-flow rights to firms in which that shareholder has high rights. This can be accomplished through a multitude of mechanisms, including transfer-pricing, preferential purchasing within the conglomerate, acquisitions, private-securities offerings, or the provision of loans or loan guarantees.

Despite years of government efforts to improve the corporate governance system, the quality of corporate governance in Korea continues to be a serious concern. Seven of the leaders of Korea’s ten largest chaebol, including the chairmen of Samsung, Hyundai Motors, and SK, have been convicted of crimes such as breach of trust, corruption, embezzlement, and large-scale accounting fraud (Power 2012). In 2010, the Asian Corporate Governance Association (Gill, Allen, and Powell 2010) rated Korean corporate governance 9\(^{th}\) among 11 countries, a drop of three places compared with 2007. Only Indonesia and the Philippines scored worse, while China and India, hardly paragons of corporate governance, scored better. Of various factors affecting the overall score, only accounting and auditing practices were

\(^3\) Controlled does not necessarily mean owned, as will become clear below.
seen to be close to world-class standards. By contrast, the report identified enforcement as the weakest link in the corporate governance system, scoring 28 out of 100 points — 52 points below the world-class benchmark. While government reforms may have improved the formal institutions of Korean corporate governance in recent years, lax enforcement seems to enable considerable deviations in actual practice (Lee and Lee 2008). A number of reasons may be in play. One is the generally pro-chaebol stance of the current president, Lee Myung-bak, himself a former chaebol executive. Another may be genuine fear that full enforcement of corporate governance reforms may weaken the competitive power of the chaebol; given their importance to the economy — Samsung alone is said to account for about 20 percent of Korean exports — it seems plausible that prosecutors and politicians will try to avoid the risk of blame for weakening Korea’s industrial powerhouses.

Perhaps the most powerful check on the chaebol is the force of public opinion, with a considerable part of Korea’s population being generally critical of the power and business practices of the chaebol. For instance, in a 2012 opinion poll, 74 percent of respondents indicated that they considered the chaebol ‘immoral’ (Kim and Park 2012). At the same time, research in the first half of the 2000s found that Korean top executives regarded charity and contributing to the development of the South Korean economy as important (Witt and Redding 2012a). The same executives identified employees and society as major stakeholders alongside shareholders (Witt and Redding 2012b). It seems likely that a need to respond to the hostility of labour unions and public opinion were major considerations in shaping executives’ views. The overall picture is thus one of owner families checked not by the force of law or activism of international shareholders, but by a need to maintain social licence by appeasing employees and society as a whole.

**Internal Structure of the Firm**

The post-war Korean management system has been described as authoritarian and top-down in nature, personalistic and paternalistic, with high supervisory control and key decisions made by top managers, especially the chairman. In a chaebol, the chairman was a member of the ‘owner’ family (Janelli and Yim 1995; Whitley 1999; Lee, Roehl and Choe 2000). To implement control over the conglomerate, the chairman would maintain a central staffing office (also known as the chairman’s office) of up to several hundred dedicated staff, and direct matters such as staffing, auditing, planning, and finances in member firms of the chaebol (Whitley 1999). This control could be extensive, as illustrated by the report that the founder of Samsung, Lee Byung-chull, participated personally in all hiring interviews between 1957 and 1986, a total of over 100,000 interviews (Whitley 1999). Promotion and pay under this system were predominantly a function of seniority (Whitley 1999; Bae, Chen, and Rowley 2011), that is, the number of years of service with the firm.

In the 1990s, globalization and the 1997/8 Asian financial crisis combined to bring considerable pressure for change to bear on this system (Bae, Chen, and Rowley 2011; Lee and Kang 2012). However, on the evidence available today, it seems that the changes have been considerably less pronounced than expected immediately after the crisis. Korean management continues to be top-down, authoritarian, and paternalistic (Park and Lee 2008; Bae, Chen, and Rowley 2011; Chang 2012). The willingness to delegate in Korea scores 3.6 out of 7, par with Thailand; in this handbook, only Vietnam scores lower (Schwab 2011). For Samsung Electronics, a paragon of Korean industry, a 2009 survey revealed that respondents denied that decision-making had become less authoritarian and top-down, that there were now fewer layers in the hierarchy, and that leadership was less paternalistic (Chang 2012). A time-series study of Korean human-resource practices shows that the influence of employees on the running of the firm, if anything, declined somewhat between 1996 and 2004/5 (Bae,
Despite repeated proposals to outlaw the chairman’s office, the practice of centralized control by the chairman and his staff continues (Park and Lee 2008).

