



Determinants of ownership structure: An empirical study of the Korean conglomerates

Ungki Lim^a, Chang-Soo Kim^{b,*}

^a*Department of Business Administration, Yonsei University, Seoul, South Korea*

^b*Department of Business Administration, College of Commerce and Law, Yonsei University,
234, Maeji-ri, Heungup-myon, Wonju, Kangwon-do 220-710, South Korea*

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Abstract

This study characterizes the ownership structure of multifirm conglomerates in terms of two dimensions; the degree of direct ownership and the amount of family stake. The determinants of the two dimensions are investigated simultaneously using the seemingly unrelated regression model. The results show that the conglomerates with a higher leverage and the bigger proportion of nonmanufacturing businesses tend to have a direct ownership. On the other hand, the conglomerates with a bigger size and a larger proportion of nonvoting shares tend to have a pyramidal ownership. As for the family stake, conglomerates with focused business lines tend to have a larger family stake. However, conglomerates that use more nonvoting shares and have more listed firms tend to have a lower family stake. The empirical results can be interpreted as a rational response of the market participants to the business environment that looks like ‘financing without governance.’

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1. Introduction

Ever since [Berle and Means \(1932\)](#) brought up the issue, researchers have attempted to figure out the factors and mechanism by which the ownership structure is formed. However, existing literature have focused on the ownership of a single company rather

* Corresponding author. Tel.: +82-33-760-2331; fax: +82-33-763-4324.

E-mail address: kimc@dragon.yonsei.ac.kr (C.S. Kim).

than that of a group of interrelated companies. Only in recent years have some studies explored the ownership structure of conglomerates. In fact, the study on the ownership structure of conglomerates would be much more important and interesting because outside the United States, conglomerates constitute a significant portion of business activities in the current global economy.

This study investigates how business environments affect the formation of ownership structure of Korean conglomerates called *chaebol*. The following considerations have motivated the study. First, there are only a limited number of academic papers about Korean corporate ownership structure despite its significant economic role in the world economy.¹ Second, Korean *chaebol* and Japanese *keiretsu* are quite different in the manner they are owned and operated. The Korean *chaebol* is owned and managed by the family whereas the Japanese *keiretsu* is largely owned by the group's member companies and operated by professional managers. Thus, the Korean case can help us understand the workings of corporate ownership structure under different cultural and economic settings. Third, because the Korean economy is heavily dependent on the *chaebol* system, the study on the ownership structure and its determinants has a significant practical implication.

The main focus of this study is to investigate how and with what rationale Korean entrepreneurs choose among different ownership structures. Specifically, we study the ownership patterns of the 30 major conglomerates in terms of two dimensions. First, we investigate whether *chaebol* families own their subsidiary firms directly (horizontal ownership structure) or own them indirectly through interfirm shareholdings (pyramidal ownership structure). Second, we consider the size of wealth the *chaebol* families invest for the control of member firms.

According to the agency theory, a pyramidal ownership structure with a low stake is expected to have serious incentive problems due to potential conflicts of interest between the controlling minority shareholder and the outside shareholders.² In an efficient capital market, the agency problem should be well recognized by the investors and such ownership structure might not be able to survive. And yet, this type of ownership structure is very common among major Korean conglomerates. We attempt to explain this seemingly incomprehensible phenomenon. For this, we investigate two different sets of variables that may explain the degree of direct ownership and the magnitude of family shareholdings. The results indicate that the seemingly incomprehensible phenomenon can be explained as a rational response to the business environment in Korea.

This paper is organized as follows. Section 2 examines the existing theories and literature related to the current study. Section 3 presents a brief overview of Korean *chaebols*, which are classified as the 30 big business groups by the Korean Fair Trade Commission. In Section 4, we define two dependent variables characterizing the

¹ Korea was ranked at the 11th in terms of GDP before the IMF bailout. The US export to Korea in 2000 is US\$ 22billion; that is, 3.1% of the total US exports. This figure is comparable to the US export to Japan of US\$ 57 billion (8.2%), England US\$ 38billion (5.5%), and Germany US\$ 27 billion (3.8%).

² We use the term 'controlling minority shareholder' to emphasize the fact that the controlling shareholders hold only a very small fraction of equity compared to the other shareholders as a whole. The amount of equity of the *chaebol* owner and his family explains only less than 2% of the amount of total asset. Bebchuk et al. (1999) describe the controlling minority structure in further detail.

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