

MACQUARIE KOREA VALUE-UP PROGRAM CONFERENCE

Two Obstacles & Two Catalysts On the Way to the Korea Premium Market



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Introduction.

- ❖ About myself
 - ✓ Practiced for 18 years in Korea
 - Corporate & antitrust lawyer at one of the big 4 in Korea (Shin & Kim)
 - General counsel in two IT unicorns (Wemakeprice, Danggeun Market)
 - VP for corporate crisis management (Danggeun Market)
 - ✓ Founded Wise Forest Management Consulting & Law Office (www.wiseforest.co)
 - ✓ Vice Chairperson at Korea Corporate Governance Forum (non-profit)
 - ✓ Comprehensive knowledge and experience of corporate governance laws in Korea
 - One of rare experts in both antitrust law and corporate law

Overview.

- ❖ Legal Perspectives of Korea Discount Phenomenon
- ❖ Two Major Obstacles
 - ✓ Weak shareholder return (related to mistreatment of minority shareholders)
 - ✓ Poor corporate governance (related to corporate law and decision-making system)
- ❖ Two Major Catalysts
 - ✓ More than 14 million individual stock market investors after COVID-19
 - ✓ Success news in stock market reform from Japan, a fateful competitor
- ❖ Legal evaluation of the first step, 2024 Value-up Disclosure (Guidelines)
- ❖ Way to the Korea Premium Market (not Korea Discount!)

Two Obstacles.

- ❖ In 2021, FSC identified two major reasons for infamous “Korea Discount”
 - ✓ Weak shareholder return
 - ✓ Poor corporate governance
 - ✓ Almost identical with those of 20 years ago
 - ✓ Korean legislators failed to fix the problems, eventually
- ❖ What specifically do these two mean?
- ❖ Why did the laws fail?
- ❖ How will it be different this time?

Weak Shareholder Return.

- ❖ More precisely, it means weak return specifically for minority shareholders
 - ✓ In other words, unequal benefit between controlling & non-controlling shareholders
- ❖ Inequality does exist.
 - ✓ Non-controlling shareholders: only dividends
 - ✓ Controlling shareholders: dividends + profits from inter-affiliates transactions + profits from inter-affiliates merger or split-off + enjoy a control premium (to be exact, a non-control discount) when selling shares + high salaries from multiple affiliate companies
 - ➔ The laws failed to prevent them so far.

Controlling Shareholders' Additional Benefit : Failure of the Law (1)

- ❖ Controlling shareholders' gains from inter-affiliates transactions
 - ➔ Regulated by Fair Trade Act, but failed as it focused on unprovable “reasonable price” instead of the conflict of interest between controlling & non-controlling shareholders
 - ➔ Corporate laws strengthened to fix this in 2011 as well but haven't be effective so far as the requirements were too complicated and impractical
- ❖ Gains from inter-affiliates merger (or split-off)
 - ➔ Regulated by strict stock market price, but easily circumvented by market intervention not stock price manipulation or just timing (split-offs haven't regulated through 2022)

Controlling Shareholders' Additional Benefit : Failure of the Law (2)

- ❖ Control premium over 50% when selling shares
 - ➔ Market prices (traded among general minority shareholders) are low, but controlling shares are traded high reflecting the intrinsic value of the company
 - ➔ Lack of mandatory tender offer rules is one of the main causes (revision in progress)
- ❖ High salaries from multiple affiliates
 - ➔ Annual salaries over KRW 500 million (about USD 3.7 million) should be disclosed
 - ➔ Circumvented by holding non-executives or positions for multiple affiliates
 - ➔ Even votes for him/herself at shareholders meetings to set his/her salaries

Poor corporate governance.

- ❖ Law really matters.
- ❖ Corporate groups with family controlling shareholders (chaebols, conglomerates)
 - ✓ Characteristics of large listed Korean companies
- ❖ Complex legal structure
 - ✓ Individual companies: corporate law (and capital market law if listed)
 - ✓ Corporate groups: fair trade (antitrust) law
 - ➔ But it focuses on containing the size of the groups and influence on whole economy
 - ➔ Does not concern rights and interests of shareholders within corporate group

Poor corporate governance.

