

Korean Companies Five Years After the Global Financial Crisis

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Weekly Insight

I. Current State of Korean Companies

Five years after the global financial crisis, Korean companies are feeling the pinch yet again. Earnings rebounded strongly in 2009 and 2010, but have been steadily slowing since then. In the first half of this year, sales growth stalled. The situation starkly contrasts with robust corporate performance that was evident five years after the 1997 currency crisis.

This raises concerns on whether Korean companies are fully cognizant of the severity of the current weakness or have become complacent. They who were slammed hard by the 1997 crisis, an Asia flu, and their aggressive responses brought quick results amid a global economy that had not slowed. The 2008 crisis, of course, has been felt worldwide and many countries remain stuck below pre-crisis economic levels. Furthermore, competition is more intense, with Chinese companies rising on the back of a vast domestic market, Japanese rivals reviving on yen depreciation, and domestic social demands on

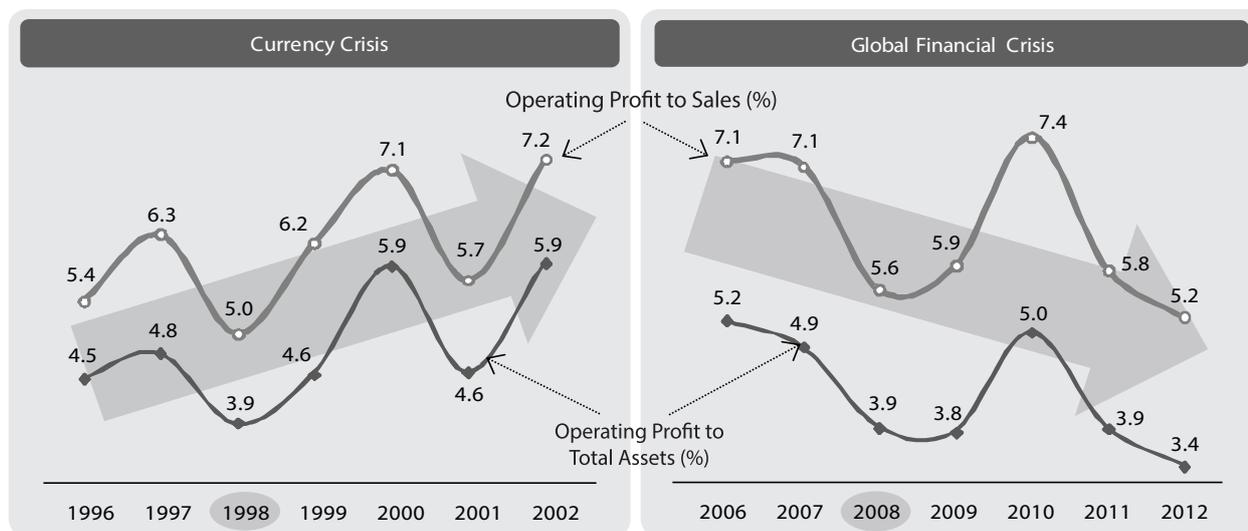
Korean companies intensifying.

The current challenges clearly require new management systems. This paper examines earnings performance (quantitative aspects) of Korean companies and how their business management has transformed (qualitative aspects) since the global financial crisis and how they can lead to new directions for Korean businesses.

