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## Chaebol Structure

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### ABSTRACT

Chaebol Structure refers to a conglomerate of businesses that emerged in South Korea in early 1960s and have led the Korean economy since then. Chaebol Structure can be characterized as being owned by the founder's family and managed by the professionals to make the most of the merits of ownership and management, differently from that of the western style to call for the separation of ownership and management.

Chaebol were formed in 1960s-1970s by the founders who had, in common, an unyielding character with 'hurry-hurry mind and hungry spirit, with organization(s) composed of well educated, energetic manpower, as it were not highly qualified. Chaebol followed the government's export-oriented economic and industrial policies, which were in good match with the world economic trends then; fully ripened mass economy age, Vietnam War and Middle East boom. Chaebol Structure, after being formed, started to lead the Korean economic development through the innovation strategy of 'from imitation to innovation' to go with some public R&D institutions established by the government then.

In early 1980s when US' manufacturing industries were collapsed, the 2<sup>nd</sup> generation who took over the style of the founder's leadership and entrepreneurship were able to adapt to the declining trend of US manufacturing industry by such expansion strategies as the horizontal & vertical integration, and related & unrelated diversification during 1980s-1990s. As a matter of course, these styles of Chaebol's expansion (called octopus' expansion) sometimes aroused a public criticism on it socially or politically. Yet Chaebol Structure, after possessing the manufacturing-based businesses, continued to expand their business domains and to enhance their businesses through the innovation strategy of 'from incremental innovation to radical innovation' and to manage the diversified business

portfolios in a manner of 'centralized decision-making by owner CEO and decentralized execution by professionals.'

However, Chaebol Structure should be reformed late 1990s when there was the Asian financial crisis. Twelve among thirty Chaebol who were lack of innovative capabilities or proper strategic approaches, or had poor management could no longer stand and eventually bankrupted.

In 2000s, Chaebol who overcame the financial crisis have also been in a trouble under a social anti-mood for free enterprise systems. In spite of such challenges, Chaebol Structure have highly contributed in changing the Korean economy from trade debtor to trade creditor, thanks to the change of exchange rate system by the government and their manufacturing-based business portfolios. Accordingly Chaebol have also become more stable and solid financially and socially.

The Wall Street meltdown 2008 ultimately caused by the imbalances between rapidly declining manufacturing industries and boosting services, and between dwarf of real economy and mammoth of money derivatives economy, has brought about global economic crisis, giving heavy impacts on all over the world. Chaebol Structure also could not avoid the impacts of that crisis, yet the crisis turned out to be a chance for Chaebol Structure to get their businesses more upgraded and to reinforce preparing the leadership of the 3<sup>rd</sup> generation, thanks to their manufacturing-based business portfolios equipped with a more intensified 'from incremental innovation to radical innovation' strategy, and business domains confined to within real economy rather than money economy by the laws not to permit for Chaebol to enter money-oriented business fields.

In short, Chaebol Structure have been working as the most powerful driving forces in developing the Korean economy, having greatly contributed to becoming Korea as one of G20 in 2010. And the emergence and evolution of Chaebol Structure demonstrate that no firm will be successful and sustainable unless it meets customer needs at every stage of needs evolution through innovation to make customers have willingness to pay (WTP).

Keywords: Ownership & management; from imitation to innovation; national innovation system; hurry-hurry mind; from incremental innovation to radical innovation; centralized decision-making and decentralized execution

## **Emergence and Evolution**

### ***Formation (1960s-1970s)***

Some Korean worked at large corporations during the Japanese colonial period were able to obtain the assets of some of the Japanese firms, after the Japanese departed following the defeats of Japan in 1945 and they have started to form a premature Chaebol with special favors from the government during the First Republic Syngman Rhee's regime, 1948-1960. Chaebol, in a real sense, has made its appearance with the policies of President Chung-Hee

Park who took power in 1961 and started to spur rapid industrialization by promoting some large businesses as an organization or organizations composed of well-educated, energetic manpower, as it were not highly qualified then. At first the government set up an industrial policy to substitute the importation of consumer goods and light industries products and yet it changed toward heavy & chemical industries for export-orientation in 1970s. In doing these, political leaders and government planners relied on the ideas and cooperation of the Chaebol leaders who had unyielding characters with 'hurry-hurry mind and hungry spirit.' The government provided the blueprints for industrial expansion and Chaebol accomplished the plans. Chaebol played a key role in developing new industries, markets, especially exploiting export markets. Accordingly, Chaebol-led industrialization accelerated the monopolistic and oligopolistic concentration of capital and economically profitable activities in the hands of a limited number of conglomerates. By the way Park's economic development plan, fortunately enough, was very fit well with the world economy trend then; opening and maturing the mass economy age. Mass economy, which can be referred to as a techno-economic paradigm to meet mass consumption by mass production through mass distribution, was initiated just after the end of WWII and kept matured over the period of the Korean War and the Vietnam War until 1980 by the US manufacturers who had been able to turn the technologies used in WWII into industries, especially into manufacturing sector through diversification strategy. In 1960s and 1970s, Park's government encouraged Chaebol to export as much as possible and this policy turned out to become so successful, especially thanks to the Vietnam War in 1960s and the Middle East Boom triggered by the oil shocks in 1970s (Figure 1).