Change seems likewise to have been limited in the area of hiring, promotions, and pay. While hiring at lower levels seems to have become more merit-based (Chang 2012), often in the context of standardized tests, the propensity to select top management from among family and loyal friends seems to persist (Chang 2012). Counter to expectations that pay and promotions would move towards a performance-related system, seniority-based wages remain dominant, and performance-related elements seem to be more of an admixture than a main component. This is clearly visible in the tenure-wage profile, which looked almost exactly the same in 2010 as 2000 (OECD 2012a). As tenure lengths have increased during that period (again counter to expectations; see next section), the age-wage profile has become considerably more pronounced, with workers in the age group 40-49 earning almost 2.75 times more than those below 20 years of age in 2010, as compared with a multiple of about 2.2 in 2000 (OECD 2012a). Survey data further show that in 2008, 52.2 percent of firms still retained a purely seniority-based base pay system (another 39.4 percent used a mixture including seniority) and on average, only one-sixth of the overall bonuses paid were variable (Park and Park 2011). To the extent that performance has become more emphasized in determining pay and promotions, this seems mostly the case for management (Rowley, Benson, and Warner 2004; Lee and Kang 2012). Interestingly, this seniority system coexists with relatively short employment tenures (see next section), which is possible because seniority is no longer defined in terms of time with the company, but in terms of working experience.

**Employment Relations**

The Park government effectively suppressed the labour-union movement. Although unions existed, with the Federation of Korean Trade Unions (FKTU) as their peak association, they were tools of government policy rather than independent representatives of labour interests. Accordingly, wage increases during the early days of Korean modern economic development lagged behind overall economic growth (Amsden 1989). The union movement reasserted itself in the 1980s, when it became a key driver of the democratization process (Lee, Y. 2011). Helped by the formation of alternative unions, such as the Korean Confederation of Trade Unions (KCTU), which emerged in 1990 (Han, Jang, and Kim 2010), unionization rates reached 19.8 percent in 1989, the year following the first democratic presidential elections after Park (Ministry of Employment and Labor 2011).

While overall membership numbers have since stabilized around the 1995 figures of about 1.6 million, a growing labour-force has meant that by 2010, the unionization rate had fallen to 9.8 percent (Ministry of Employment and Labor 2011). Structural shifts in the economy toward the service sector, which is traditionally lightly unionized, are a major reason for this change.

There is considerable variation in union strength by sector and company size (Ministry of Employment and Labor 2011). In the private sector, the unionization rate in 2010 was 8.6 percent. By contrast, 18.9 percent of teachers and 58.0 percent of government workers were unionized in the same year. Unionization rates in companies ranged from 0.1 percent for establishments with up to 29 employees to 43.4 percent for firms with more than 300 employees. The implication is that in the chaebol, whose member firms tend to be large, on average almost half of the workforce is unionized.

The organization principle of Korean unions has been in transition from company to industrial unions since the 1990s (Yoon 2010). In 2010, Korea had 346 industrial unions with 888,437 members, equivalent to 54.1 percent of all unionized workers, while the remaining 45.9 percent were organized in 4,074 company unions (Ministry of Employment and Labor
Since 2003, industrial-union membership has increased by 83.4 percent from 484,400 members (31.1 percent of the total), while consolidation has led to a decline in industrial-union numbers from 469 to 346 (Ministry of Employment and Labor 2011).

Most unions are members of one of two umbrella organizations, the FKTU or KCTU. As of 2010, the FKTU was larger, with 728,649 members in 2,292 unions, while the KCTU organized 580,064 workers in 432 unions (Ministry of Employment and Labor 2011). However, the KCTU is likely to gain in relative strength over time, as 79.5 percent of its members are in industrial unions, while the FKTU has 58.4 percent of its members in company unions (Ministry of Employment and Labor 2011). The balance of 334,400 unionized workers were members of 1,696 independent unions (Ministry of Employment and Labor 2011).

Korean unions are notorious for militancy. However, strike activity has been in marked decline in recent years. The number of strikes in 2010 was 74, down from a post-crisis peak of 462 in 2004 (Lee, S-H. 2011). The number of working days lost to strikes in 2010 was 422,000, less than a quarter of the post-crisis high of 1.893 million days registered in 2000 (Lee, S-H. 2011).