- ❖ Simple reasons
 - ✓ In Korea, many companies are treated as parts of big corporate groups controlled by one individual shareholder rather than independent and complete corporations.
 - Ex1. A job level of an affiliate's representative director (CEO) is "Jeonmu"
 - Ex2. A large affiliate can have several "Sajang" (originally meaning CEO)
- ❖ So, in practice of Korea
 - ✓ Even CEOs have some agenda requiring reporting to or approval of "Hoejang"
 - ✓ Boards of directors are thought as advisory body with limited role and responsibility
 - ✓ Corporate law does not work in practice in its integrity

Poor corporate governance.

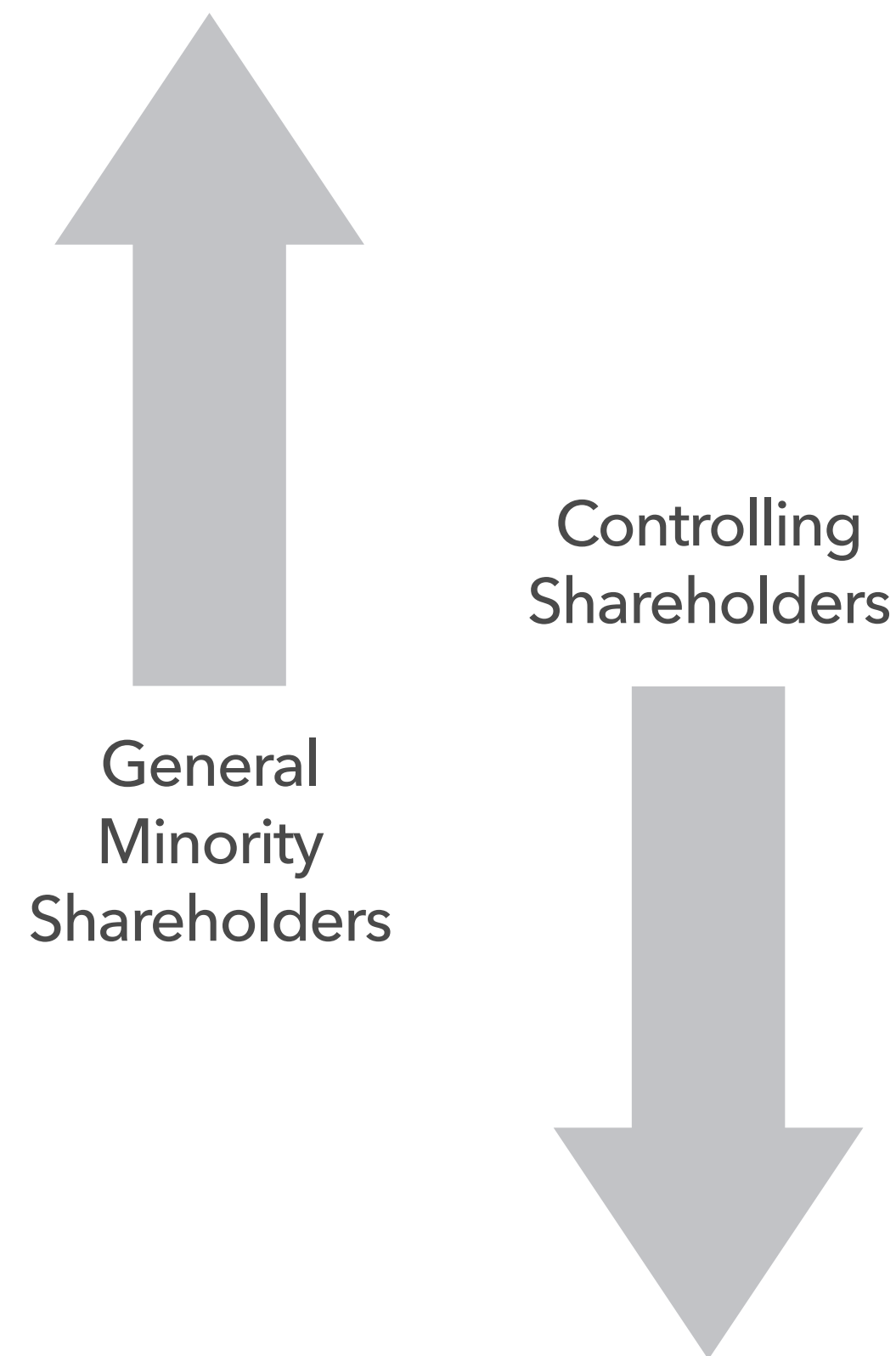
- ❖ Big loopholes in the law
 - ✓ Fair Trade Act regulates corporate groups, but only focuses on containing their sizes
 - ✓ No laws or rules on corporate governance for corporate groups (decision-making structures or interest alignment among shareholders or stakeholders)
 - Corporate laws only regulates governance of individual companies (rights of shareholders or boards, duty of director, etc)
 - Acts on corporate groups have been proposed but failed to pass
 - ✓ To sum up, the most important and basic regulations on corporate governance in Korea should be about corporate group in the first place, but there is no such law.

