

Republic of Korea

Corporate Governance Institutions, Practices and Developments

1. Key Institutional Features of Corporate Governance and Company Profile in Korea

1.1. Background

In the face of the Asian Financial crisis in the late 1990s, the Korean government carried out partial and full revisions of the Commercial Act and the Securities and Exchange Act to overcome the crisis. The process called on companies to improve their effectiveness and transparency by automating management activities and adapting to global trends. The government sought to adjust the economic environment in sync with the transformation taking hold around the world.

The government is still in the process of revising corporate governance in the Commercial Act aimed at improving corporate governance and management transparency in line with global standards. The revised version of the Commercial Act, pending in the National Assembly, introduced the following articles: Definition of outside directors (Article 382 (3)), Introduction of executive officer (Article 408-2), Extend the scope of director's self-dealing (Article 398 (1), (2)), Director's duty not to usurp corporate opportunity (Article 398 (3)), Release of director's liability (Article 400), Improvement of the auditor (Article 412 (3)).

The Act on capital market and financial investment came into force in February 2009, following its enactment in 2007. It combined six existing laws - Securities and Exchange Law, Futures Trading Act, Indirect Investment Asset Management Business Act, Trust Business Act, Merchant Banks Act, and Korea Securities and Futures Exchange Act. The special provision on corporate governance of listed companies of the repealed Securities and Exchange Law is included in the Commercial Act.

1.2. Trends

	2005	2006	2007	2008	2009
Number of Companies	702	727	745	765	770
Market Capitalization (USD billion equivalent)	580	623	842	510	786

Source: Korea Listed Companies Association, Merger, April 2010.

The market capitalization of publicly traded companies dropped by 40% during the global economic crisis in 2008, but recovered by 54% in 2009.

1.3. Key Corporate Governance Rules and Practices

Please refer to Key Corporate Governance Rules and Practices in Korea, p. 128.

2. Development, Enforcement and Assessment of Implementation of corporate Governance Rules

Development of Corporate Governance Rules

In the public sector, the Ministry of Justice spearheaded the arduous process of amending and submitting the amended version of the Commercial Act to the National Assembly. To develop corporate governance that meets global standards, the Ministry took reference of revisions to Commercial Acts from around the world. It took note of the growing importance of corporate governance in the integration of the global market and advancement of financial liberalization, and amended the Act to best reflect global standards and to shore up efficiency. As such, the new version clearly defined the role of the outside director within the board of directors as well as grounds for its disqualification; and introduced an executive officer system. It also stipulates the need to improve audit and audit committee systems to avoid conflict of interest between director and shareholder.

To promote the gradual improvement of corporate governance, the Corporate Governance Service analyzes and compiles data on the level of corporate governance of publicly traded companies. Publicly traded companies are graded annually based upon the results of the evaluation; and the results are made available to the public and used to aid improvement.

Assessment of Corporate Governance Practices

Grade	Observed	Largely Observed	Partially Observed	Materially Observed	Not Observed	Total
2008 number of companies (%)	10 (1.55)	66 (10.27)	109 (16.95)	371 (57.70)	87 (13.53)	643 (100)
2009 number of companies (%)	7 (1.09)	81 (12.56)	123 (19.07)	353 (54.73)	81 (12.56)	645 (100)

Source: Corporate Governance Service

In 2009, 211 of the 654 publicly traded companies (32.72 %) were classified under Partially Observed, a 3.95 % increase from the 185 of the 643 companies (28.77 percent) in 2008. Compared with the previous year, 38 companies saw their grades improved in 2009 (36 companies in 2008) while six companies witnessed a drop in their grades (three companies in 2008).

Following the revised articles on corporate governance of the Commercial Act in 2008, more companies performed well in advancing corporate governance with improvements in the board of directors, the rights of the shareholder and public notice. The improvements in framework and operation of the board of directors were driven in large part by greater involvement of the outside director and the bigger role of special-purpose committees in candidate nomination and compensation. In the revised version of the Commercial Act in 2009, companies with more than two trillion won in market capitalization are obliged to set up an audit committee which is deemed to have bolstered the transparency of management activities.

