

The Rise and Fall of South Korea's Chaebols*

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No discussion of South Korea's dramatic transition from a poor underdeveloped country to a developed country member of the OECD club of rich nations can ignore the role of the chaebols—its 'clans of wealth'. Consisting of a large number of legally independent firms controlled by a single family dominated-decision making centre (very much like India business groups), these Korean conglomerates grew rapidly during the regime of General Park Chung-hee (1961-1979), and today the top 10 of them earn revenues that are equivalent in value to around 80 per cent of the country's GDP.

For long credited as having implemented the South Korean state's drive to rapidly industrialise and develop the country, the chaebols have also been accused of engaging in corrupt practices to expand their empires and profiteer. That image of corruption now stands out starkly, with the de facto head of the largest of the chaebols, Lee Jae-yong of Samsung appearing on television handcuffed and on his way to jail on charges of bribery. Lee is not the only one being put to shame. On December 6, nine of the heads of some of the largest chaebols—CJ, LG, Hanwha, SK, Samsung, Lotte, Hanjin, GS Group and Hyundai—were questioned by the country's MPS as a part of a hearing (broadcast live) that was investigating allegations of large payoffs from these business groups to two foundations headed by Choi Soon-sil, a close confidant of President Park Geun-hye. President Park, is facing impeachment proceedings on charges of corruption on grounds of accepting such payments.

Similar in structure to the pre-War Japanese zaibatsu, the chaebols were after the exit of the Japanese, the business leaders of Korea favoured by the state with which it was entangled. Even then these corporate groups were seen as corrupt. Ironically, it was Park Gyun-hye's father, Park Chung-hee, who used evidence of such corruption to threaten the leaders of the chaebols with arrest and confiscation of their wealth, and offered pardon only if they implemented his plans to modernise Korea with investments in a range of industries starting with labour intensive textiles and assembly of electronic goods and going on to shipbuilding, chemicals, steel, automobiles and electronics. Besides obtaining help from the US, given its role as a frontline state in the cold war, General Park chose and backed champions in various fields, who in return for access to a protected home market, cheap credit and much else, had to agree to invest in globally competitive capacities. It was this alliance between the state and the private business it virtually fostered, bolstered with support from the US, that is seen as central to South Korea's successful transition to developed country status.

With the chaebols serving as the instrument of that transition, a few of them grew hugely in size and the families that controlled them accumulated large volumes of wealth, all facilitate by generous doses of credit from the state-controlled financial system. What the disciplining power of the South Korean state did not change was the control of the families that ran these enterprises. That control was exercised with relatively little own capital, as holding companies, a complex chain of cross-holding investments in the equity of companies within the group and the strategic placement of family members or loyalists in positions of power in individual enterprises, ensured

the domination of the chongsu or the member of the ruling family who serves as the head and final decision maker.

If the dependence of the chaebols on the government was crucial for access to cheap finance, so was such dependence central for maintaining control. According to analysts there is a strong link between alleged bribery and corporate control in South Korea. With the controlling family holding a relatively small proportion of equity, state support and willingness to turn a blind eye to manipulated share transfers and acquisition are quite crucial. This is an important charge against Lee Jae-yong, who is has been recently subject to the ignominy of arrest. He has been the de facto chongsu, of Samsung, since his father, the elder Lee, was incapacitated by a heart attack he suffered in 2014. At issue here is a controversial merger of two firms in the Samsung stable, Cheil Industries and Samsung Construction and Trading (C&T) Corporation, which would help restructure shareholding in ways that would ensure the younger Lee's control over the empire. Given the controlling stake held by the Lee family in Cheil Industries, the merger that transferred Samsung C&T's shareholding in other firms including the flagship Samsung electronics to Cheil at a discount, helped cement Lee's control. Elliott Management a US hedge fund with investments in Samsung C&T objected, on the grounds that the deal undervalued the shares involved. But South Korea's National Pension Service, which is the Samsung C&T's largest shareholder with a 11.9 per cent stake, managed to tilt the vote marginally in favour of the merger. The decision of the pension fund to back the deal, which allegedly involved a loss of around \$300 million for the organisation, was only possible because of support from the executive office and residence of the President—the Blue House.

Under investigation now is the money and gifts (including a horse worth \$900,000) delivered directly to Choi Soon-sil, allegedly in return for favours from the government. The largest such payment of around \$17.5 million equivalent in Korean won was from Lee Jae-yong and the Samsung group. This is by no means startlingly new as an allegation. In fact, in 2008, Jae-yong's father, Lee Kun-hee was indicted for tax evasion to the tune of 112.8 billion won and for breach of trust for being involved in sale of shares at low prices by Samsung subsidiaries to his son so that he would have a holding that can help him take over the conglomerate. Though father Kun-hee was sentenced to serve a prison term, that sentence was suspended on the grounds that he and his aides had admitted to wrongdoing and apologised, and because it would affect the functioning of a leading business group that had contributed to South Korea's export-led development.

Analysts sense a transition in the relationship between the state and big capital in South Korea from a period in which the state was a disciplining force (and an ally) under Park to one where it is a partner in profiteering through means that are not always legal. Liberalisation and democracy it is argued has not helped, but provided the flexibility to engage in suspect transactions. The net result is a growing disillusionment with the chaebols, earlier considered leaders of Korea's economic success, and with the government that colludes with them. The huge popular demonstrations that preceded the impeachment of the President also saw the display of anger against the chaebols. This is not surprising given the evidence that politics too has come under the influence of the chaebols.

Of significance, here is the role of the Federation of Korean Industries (FKI), an alliance of big business groups. According to reports from The Hankyoreh, based on instructions from the Blue House the “social collaboration fund” of the FKI has in recent years been financially supporting right wing groups, including some that are now protesting the impeachment of Park Gyun-hye. A January 30, 2017 report on the English language website of the Korean newspaper said: “The investigative team of Special Prosecutors has learned that the Blue House received money from South Korea’s four largest chaebols (Samsung, the Hyundai motor Company, SK and LG) to fund pro-government demonstrations by conservative and far-right organisations such as the Korean Parent Federation (KPF) and the Moms Brigade. An executive from Samsung’s Future Strategy Office personally attended all the fundraising meetings, which were organised by the Blue House Senior Secretary for Political Affairs, to discuss the amount of funding and the organisations to support.”

Under attack, Samsung’s Vice-chairman Lee Jae-yong has announced that his group will stop paying its contributions to FKI and exit the organisation. Samsung is the largest contributor. Meanwhile, pressure on FKI to disband is growing because of its role in furthering corrupt practices in the chaebols. The state-capital nexus is under challenge.

It hardly bears stating that in the age of liberalisation South Korea is not the only country where an alliance between big business and politicians is threatening the survival of democracy. India too is not far behind. In Korea, however, a near-unprecedented process in which corruption and bribery are being penalised because of popular pressure has begun. Other countries look on to see who wins in that battle, and what lessons that experience holds.

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