Poor corporate governance.

- ❖ As a result, in Korean practice,
 - ✓ Boards of individual companies are not the highest decision-making body
 - ✓ Corporate law is lethargic when it comes to problems related to corporate group
 - ✓ More than 70% shareholders without one single director representing themselves
 - ✓ Weak and vulnerable governance relying on one individual controlling shareholder

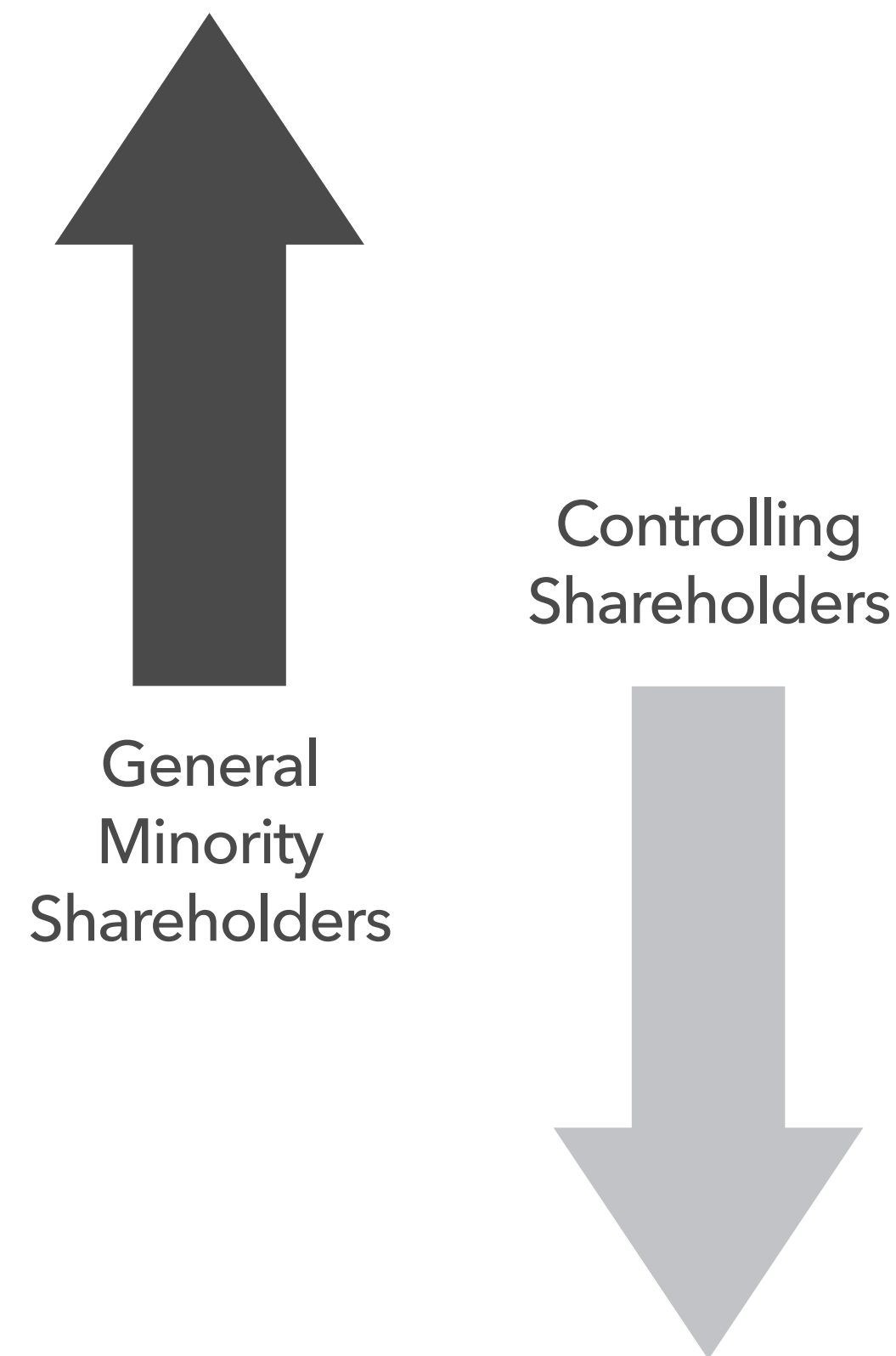
Group	Core Company	Controlling Person	General Minority Shareholders
Samsung	C&T	17.97%	66.53%
SK	Holdings	17.50%	74.01%
Hyundai Motors	Motors	2.0%	70.62%
LG	Holdings	15.70%	58.30%
Hanhwa	Holdings	22.65%	56.39%
GS	Holdings	4.7%	48.08%
Hyundai Heavy Indust.	HD Hyundai	26.60%	63.67%
Shinsegae	Sinsegae	10.0%	71.44%