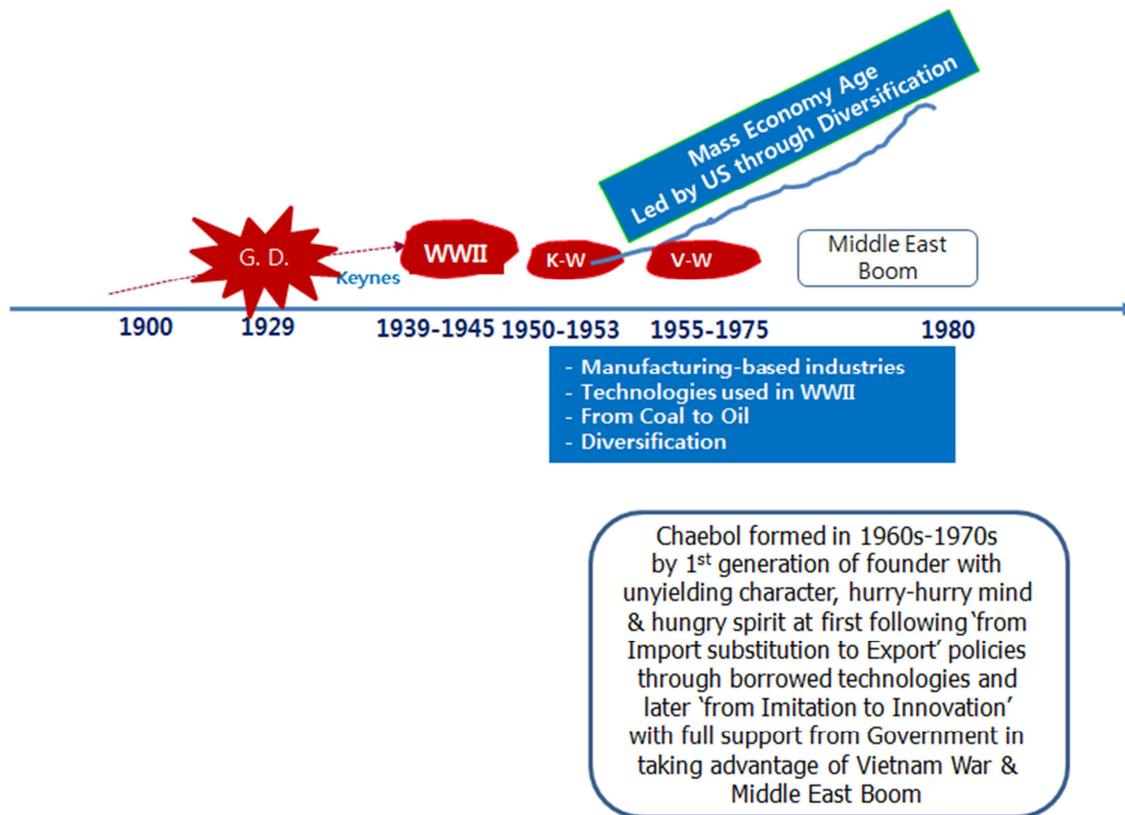


Figure 1 World Economy Trend (1950-1980) and Formation of Chaebol Structure

**Expansion (1980s-1990s)**

In early 1980s US' manufacturing industries started to be waning just after the 2nd oil shock and rapidly declined by the deregulation policy taken by the Reagan's government. As a matter of fact, under the deregulation circumstances backed by the ideas of neo-liberalism, most US manufacturing firms, even though they were then in a little trouble in implementing and commercializing the advanced technologies in spite of their strong innovative capabilities, too easily gave up their businesses and indulged themselves in service-oriented and/or money-related businesses, following the idea of maximization of stockholders' value. On the other hand, Chaebol Structure were able to adapt well to this declining trend of US manufacturing industry by horizontal and/or vertical integration, related and/or unrelated diversification strategies mainly entering into the fields of manufacturing industries by the 2nd generation of Chaebol who took over the founders' powerful leadership and entrepreneurship. Chaebol continued to expand just like an octopus spreads its arms, so called octopus' expansion, though it aroused sometimes a public criticism on it. And Chaebol Structure also was able to establish the unique management systems with the well-educated & trained manpower, with which they have managed the diversified business portfolios in the manner of 'centralized decision-making by ownership and decentralized execution by professionals' in order to make the most of ownership and management. Chaebol Structure, after possessing the manufacturing-based businesses, have continued their explosive growth in export markets in late 1980s to 1990s through the innovation strategy, 'radical