3. Awareness and Advocacy for Good Corporate Governance

3.1. Company Directors

The Corporate Governance Service evaluates all publicly traded companies on corporate governance and the operation of the board of directors. Its mission is to improve corporate governance to build a healthy capital market culture and to promote greater transparency in management. All publicly traded companies are subject to evaluation regardless of their membership in Corporate Governance Service.

The Korea Listed Companies Association (KLCA) is an organization that manages and supervises all publicly traded companies. The KLCA educates its members on laws related to publicly traded companies in areas such as corporate governance structure, internal accounting control system and securities class action. It also offers classes dealing with current issues surrounding public notice and accounting. These classes are not mandatory.

The Economic Reform Research Institute and the Korea Information Service Inc. jointly provide online services on corporate governance analysis. Users can access the information on the website by clicking on a menu titled “corporate governance”. It provides a thorough analysis on shareholders (ownership structure), board of directors (management), articles of incorporation and related laws.

Publicly traded companies offer education programs based on workers’ performance and work period. Companies offer professional MBA programs or opportunities to study at law school for one to two years.

3.2. Media

There is no educational program focusing on building awareness among print and television journalists to enable them to cover corporate governance responsibly.

The financial press does not regularly report on corporate governance issues and developments.

3.3. Educational System

Corporate governance is taught as part of a course on the Commercial Act.

Corporate governance is a component in courses on corporate audit and company internal control.

Judges and other judicial officers study corporate governance as well as cases related to the Commercial Act and financial group.

3.4. Stock Exchange

KLCA is in charge of managing, supervising and educating publicly traded companies.

The stock exchange does not have outreach programs in support of good corporate governance.

4. Corporate Governance of State-Owned and Family-Controlled Enterprises

4.1. State-Owned Enterprises

Respecting the independence of state-owned companies, Minister of Strategy and Finance and competent ministers oversee the state's investments in companies within the limit stipulated in the Act on the Management of Public Institutions. Under the law, competent ministers oversee projects entrusted to the state-owned company by the government that are directly related to the work of the ministry and areas set out in relevant laws. Minister of Strategy and Finance, on the other hand, oversee whether state-owned companies are faithfully adhering to management guidelines including guideline on human resource and organization management.

The corporate governance structure of state-owned and private enterprises are similar in juridical sense. As stipulated in Act on the Management of Public Institutions, the number of non-executive directors should account for a half of outside directors including head of board of directors. State-owned enterprises with more than two trillion won in capital are obliged to put in place an audit committee.

Ensuring transparency and efficacy for corporate governance of state-owned companies is an important corporate governance issue. To do so, we believe in the importance of establishing a system that guarantees transparency in nominating prospective candidates to the board of directors. Companies also have to establish a system to properly evaluate and report the performance of state-owned corporations, compensating directors to adequately incentivize and attracting talent.

4.2. Family-Controlled Enterprises

One of the major issues is the transfer of management control in some large companies and family-owned enterprises that retain both ownership and management control. The other issue is the practice of "chaebol" owners who expand their control through cross ownership or through shares held by affiliated companies and family ownership.

Since the Asian financial crisis, family-owned enterprises have been striving to create a better business environment by restructuring and putting greater emphasis on the transparency of corporate governance. They have therefore been at the forefront of advancing corporate governance and protecting the rights of small stakeholders by normalizing the function of the board of directors and the shareholders' meeting to effectively oversee chief executive officers and control the dogmatic management of major stakeholder.

5. Role of Professional Service Providers in Corporate Governance

Accounting and auditing firms. Accounting and auditing firms oversee companies' enforcement of IFRS and reports and companies' performance and fiscal conditions by making their annual report public.

Rating agencies. The Corporate Governance Service evaluates publicly traded companies annually on the level of their corporate governance. The evaluation is made public and used to help companies identify areas for improvement.

Commercial banks. Investment banks are working to improve the transparency and the effectiveness of corporate governance by establishing an internal control mechanism with the Audit Committee, in line with laws on the capital market and financial investment.