Single Structural Cause.



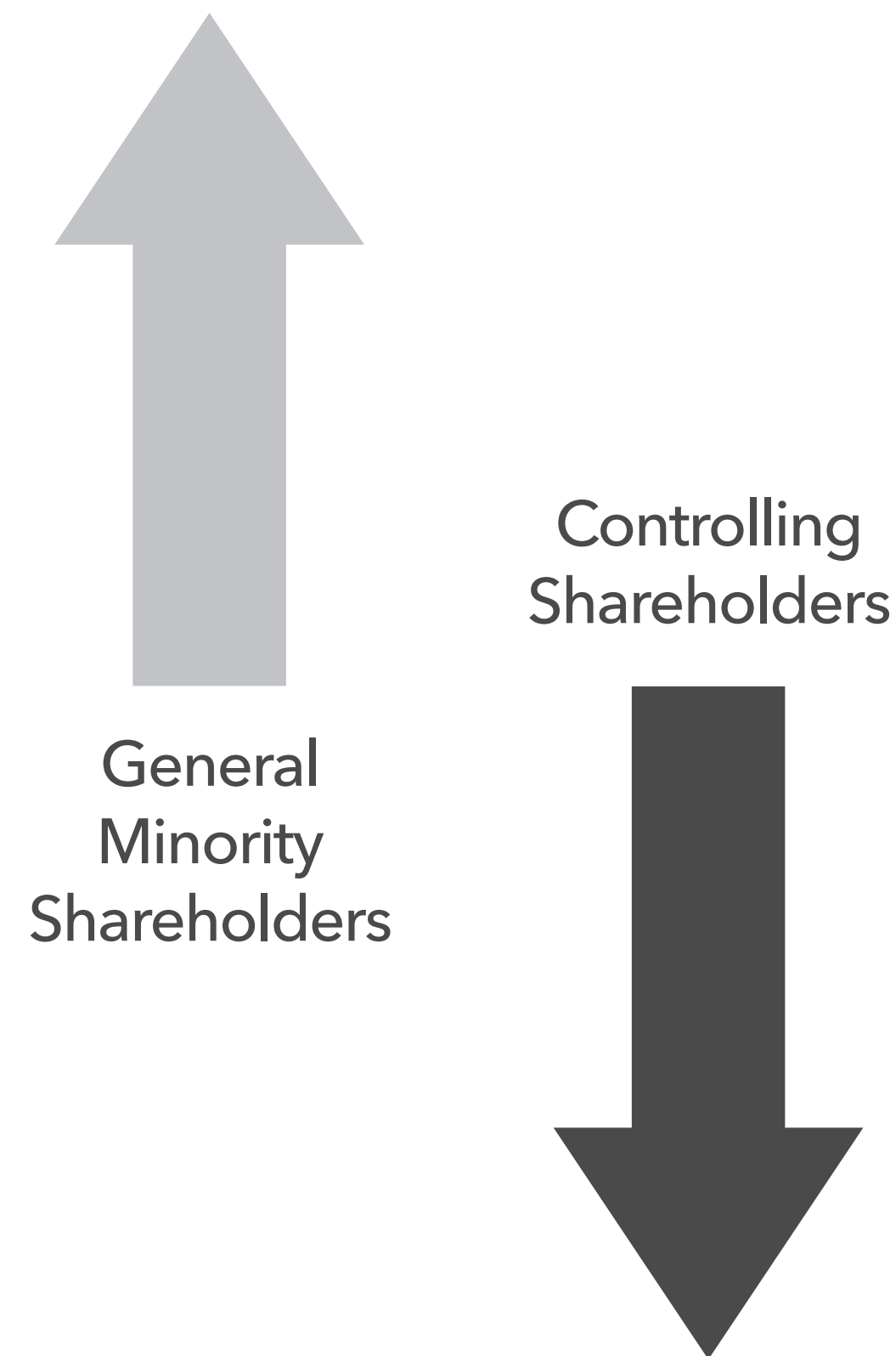
- ❖ Two major obstacles converge on one single structural cause
- ❖ Conflicting interests of controlling & non-controlling shareholders in “stock price”
 - ✓ Controlling shareholders do not really like to see the stock price go up (or rather, they may like to see it go down)
 - ✓ Non-controlling shareholders always like to see it go up (not talking about short selling banning in Korea)
 - ✓ Anyone would do that in each situation. Why?