Since 1998, Korea has officially had a tripartite industrial-relations system built around the Korea Tripartite Commission (KTC) (Han, Jang, and Kim 2010). There is considerable disagreement over its effectiveness in balancing the interests of capital and labour, with some authors seeing most benefits accruing to capital (Han, Jang, and Kim 2010), while others take a more balanced view (Yoon 2010). There is agreement, however, that Korean-style tripartism would be considered dysfunctional by European standards (Han, Jang, and Kim 2010; Kim, Y-S. 2010; Yoon 2010). In particular, the KCTU withdrew from the KTC in 1998 and again in 1999 and has since remained outside the frame (Han, Jang, and Kim 2010; Kim, Y-S. 2010). In addition, Korean unions continue to be highly decentralized, and even where industry-level bargaining occurs, the most important issues are still addressed in 'supplementary bargaining' at company level (Yoon 2010). Employers have generally resisted industry-level bargaining (Lee, S-H. 2011).

Korean companies, especially chaebol, used to offer a form of lifetime employment, though on looser lines than its Japanese counterpart, in that mass dismissals did occasionally occur (Lee, Roehl, and Choe 2000). The model was effectively abrogated in the context of the 1997/8 Asian financial crisis, as bankruptcies and restructurings of chaebol led to a high number of involuntary separations. Today, Korea features short- to medium-term average employment tenure – for companies with five or more employees, 6.2 years in 2010 (Ministry of Employment and Labor 2012). This is far shorter than for Japanese companies (Witt 2013) and only slightly longer than the median tenure of 4.4 years for US firms in 2010 (United States Department of Labor 2010). Job-hopping is common (Park and Lee 2008). Unlike the Japanese case, there is also considerable variation by firm size. Average tenure for small firms employing 5–9 employees was 4.5 years in 2010, while for large firms with more than 500 employees it was nine years. While average tenure has become longer for firms up to 500 employees between 2003 and 2010, it has actually fallen from 9.3 years to nine years for firms with more than 500 employees.

This tendency toward short- to medium-term employment is visible despite relatively high levels of employment protection. The OECD (2012b) rated formal employment protection for regular employees in 2008 at 2.37, higher than that of Japan (1.87) and the Anglo-Saxon countries, but a bit lower than Northern European countries, as well as China,

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4 The United States does not publish average (mean) tenure data, while Japan and Korea do not publish median tenure data.
India, and Indonesia.\(^5\) The extent to which these regulations represent an actual (rather than merely formal) constraint is evident in data from *The Global Competitiveness Report* (Schwab 2011), which indicate the ease of hiring and firing on a scale from 1 to 7 (1=impeded by regulations, 7=flexibly determined by employers). Korea scores 3.3, which is lower than all other Asian nations except Japan (3.0), and in Western Europe would rank between the Netherlands (3.1) and Luxembourg (3.4). The difficulty of dismissal seems to be a function not only of legal regulations, but also of union strength (OECD 2012a).

One consequence of employment protection for regular workers is a pronounced labour-market dualism. In response to the difficulty of laying off regular employees, firms hire non-regular employees, such as temporary, part-time, and dispatched workers (OECD 2012a). In 2011, non-regular workers were 34.2 percent of all wage workers, an increase from 26.8 percent in 2001 (Han, Jang, and Kim 2010) and considerably higher than before the Asian financial crisis of 1997/8 (Lee and Lee 2007). The growth in non-regular employment to current levels was facilitated by a loosening of employment protection for temporary employment, from 2.25 up to 1997 to 1.69 from 1998 to 2007 and to 1.44 from 2008 onward (Lee and Lee 2007; OECD 2012b). The non-regular category includes relatively more workers who are “older, female, less educated, engaged in elementary work and employed in small and medium-sized enterprises” (OECD 2012a: 49). In 2011, these workers earned on average 13 percent less per hour after controlling for individual characteristics such as age and education (OECD 2012a), a relatively moderate gap that is consistent with the notion that firms are seeking flexibility, rather than large savings in wages. Given strong public opposition to the proliferation of non-regular employment and increasing union attention, it remains to be seen whether current levels are sustainable.