II. Post-crisis Corporate Scorecard

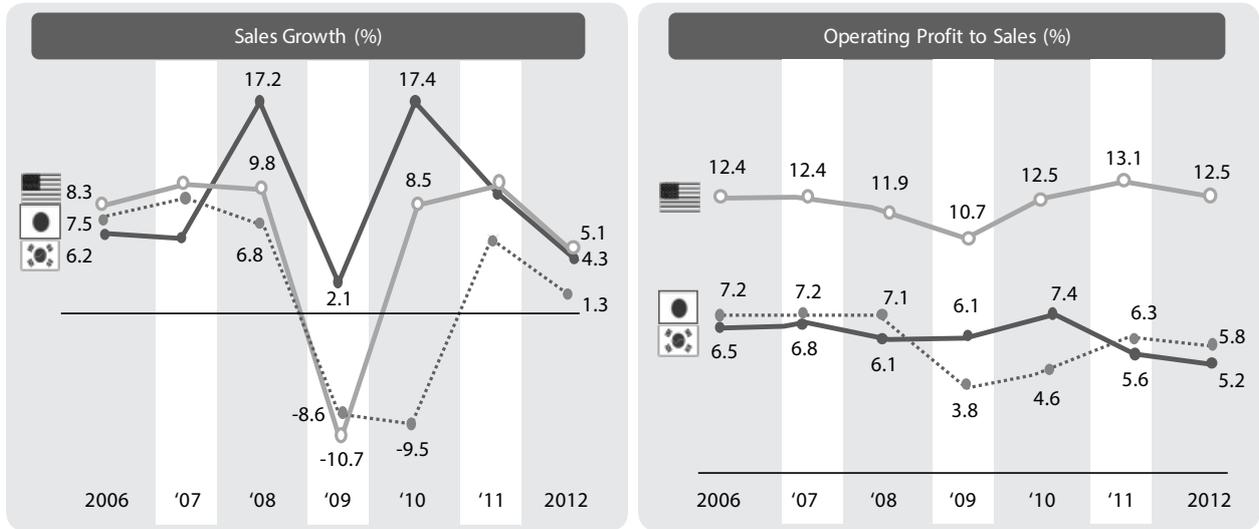
Immediately following the crisis, Korean companies fared relatively better than leading global companies. In 2009, sales growth was in the 2% range while that of US and Japanese companies remained in negative territory. Also, Korean businesses had greater profitability over their Japanese counterparts and narrowed gap with US companies. Lessons learned from the 1997 crisis gave them an intuitive understanding of how to handle the 2008 crisis. Yet, the relative success of the Korean compa-

Corporate Earnings After Crisis (Asian Currency Crisis 1997 vs. Global Financial Crisis 2008)



Note: Based on 734 non-financial listed companies whose data are available from 1996.
 Source: FnGuide.

Cross-Country Comparison of Corporate Earnings Before and After Crisis



Note: Based on top 500 non-financial listed companies in terms of sales.
Source: Thomson One Banker; FnGuide.

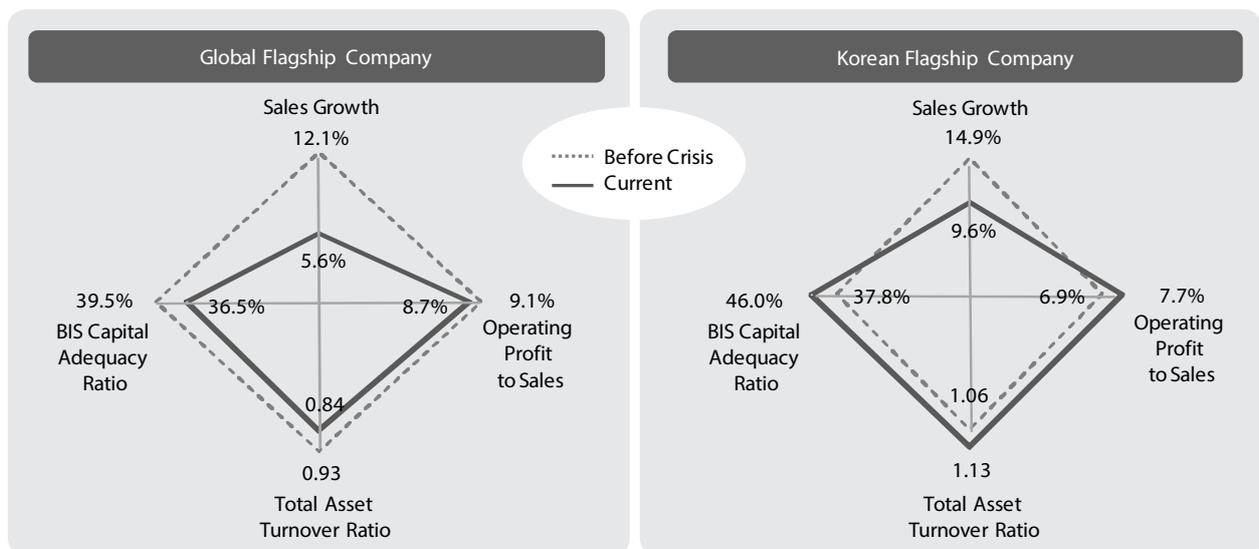
panies also must give some credit to sharp depreciation of the won against the US dollar and the Japanese yen. This may have produced a false sense of corporate strength.

With low growth mode prolonging, the momentum of Korean companies has been ebbing since 2011. Sales growth slowed faster than that of US and Japan companies, and the operating profit growth of the latter has eclipsed Korean companies.

The number of underperforming Korean companies is surging. Moreover, the operating profit of 32% of the companies was lower than their interest payments in 2012 compared to 22% in 2010. That means their ability to service their debt is so weak that even a small financial shock can send them into bankruptcy.