innovation for exploration and incremental innovation for exploitation' to produce and provide a higher level of products/services and to develop new products for covering a wider range of markets, especially in such manufacturing industries as steel, shipbuilding, automobiles, electronics & semiconductors and IT-oriented fields (Figure 2). As a result, Chaebol Structure has obtained reliability from global and/or domestic market customers and became independent financially and less dependent on the government's support, and also obtained strong R&D capabilities to develop even the advanced technologies, yet still relying heavily on national innovation system. By the 1990s, South Korea was numbered among the Asian 4 NICS.

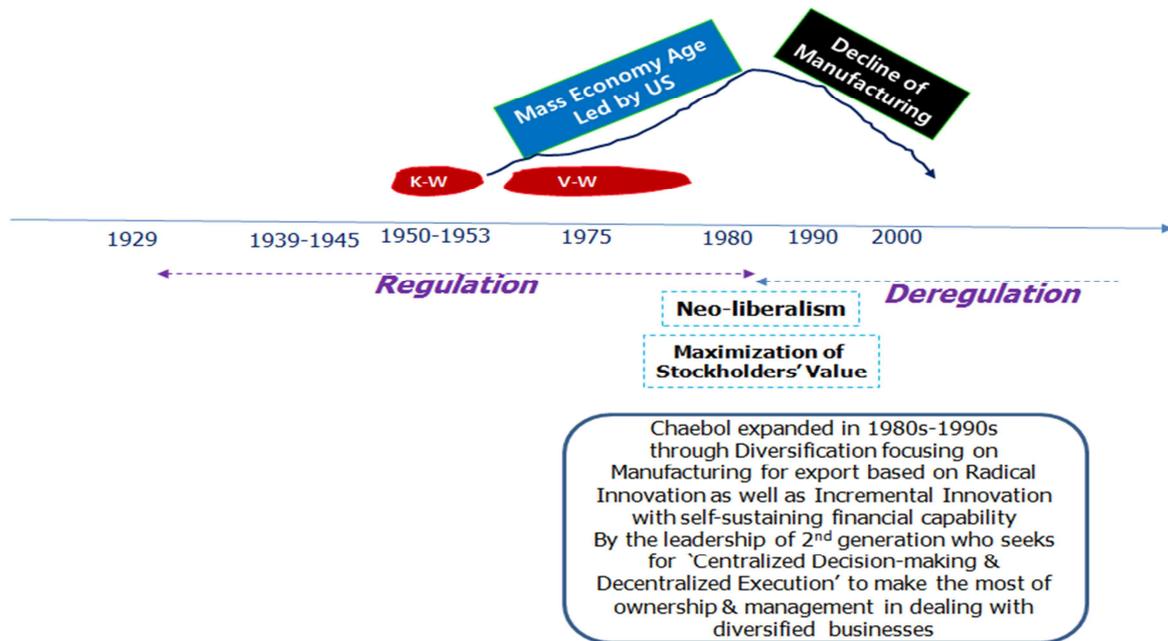


Figure 2 Decline of Manufacturing in US and Chaebol's Strategic Behaviors 1980s-1990s

### **Reforms (from the late 1990s to late 2000s)**

However, when there was the Asian financial crisis in late 1990s caused by the lack of currency of US dollars and by willful global speculative investors, it was inevitable for Chaebol Structure to be reformed. The reform had been done under the Dae-jung Kim's government just started then. The Kim's government carried out extensive reforms to cover banks and Chaebol Structure as well. Especially the reforms of Chaebol Structure included enhancing transparent business management through the early introduction of consolidated financial statements, banning the system of cross guarantees between individual subsidiaries of a business group, defining core sectors and cooperation with small and medium-sized firms, making majority shareholders and management more accountable for their actions, banning Chaebol dominance of nonbanking financial institutions, prohibiting mutual investments between subsidiaries, and banning illegal hereditary transfer of Chaebol

ownership and so on. Accordingly, many of Chaebol Structure who were in a poor management to deal with foreign exchanges and/or labor unions, or invested heavily in manufacturing with less innovative technologies or easily vulnerable to expose every downturn in overseas markets could no longer stand. As a result of the reforms, 12 among 30 Chaebol were eventually bankrupted. What's more, Chaebol who overcame the financial crisis have also faced against strong social challenges from inside and outside the firm under a social anti-mood for free enterprise system in 2000s, especially regarding their style of octopus' expansion, irregular inheritance, slush of fund or undue succession of the founder's family. As a matter of course, in some respects, it certainly brought about a moment for Chaebol Structure to refine reliability and integrity within and without their organizations. Notwithstanding the financial crisis and severe social challenges in 2000s, Chaebol Structure have been able to contribute highly in changing the status of the Korean economy from trade debtor to trade creditor, thanks to the change of exchange rate system by the government and their manufacturing-based business portfolios. As a matter of course, Chaebol Structure became more solid and stable financially.