**Education and Skills Formation**

The present education system was put in place after World War II on the basis of the US model. Students go through six years of primary school, three years of junior high school, and three years of high school, before moving on to two-year or four-year college, which in turn may be followed by graduate-degree programmes. Schooling is essentially universal through high school, and Korea’s 2010 secondary gross enrolment rate of 97 percent was the third-highest in Asia, after Brunei and Japan (World Bank 2012a). The proportion of students attending college is even higher, with a 2010 tertiary gross enrolment rate of 103 percent, the highest in the world (World Bank 2012a). Of all high-school graduates, 72 percent advance to tertiary education, down from a previous peak of 84 percent (OECD 2012a). This level is so high that even the OECD, which usually emphasizes the need for tertiary education, has diagnosed an “over-emphasis on tertiary education” (OECD 2012a: 73).

The output of this system is generally good. In the 2011 UNDP education attainment index, which presents a composite score of mean years of schooling of adults and expected years of schooling of children (United Nations Development Programme 2011), Korea scores 0.934. Among the nations of the world, this places Korea 6\(^{th}\), approximately par with the Netherlands and United States and ahead of all Asian economies. In comparative studies of student attainment, Korea similarly tends to perform well. In the 2009 PISA studies (OECD 2010) comparing students’ ability in reading, mathematics, and sciences, Korea overall placed 4\(^{th}\) of 65 economies, bettered only by Hong Kong, Finland, and Singapore. In the 2007 Trends in Mathematics and Science Study (National Center for Education Statistics 2009), Korea ranked 3\(^{rd}\) among 36 economies, behind Taiwan and Singapore.

By contrast, vocational training schemes are relatively weak and weakening. The share of vocational high-school students fell from 42 percent in 1995 to 24 percent in 2010.
OECD 2012a), and in 2010, only 6.4 percent of parents of middle-school students indicated an intention to send their children to a vocational high school (OECD 2012a). Technical colleges are similarly undergoing decline (Chang, Jung and Oh 2009). Reasons behind these developments include the almost universal availability of generalist tertiary education — the country has about 180 universities (OECD 2012a) — paired with a social stigma attached to vocational training, as a path for under-achievers (Chang, Jung and Oh 2009; OECD 2012a). In addition, for technical-college graduates vary little from those offered to high-school graduates (Chang, Jung and Oh 2009), in part because of the skills mismatch between curricula and real-world needs (OECD 2012a). Accordingly, the total number of graduates from vocational and technical programmes at the upper secondary level fell from 306,713 in 1998, the beginning of the time series, to 151,975 in 2009 (OECD 2012b). The 2009 numbers for Germany and Japan were 441,522 and 279,434, respectively (OECD 2012b), so adjusting for population size, Korea produces more vocational training graduates than Japan, but considerably fewer than Germany. Whether recent government policy aimed at strengthening vocational training, such as the introduction of 28 'Meister' schools from 2010 onward (OECD 2012a), will help change the trend remains to be seen.

As in most other East Asian nations, entrance examinations are an integral part of the education system. Most colleges have such exams, and competition at top schools is stiff. These examinations, which have their origins in the Confucian examination system for civil servants, give the system in principle a strong meritocratic element. However, family wealth seems to be an important component in how well students fare in this system. In 2008, almost 30 percent of total spending of households in Korea went on education — excluding private after-school tutoring — and Korean universities are the most expensive in the world after those of the United States and Israel (OECD 2012a). In addition, 73.6 percent of Korean children attended private after-school tutoring in cram schools (hagwon) in 2010, costing on average 10.7 percent of household income, equivalent to 1.8 percent of GDP (OECD 2012a). Such spending increases with household income (OECD 2012a). As a result, Koreans identify education costs as the most important discouragement to having children (OECD 2012a), a highly relevant fact, given the impending shrinking of Korea's population.

Even if the influence of money leaves some room for meritocracy, the examination system has several drawbacks. Pressure on students is tremendous, and it is common for school, cram school, and homework to keep students busy until the late evening hours. Rote rehearsal and recall are emphasized over application and creativity. And all else being equal, the fact that graduation is virtually assured once students have passed their entrance examinations is unlikely to be a strong motivating force.