Korea's flagship companies remain robust with higher competitiveness than their global rivals after the crisis

Korean Flagship Companies vs. Global Rival Companies Before and After Crisis



Note: 1. Pre-crisis years refer to 2006-2007, and current period is 2011-2012.
2. Comparison of two key companies in Korea and global rivals was made in electronics, automobiles, metals, heavy industries and chemicals.
Source: Thomson One Banker.

erupted. They have reason to be upbeat but optimism, of course, is no guarantee that they can sustain their high performance.

III. Transformation of Corporate Management

In the post-global crisis period, Korean companies have shown notable changes in their leadership style, business structure and management methods. The causes are global economic slowdown, technological developments and a search for new approaches to capitalism.

1. Leadership: Emphasis on continuity, professionalism and transparency

Amid growing uncertainty in post-2008 business environment, Korean companies have emphasized continuity and professionalism in leadership. CEO replacement was higher than global leading companies before the crisis, but it now approaches the global average.

Korean businesses are also stressing the need for transparency in decision making by increasing the number of outside directors and setting up audit committees. This is in response to rising demand for management improvement by interested parties such as institutional investors, the government and society. As of 2012, there were 218 companies where the National Pension Service had stakes over 5%.

2. Business structure: Integration of existing businesses and product line expansion

Pursuit of new business ventures has contracted amid lingering uncertainties over the global business envi-

ronment. Very few successful new businesses have been launched and the percentage of companies considering new business segments has been stagnant since 2008. Before the crisis, foreign direct investment of Korean companies grew by an annual average of 47.2%. Post-crisis, the annual average has sunk to minus 0.8%. Acquisition of other companies, a primary way to obtain new growth engines, also is in decline.

Amid difficulty in finding drivers for breakthrough, Korean businesses have been integrating their business units to bulk up, strengthen existing businesses, cut costs and raise management efficiency. They also have expanded product lines to boost sales growth. As a result, the share of core products in total sales has declined over the past two years.

3. Management: Seeking structural changes in management functions

Even amid heightening risks, Korean companies have steadily expanded investment in research and development (R&D) while simultaneously stepping up oversight of liquidity. Facilities investment has remained stagnant but R&D investment has grown 13.5% on average annually since 2008.

In addition, in order to efficiently manage limited resources amid slowing sales growth, companies are paying more attention to keeping their workforce motivated. Accordingly, they are focusing more on performance-based pay, departing from traditional age-based criteria, and bolstering non-monetary incentives.

Furthermore, use of new marketing channels like mobile and social networking services has expanded to

Korean Companies' Transformation after Global Financial Crisis

Drivers	Transformation of Corporate Management		
	Leadership	Business Structure	Management
Global Economic Slowdown	① Emphasis on continuity and professionalism	③ Less pursuit of new ventures	⑤ Continuous R&D investment
Technology Development		④ Integration of business units and expansion of product lines	⑥ Performance-based compensation, emotional motivation of workforce
Seeking Change in Capitalism	② More emphasis on transparency in decision making		⑦ Use of new marketing channels

increase marketing efficiency amid an economic slowdown. While advertising costs through traditional media like TV and radio declined, the cost for online and mobile advertising has multiplied.

Finally, companies have renewed awareness about sustainability. Corporate citizenship activities -- efforts toward the environment and society, etc. -- have emerged as a major management function.

III. Implications

The main focus of Korean companies has been minimizing shocks and maintaining the status quo. This has softened the impact of internal and external pressures slowly gathering steam. Also, strong performance at a handful of flagship companies and still acceptable foreign exchange rate has diminished crisis awareness. The government, company and society should be keenly perceive the severity of the current situation and support Korea's flagship companies to remain healthy and so-called smaller hidden champions to make meaningful advances.

Following the 1997 currency crisis, Korean companies concentrated on restructuring and downsizing to restore financial stability. In the wake of the 2008 crisis, they have been focusing on integrating internally and expanding product lines to create new demands. It is time for Korean companies to pause and reassess. They should weed out inefficiencies and carefully decide where to commit for future sustainable growth.

The speed at which management can change course will also be critical to staying ahead in a new environment triggered by technology developments. Adhering to existing management systems can only result in lost opportunities and risk to survival. The current changes being pushed at Korean companies, such as new marketing channels and motivating employees, should be further promoted, while trying to stay one step ahead of rivals on promising areas. To this end, continuous benchmarking of companies in the same and different industry or business is necessary, in order to upgrade management techniques in R&D, production, supply chain management and marketing, etc. SERI

Current State and Future Directions of Korean Companies