Securities analysts. Stock analysts forecast and report the status quo and the future prospects of companies based on their corporate governance analysis and annual report.

Law firms. Law firms take part in the development of sound corporate governance by providing information or consultation on corporate governance to the founder or owner of a company when the company goes public.

Corporate governance consultants. The Korea Listed Companies Association provides education and consultation on corporate governance free of charge to promote the improvement of corporate governance. The Economic Reform Research Institute and the Korea Information Service work together in analyzing the corporate governance of a company and enable users to browse the information on the web.

6. Recent Developments in Corporate Governance

6.1. Corporate Governance Developments

To better equip Korean companies against fierce global competition, the revised version of the Commercial Act, currently pending in the National Assembly, consists of new developments aimed at shoring up the transparency and the efficacy of corporate governance. It includes the following articles to ease the burdensome regulation on the capital management of companies and to enhance the independence of companies in running a business.

j) Outside Director System and Executive Officer System

Starting from 1998, companies are obliged to appoint a minimum of one outside director for the shareholders' meeting. As of 1999, they must also name more than a fourth of their board of directors in the annual shareholders' meeting as outside directors (KOSDAQ-listed corporations or companies with market capitalization of more than two trillion won have to appoint more than three outside directors or fill more than a half of their board of directors with outside directors).

With the revision of the Commercial Act, a company can no longer keep the current audit system if it introduces an audit committee that has more than two-thirds of its board of directors composed of outside directors and an audit committee.

In September 1999, the Ministry of Strategy and Finance announced a standard for corporate governance that calls for the appointment of more than a half of the board of directors from outside directors. Large listed companies, government-funded institutions, and financial institutions have to establish an audit committee; and have more than two-thirds of the board of directors as outside directors. By increasing the number of outside directors, shareholders are able to keep major shareholders in check from pursuing personal gains, and defend the rights of small shareholders.

The executive officer system is also put in place to oversee executive the functions of the board of directors and the chief executives. The board of directors is entitled to appoint or dismiss personnel.

ii) Committee within the Board of Directors

The revised law adopted the common practice in which the board of directors can establish a sub-committee that exercises the same authority as the board of directors in carrying out tasks passed on from the board. The mission of the sub-committee is to guarantee objectivity and expertise so that the board of directors operate efficiently and make the right decisions. The law stipulates that KOSDAQ-listed corporations and companies with assets of more than 2 trillion won are obliged to establish a sub-committee to recommend candidates for outside directors. It must also fill more than half of the committee with outside directors.

The Ministry of Strategy and Finance advises companies to put in place a compensation committee and obliges listed companies with more than one trillion won in assets (Model Rule of Corporate Governance, 6.2 Principles) to do so. All members of the committee must be outside directors to ensure the committee's independence. (Criterion 6.3)

KOSDAQ-listed corporations or publicly traded companies with more than 1 trillion won in market capitalization can have a full-time auditor or an audit committee. The law was amended to protect the interests of the employees and creditors of corporations with more than two trillion won in market capitalization by establishing a sub-committee that can audit the operation of the board of directors and accounting.

iii) The right of shareholder's proposal

As the board of directors gained more control, the shareholders meeting slowly lost its influence. To address this concern, the Commercial Act was amended in 1998 to revive the initial purpose of the shareholders meeting by increasing its role in management. Small shareholders were recognized for their right to make proposals that must be addressed in the shareholders meeting. Under the revised Act, shareholders with more than 3% of listed shares, except for shareholders that do not have voting rights (Article 363-2 I of Commercial Act) can participate in management by making a written proposal to the board of directors six weeks prior to the meeting.

iv) Class Action

When small shareholders want to take class action against the board of directors, to hold them liable for any damages done to the corporation's interests, the auditor has to file a suit on behalf of the company. Given the difficulty of the circumstance, the law was amended to guarantee *locus standi* for small shareholders. Shareholders with more than 1% of listed shares can file a suit. If they win, they can charge the company for the cost incurred from the lawsuit. If they lose and if both sides agree that there were no bad intentions behind the suit, the shareholders do not have to pay the compensation.

v) Cumulative Vote

Shareholders are entitled to one vote for each share in the event of selecting and appointing more than two directors. The system was introduced in 1998 when the commercial code was amended to vote for one or more candidates. Based on the articles of association, the cumulative vote can be put aside, thereby leaving room to select or appoint the representative of small shareholders as a director.

vi) Merger and Acquisition

Article 527-3 of the Commercial Act eased the total number of new shares issued by the surviving company of a merger not to exceed 10/100 of the total issued shares of the company from the initial requirement of 5/100.