The combined effect of weak vocational training and an over-emphasis on university degrees with limited practical applicability creates a large skills gap in the economy (Chang, Jung and Oh 2009; OECD 2012a). A 2004 survey by the Federation of Korean Industries found that firms needed to invest “23 months of general management work and 30 months of technical work” to imbue inexperienced workers with the skills firms required (Park 2007:420). Another indicator is that within the OECD, Korea has by far the highest proportion of inactive youth, i.e., those not in employment, education or training ('NEETs'). In 2009, approximately 17 percent of youths in the age group 15–29 fell into this category (OECD 2012a). For those with tertiary education, the proportion was even higher, at about 22 percent, or around three times the OECD average (OECD 2012a). In 2007, only 51.9 percent of university graduates secured regular jobs within a year of graduation, and only about 60 percent of natural and social-science university graduates find jobs in their fields of study (OECD 2012a). Returns on education in terms of employment rates and salaries are low by OECD standards (OECD 2012a).

To the extent that skills training does occur, it tends to happen inside firms (OECD
In 2005, only 12.8 percent of waged workers participated in training, compared with an OECD average of 37.1 percent, and firms generally spend little on training employees (Chang, Jung and Oh 2009), preferring instead to hire people with the requisite experience and skills (Park 2007; Chang, Jung and Oh 2009). Training intensity increases with firm size, and regular workers receive more training than non-regular workers (Park 2007; Chang, Jung and Oh 2009). This is consistent with employment tenure patterns: regular employees tend to remain on the payroll longer than non-regular ones, and as discussed, larger firms tend to have longer average tenures than small firms. Willingness to train thus seems to be linked to the expectation that firms can reap some benefit from investing in their employees. Where training occurs, most of it takes the form of classroom training (67.1 percent); on-the-job training (OJT) is relatively rare (12.2 percent) (Chang, Jung and Oh 2009).

**Inter-Firm Relations**

The dominant form of inter-firm relations in Korea is the business group, in the form of the chaebol. As already discussed, these conglomerates play a dominant role in the Korean economy, and centralized control by the chairman facilitates a degree of coordination and resource-sharing among member firms (cf. the discussion on tunnelling, above). The business association of the chaebol is the Federation of Korean Industries (FKI). However, the FKI seems to serve mostly a coordinating function with respect to politics. At the business level, rivalry rather than cooperation seems the norm.

Supplier networks exist in the shape of long-term sourcing arrangements, especially between chaebol and SME suppliers. For instance, Hyundai Motors in 2008 had about 2,400 SME suppliers (just-auto.com 2008). These networks seem to be qualitatively different from Japan's supplier networks, with trust levels in Korea much lower than in Japan (and indeed lower than in the United States) (Dyer and Chu 2000). This may be linked to a sense of dependence of SMEs on the chaebol and the resultant potential for abuse (Dyer and Chu 2000).

Korea has numerous business associations at various levels. The Korea Chamber of Commerce and Industry (KCCI) has approximately 135,000 members from various industries (Korea Chamber of Commerce and Industry 2012). At the industry level, Korea created Japanese-style control associations to help implement developmental policies (cf. Park 1987; Witt 2006; Park 2009). While industry associations have since shed their function as instruments of control, their presence does not seem to have fostered the emergence of strong intra-industry cooperation. For instance, only a minority of 39.2 percent of SMEs with fewer than 300 employees reported seeing a need for cooperation with other SMEs (Kim, S-B. 2011). Similarly, cooperation levels within R&D consortia in Korea seem to have been at considerably lower levels than those observed in Japan (Sakakibara and Cho 2002).

Informal networks matter to some extent. Members of chaebol families seem to mingle socially, and intermarriage occurs. Similarly, chaebol leaders often enjoy good personal access to politicians and bureaucrats. The incumbent president, Lee Myung-bak, while not a member of any chaebol family, is connected to the chaebol world through his former position as CEO of Hyundai Engineering and Construction.

**Social Capital**

Korean society has a tradition of relatively high interpersonal trust, with such trust being based mostly on family membership or shared collective experiences (Whitley 1999). Accordingly, 2005 data suggest that Koreans, like most Asian societies, place high levels of trust in their families, with 87.2 percent of them indicating such trust to be complete (average of other Asian societies for which data are available: 85.8 percent) (World Values Survey 2009). By contrast, only 14.9 percent of Koreans reported trusting, at least a little, people
they meet for the first time (other Asian nations: 19.1 percent) (World Values Survey 2009).