Single Structural Cause.



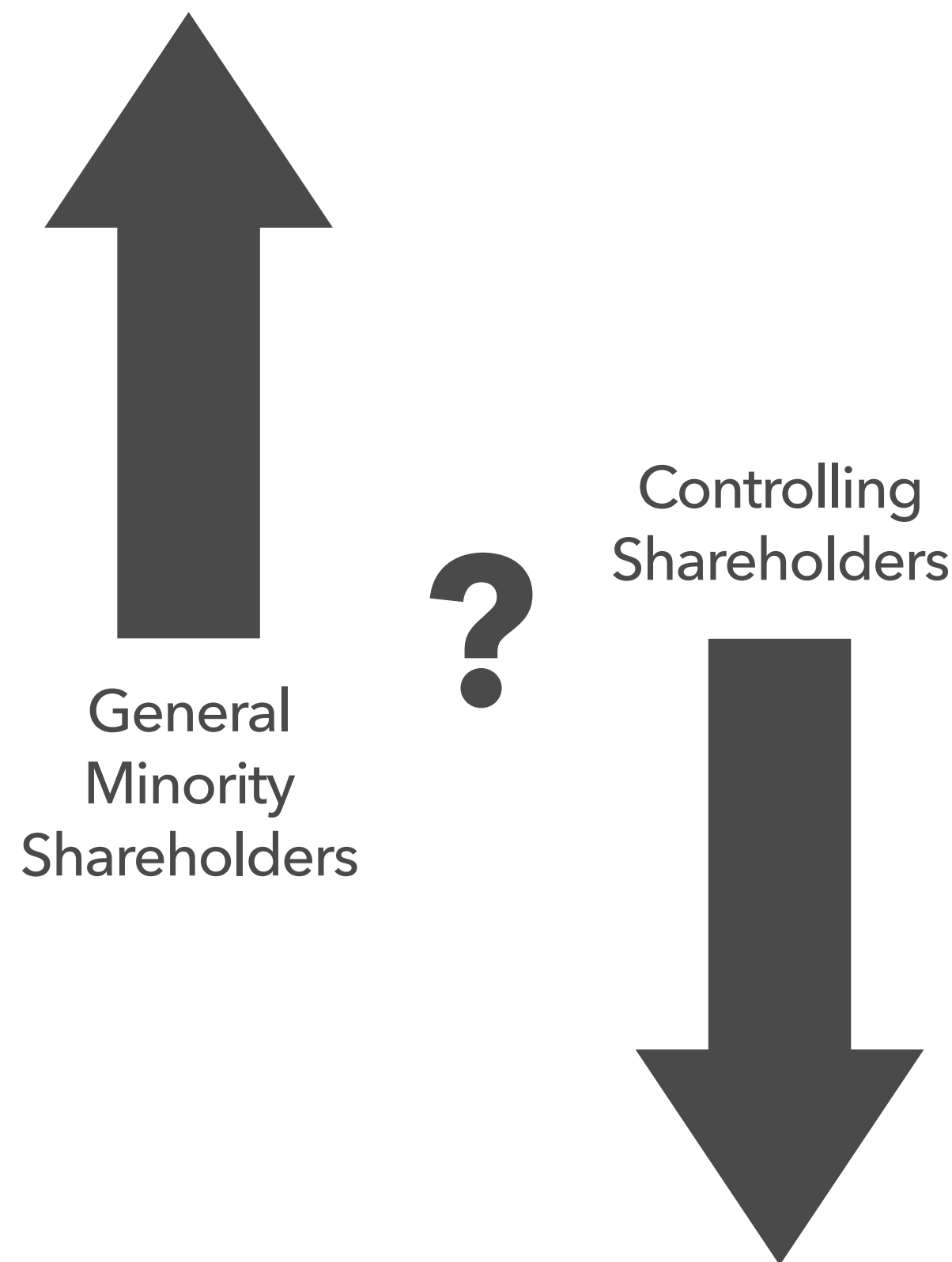
- ❖ Non-controlling (general minority) shareholders
 - ✓ Price matters, but shareholding really does not.
 - ✓ Average more than 70% are general minority shareholders
 - ✓ Whether institutional or individual, all investors have the same goal of selling at a profit.
 - ✓ (Except for long-short strategy funds) Most institutional and individual investors want to see stock prices go up
 - ✓ Higher is better, as taxes are levied on profits.