Article 523 of the Commercial Act promotes the flexibility of merger consideration, allowing companies to choose between a share of the parent company or cash.

vii) Corporate Social Responsibility

The role and mission of a company has evolved from satisfying interest groups to take part in addressing social issues in the community that the company belongs to as well as economic, social and environmental issues. More and more companies are called to take greater interest in CSR. As the concept develops, the principle of CSR has been broken down into economic, social, ethical, charity, and environmental responsibilities. To enhance the social confidence and responsibility of companies, there is an ongoing discussion on enacting the “CSR Act” to promote a responsible management and eco-friendly corporate policies.

6.3. Current Issues and Challenges for Corporate Governance

Challenges

The board of directors was introduced so that corporate decisions can be put to a vote. For the system to be effective, it requires a framework allowing the board of directors to be active in appointing and gathering opinions from executive officers. However, the system is not without fault. It is hard to find the right person for a job as important as the executive director; and directors are selected in the shareholders meeting which means small shareholders have lesser say than major stakeholders.

Financial Crisis

In August 2006, the Korean government enacted a law on capital market and financial investment to nurture the capital market and to speed up the process of becoming an advanced economy. Upon the outbreak of the global financial crisis, the government came to realize the importance of a fully functioning financial market and sound regulation; and have been working on creating a better system.

Under the revised law, financial investors can rightly demand the appointment of an outside director even in a non-listed company to secure the independence of the board of directors as well as its transparency and authority for supervision.

Major financial institutions must also build an audit committee as should companies that have yet to go public.

With an efficient internal control system up and running, financial investors can better manage potential risks. Chief executive officers can also conduct appropriate supervisory tasks. An internal control system is a standard and procedure that executives must follow at work to prevent conflict of interest and to protect investors.

Key Corporate Governance Rules and Practices in Korea

Element	Yes	No	Source(s) of Rule	Comments
RIGHTS OF SHAREHOLDERS				
1. Do shareholders add items to the agenda for shareholders' meetings?	X		CL	
2. Do shareholders ask questions of directors at shareholders' meetings and do they receive answers?	X		CL, GP	
3. Must company transactions with its insiders be on a non-preferential basis?	X		CL	
4. Is a super majority vote required for major company acts affecting shareholder rights?	X		CL, CGC	
COMPOSITION AND ROLE OF BOARDS OF DIRECTORS				
5. Must boards have independent directors? What percentage?	X		CL, CGC	
6. Do independent directors have significant influence over (a) internal and external audit and (b) executive compensation?	X		CL, CGC	
7. Do independent directors decide what information the board receives from management?	X		CL, CGC	
8. Are the chairman of the board and the chief executive officer different persons in the majority of listed companies?	Δ			
9. Are all board members elected annually?		X		
10. Does the board oversee enforcement of a company code of conduct?	X		CL, CGS	
TRANSPARENCY AND DISCLOSURE OF INFORMATION				
11. Do financial statements comply with International Financial Reporting Standards (IFRS)?	X		SL	
12. Are the identities of the five largest shareholders disclosed?	X		SL	
13. Is compensation of company executive officers disclosed?	X		SL	
14. Are extraordinary corporate events disclosed?	X		SL	
15. Are risk factors disclosed in securities offering materials?	X		SL	
16. Are transactions of a company with its insiders disclosed?	X		SL	

Note: CL – company law; SL – securities law; CGC – corporate governance code; SLR – stock exchange listing requirement, GP – general practice but not obligatory