It is not clear how Korean interpersonal trust levels have developed in the immediate past. However, there has been strong growth in voluntary non-government organizations, from virtually non-existent until the 1980s to intermediate levels by the mid-2000s and probably strengthening further since (Joo, Lee, and Jo 2006; Kim, H-R. 2012). Such NGOs have been shown to foster interpersonal trust in other contexts (Anheier and Kendall 2002), and should this mechanism hold for Korea as well, interpersonal trust levels, especially those bridging different groups in society, may well have risen in recent years.

Institutionalized-trust levels are fairly high. In the 2011 Corruption Perception Index (Transparency International 2012), Korea scored 5.4 on a scale from 0 (completely corrupt) to 10 (completely clean), ranking 43rd among 182 territories. This puts it behind most Western nations, with the exception of Italy and Greece, but ahead of all other economies in this handbook other than Singapore, Hong Kong, Japan, and Taiwan. This implies that overall, the rule of law tends to apply. In addition, Korea’s 2010 governance indicators for government effectiveness, regulatory quality, and rule of law fall between the 75th and 90th percentile, and the indicators for voice and accountability, political stability, and control of corruption lie between the 50th and 75th percentile among 213 economies in the world (World Bank 2012b). Looking at the average of all indicators, most Anglo-Saxon and northern European nations score higher, as do Japan, Hong Kong, Singapore, and Taiwan within the region studied in this handbook. To the extent that these statistics are indicative of institutionalized trust, they suggest a relatively high level compared with most of Asia, though relatively low by advanced industrialized-country standards. Holding back further development on this dimension may be the tendency of the Korean state to pardon chaebol leaders convicted of various crimes, effectively putting some parts of society above the law. Accordingly, public trust in government is generally low (Kim, S. 2010).

Institutional Complementarities

The Korean business system features a range of institutional complementarities. Focusing on those relevant to the chaebol as the most significant type of Korean firm, the main complementarities among the elements laid out earlier can be summarized as follows:

1. Indirect finance and long-term availability of financial capital to chaebol are linked. As noted before, chaebol can cover part of their capital requirements through non-bank financial organizations that they own. Given their ownership control over the lending entities, it is unlikely that these entities will recall loans.

2. Indirect finance, in part provided by captive lenders, is connected to weak corporate governance, in the sense of weak shareholder control over the fate of the company. Korean companies remain firmly under the control of ‘owner’ families, who can afford to pay little attention to the interests of other shareholders, because the low dependence on capital markets deprives shareholders of an important source of leverage.

3. Weak corporate governance is linked to cross-shareholdings, pyramidal shareholdings, and the prevalence of conglomerates more generally. These structures help ‘owner’ families remain in control of large numbers of firms even though they own, on average, only a small minority of shares. They further help insulate ‘owners’ from shareholder pressure in form of the threat of selling to the highest bidder in the context of a hostile take-over.

4. The presence of a controlling (but not really owning) shareholding dampens long-term employment, which should in principle be facilitated by the combination of indirect finance and weak corporate governance. Given historical experiences such as disproportionately slow wage growth in the 1970s and mass dismissals in the late
1990s, the track record suggests that 'owner' interests supersede those of employees. As a result, employee loyalty is relatively low, and tenure lengths are accordingly below those seen in Japan.

5. Average durations of employment are linked to training. Small Korean firms have relatively high staff turnover and consequently make little effort at training. Large firms have average tenures of around nine years, which seems to provide sufficient time to recoup investments on training and is thus related to higher levels of training.

6. Strong 'owner' control and the attendant top-down centralized decision-making are connected to disharmonious labour relations. Top-down decision-making means that there is little transparency inside the firm about the circumstances of particular corporate policies. The resulting opacity prevents labour from verifying whether claims about the state of the company made by management — e.g., in the context of pay reductions or dismissals — are credible. Given the inherent possibility that 'owners' may be maximizing their own benefits at the expense of their employees, Korean labour tends to exhibit relatively militant behaviour.

7. The inherent conflict between 'owners' and employees is related to relatively low levels of institutionalized trust and delegation in Korean firms. Delegation means entrusting a task to someone in the confidence that the task will be done as the delegating party him/herself would have executed it. In the Korean context, there is a risk that empowering lower echelons to make decisions on behalf of the chairperson could lead to a greater emphasis on employee interests. Levels of institutional trust, which would entail a trust that a company will act appropriately and fairly toward its employees, seem to be too low to mitigate this effect (and it stands to reason that sufficiently high levels of institutionalized trust in Korea in general would imply a legal system that would put an end to the eminence of the 'owner' families).