Single Structural Cause.



- ❖ Controlling shareholders
 - ✓ Shareholding matters, but price does not.
 - ✓ Most listed companies still have controlling shareholders, most of whom are heirs of founding family groups
 - ✓ Do not & will not sell their shares which means their power and influence over their corporate group (take equity loan if need big money - average approx. 30%)
 - ✓ Asset you don't sell forever, the price doesn't matter.
 - ✓ Cheaper is better, rather, when you buy more or inherit.

Single Structural Cause.



- ❖ The problem is law.
- ❖ Is the Korean law designed to make stock prices go up?
 - ✓ Does the law prevent incentives for controlling shareholders to drive down the share price and protect the value of minority shareholders' investments?
 - ✓ More specifically, does the law effectively prevent controlling shareholders' gains from inter-affiliates transactions, inter-affiliates merger or split-off, control premium when selling shares or high salaries from multiple affiliate companies?

Two Keywords for Improvement.

- ❖ Again, two major reasons for “Korea Discount”
= two major obstacles

- ✓ Weak shareholder return
- ✓ Poor corporate governance



KEYWORDS
FOR
SOLUTION

- ➔ Duty of Boards of Directors
- ➔ “One Same Person (*dong-il-in*)”

First Keyword: Duty of Directors

- ❖ Duty of Boards (Directors)

- ✓ In Korea, boards (and directors) have no direct duties to shareholders
 - ➔ The most fundamental differences from the laws of other developed countries.
Korean courts: Duties of the directors owe to the “company”, not to “shareholders”.
- ✓ “Duty to the company” rule works well in the ordinary course of business situations
 - ➔ “Doing your best for the company is doing your best for the shareholders.”
- ✓ But what if a board’s decision will have different outcomes for different shareholders?
 - ➔ In cases of inter-affiliate transactions, inter-affiliate merger, split-off etc.
 - ➔ “Do your best for the company” rule provides no criteria for solving the conflict.

First Keyword: Duty of Directors

- ❖ Other Developed Countries
 - ✓ US, UK: Duty of loyalty to shareholders is established case law
 - ✓ Tokyo Stock Exchange's Corporate Governance Code: "fiduciary responsibility of boards to shareholders"
 - ✓ OECD Principles of Corporate Governance: "a key mechanism for addressing such potential for abuse is the existence of a clearly articulated duty of loyalty by board members to the company and to all shareholders."