Overall, the Korean business system and this set of complementarities seem to be conducive to fast-follower business strategies (cf. Redding and Witt 2007). Chaebol are quick to move into promising markets and can leverage patient finance as well as profits from other businesses in the conglomerate (and, in the background, a supportive developmental state) to finance their forays. Suitable employees can be hired from other firms, given the absence of true long-term employment, or from other firms inside the chaebol.

Evolutionary Dynamics
Institutional change in the Korean business system seems to be driven predominantly by the state. It was clearly a major force, and also the object of institutional change itself, in the creation of the developmental state under Park. In the aftermath of the 1997/8 Asian Financial Crisis, the state was the major instigator of institutional changes aimed at reforming the chaebol, albeit egged on by powerful external actors such as the IMF and United States as well as foreign investors (cf. Kim, Kang, and Kim 2012). That these reforms were ultimately less far-reaching than expected is perhaps as much a testament to the resilience of the chaebol as it is of the unwillingness of the Korean state to push the envelope on chaebol reform for fear of damaging Korea’s leading businesses, and thus the foundations of the country’s economic prosperity.

The top-down structure of institutional change in Korea is subject to the usual array of known constraints and flaws, such as creating policies without full information about relevant circumstances or due deliberation (cf. Witt and Lewin 2007). In addition, top-down decision-making invites political strikes, as the public usually does not get asked what it wants when the state makes decisions. For instance, in the context of the 2008 Free Trade Agreement negotiations with the United States, tens of thousands of Koreans protested against part of the agreement that called for the resumption of beef imports from the United States, because of
concern over the prevalence of BSE in US cattle. By contrast, positive demonstrations, in the sense of those demanding changes (such as the introduction of democracy) rather than those seeking to prevent them, seem to have become relatively rare.

Conclusion
In summary, in the absence of clear shifts to another state model and given continued emphasis on growth and industry promotion, the Korean state is probably best classified as a reconfiguring developmental state. The financial system is indirect, with non-bank financial institutions having special importance for the chaebol. Corporate governance continues to be among the weakest in Asia, with so-called 'owner' families retaining control over the chaebol despite low levels of overall shareholdings. Internal dynamics are top-down with limited delegation and promotion mostly based on seniority and, at the very top, family ties. Employment relations are characterized by a fragmented but militant union landscape, short-to medium-term average tenures that vary greatly with firm size, and a pronounced labour-market duality between regular and non-regular workers. The education system performs well in international comparisons, but fails to produce workers with needed skills, in part because vocational training is very weak. Firm-based training is present mostly in large firms such as the chaebol. Networking among firms occurs predominantly among members of the same chaebol. Social capital is high on an interpersonal level and reasonably well-developed in terms of institutionalized trust, though the latter does not seem to extend strongly to the corporate realm. A series of institutional complementarities are present, and institutional change is mostly a top-down process driven by the state.

Interpreted in the context of the Hall and Soskice (2001) model, Korea falls somewhere between the opposite poles of coordinated and liberal market economies (CMEs and LMEs). Developments over the past fifteen years seem to have pushed the system somewhat closer toward the Anglo-Saxon LME model, though as we have seen actual practice is far from what one would expect of an LME. Indeed, the closest relatives of the Korean business system in the West might well be the Southern European 'mixed' or 'state-led' economies, as also suggested in earlier analysis (Whitley 1999; Kang 2010).

As this chapter has illustrated, the Korean business system has changed less than expected since the 1997 financial crisis. This highlights the importance of structural inertia in institutional change, especially in response to sudden external shocks. By contrast, major internally-generated institutional changes seem possible and even likely in the coming decades, especially with respect to the role of the state and the pre-eminence of the chaebol. Affecting the former is rapid societal ageing and attendant shrinking of the working population. In response, Korea will probably need to construct a much stronger social welfare system and in effect become a welfare state, ideally avoiding the pitfalls of the European experience. As regards the chaebol, we have discussed how the Korean industrial landscape is highly concentrated on a few conglomerates, whose ‘owners’ have often seemed above the law. Public disquiet in both these areas is leading to growing pressure for change, supported at least rhetorically by major politicians across the political spectrum. While one should not underestimate the ability of the chaebol to resist, as the past decade has shown, eradicating these issues from the political agenda without major concessions will be difficult. For students of institutional change, Korea promises to be an interesting case to watch.
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