First Keyword: Duty of Directors

- ❖ If duty of boards (directors) to all shareholders introduces
 - ✓ Boards should treat all shareholders equally
 - ✓ Boards should evaluate the effect to all shareholders in cases of inter-affiliate transactions, mergers or split-offs
 - ➔ Failure to fulfill the obligation may result in a claim from other shareholders
 - ➔ Willful failure might lead to criminal liability for malfeasance in Korea
 - * This will be perhaps one of the most thorny issues.
 - ✓ Equalize the interests of controlling & non-controlling shareholders
 - ✓ Will be the legal basis for normalizing shareholder return

First Keyword: Duty of Directors

- ❖ Evaluation of 2024 Value-up Guidelines?
 - ✓ No duty or responsibility
 - ✓ Boards of directors “need to actively participate” in disclosing Value-up Plan
 - monitor; request to report; review or make a resolution
 - ✓ Mentioning the boards as a governing body is one great first step forward
 - preparatory period for building board capacity
 - practical basis for next step, e.g. boards of directors as submitting body

First Keyword: Duty of Directors

- ❖ FSS Governor expressed strong will to revise the Commercial Code on 16 May,
 - ✓ "My personal opinion is that directors' fiduciary duties to shareholders should be introduced without fail,"
 - ✓ "The final outcome will have to be debated in National Assembly, but at least at this time when we are pushing for corporate value-up and capital market level-up, it would cast doubt on the government's commitment to value-up if this discussion is not even on the table."

Second Keyword: “One Same Person”

- ❖ Corporate Grouping Based on “One Same Person” (*Dong-il-in* in Korean)
 - ✓ Legacy of government-led economy in the 1980’s
 - Lack of established legal system & practice for judicial measures to fix unjust transactions between affiliates of same corporate groups
 - KFTC indicates “One Same Person” for each large corporate group
 - ✓ After 40 years of application
 - Hinders the development of corporate law (many contradictions and conflicts)
 - ➔ Ex. “One Same Person” *de facto* controls the businesses of all affiliates within the corporate group. Then who is the final decision maker for a company?

Second Keyword: “One Same Person”

- ❖ Growing Criticism of “One Same Person” System
 - ✓ Anachronistic
 - ✓ Controversies on indicating “one same person” for Coupang’s corporate grouping
 - Coupang LLC was indicated as the “one same person” rather than Bom Kim, the founder and the largest shareholder of the U.S. parent holding company
 - Criticism of the vagueness of the criteria, along with skepticism of the system itself
 - ✓ Shareholder-centric governance will weaken the necessity of the outdated system
 - Stewardship code for asset managers
 - ✓ 2024 Value-up Guidelines emphasizing the indicators such as ROE, TSR etc

Legal Perspectives on Value-up.

- ❖ 2024 Value-up Disclosure (Guidelines)
- ❖ Many disappointing reactions from the market
- ❖ But FSC did its best under various constraints
 - ✓ Fundamental changes need revisions of legislations (long story)
 - Need cooperation of Dept. of Justice & National Assembly (Democratic Party)
 - ✓ If disclosures make meaningful changes, it will be the best sustainable result
- ❖ Hopeful indications
 - ✓ Public paying attention to indicators such as PER, PBR, ROE, TSR etc
 - ✓ Imposing substantive roll to board of directors

Two Catalysts for Change.

- ❖ Will they change this time?
- ❖ Two catalysts can make a difference.
 - ✓ More than 14 million people are investing in the stock market.
 - It was less than 6 million before COVID-19
 - Public attention → Non-partisan political attention → Only time matters.
 - ✓ Japan's success in stock market
 - “Korea is different from America.”, the simplest old argument against changes
 - “We will never lose to Japan.”, the everlasting slogan triggering Koreans the most
 - But Japan switches to the American way and succeeds in the stock market!

We Are Here.

- 30-year-old Korea Discount

Weak shareholder return

- 2024 Value-up Disclosure

Attention to ROE, TSR etc

- Next step?

Shareholder-centric governance

14 million individual investors
Japan's success in stock market

Poor corporate governance

Substantive roll to boards

Duty of board to shareholders

Thank you!

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