#### ***Deepening (from global economic crisis from US 2008 to now)***

Wall Street meltdown 2008 ultimately caused by the imbalances between rapidly declining manufacturing industries and boosting services, and between dwarf of real economy and mammoth of money derivatives economy, has given rise to global economic crisis, giving heavy impacts on all over the world, especially on the European countries (Figure 3). Although Chaebol Structure could not avoid the impacts of global economic crisis, and yet that crisis also turned out to be a chance for Chaebol Structure to get their businesses more upgraded and to reinforce preparing the leadership of the 3<sup>rd</sup> generation, thanks to their manufacturing-based business portfolios and business domains confined to within real economy rather than money economy by the laws not to permit for Chaebol to enter money-oriented business fields.

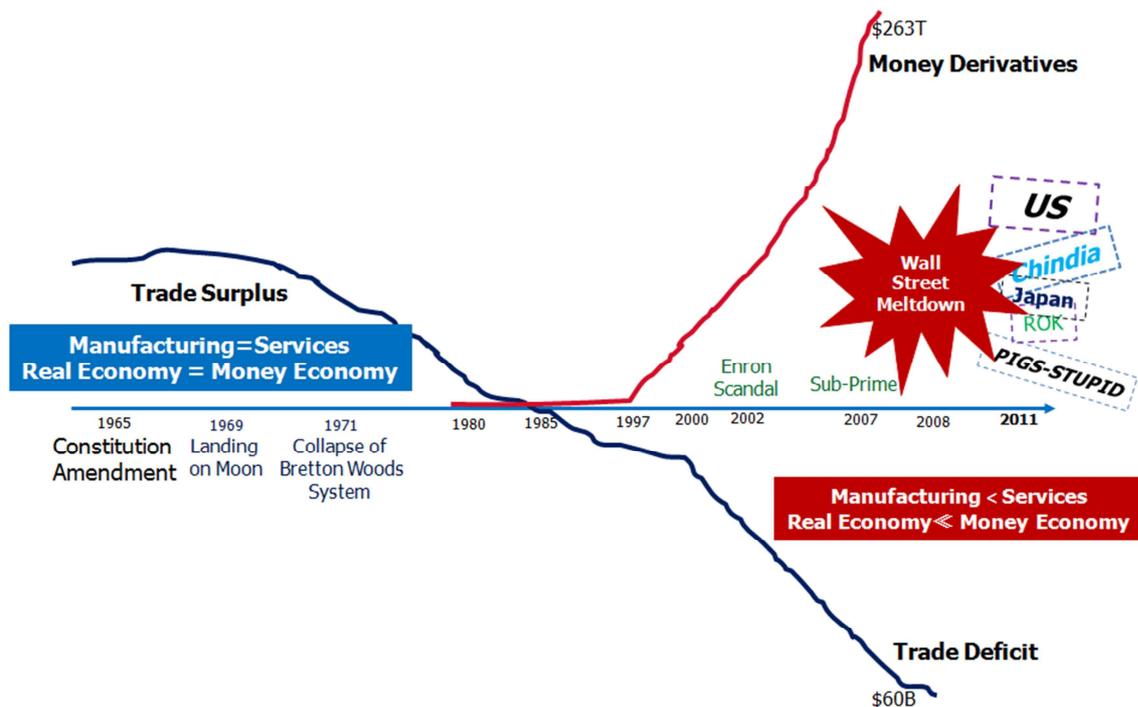


Figure 3 Causes of Wall Street Meltdown 2008 and its Impacts on Global Economy as of 2011

In short, Chaebol Structure governed by the powerful CEO leadership rooted in the founder's family, although they were so often heavily blamed socially for the octopus' expansion, slush fund, irregular inheritance or undue succession of the founder's family, has turned out to be so successful in adapting to the global economy trends, especially to the declining trend of US' manufacturing industries in early 1980s, by establishing manufacturing-based business portfolios, by setting up well-working management systems with highly educated human resources and fostering the value of integrity and reliability through overcoming many challenges from inside and outside organizations, and by pursuing energetically ceaseless innovation to improve the quality level of their products/services and to trigger market customers to have willingness to pay (WTP), having greatly contributed to becoming Korea as one of G20 in 2010.

From strategic management point of view, the emergence and evolution of Chaebol Structure demonstrate that no firm will be successful and sustainable unless it meets customer needs at every stage of needs evolution through innovation to make customers have WTP for their products/services.

The key characteristics of Chaebol Structure by evolution stage can be summarized as follows (Figure 4).

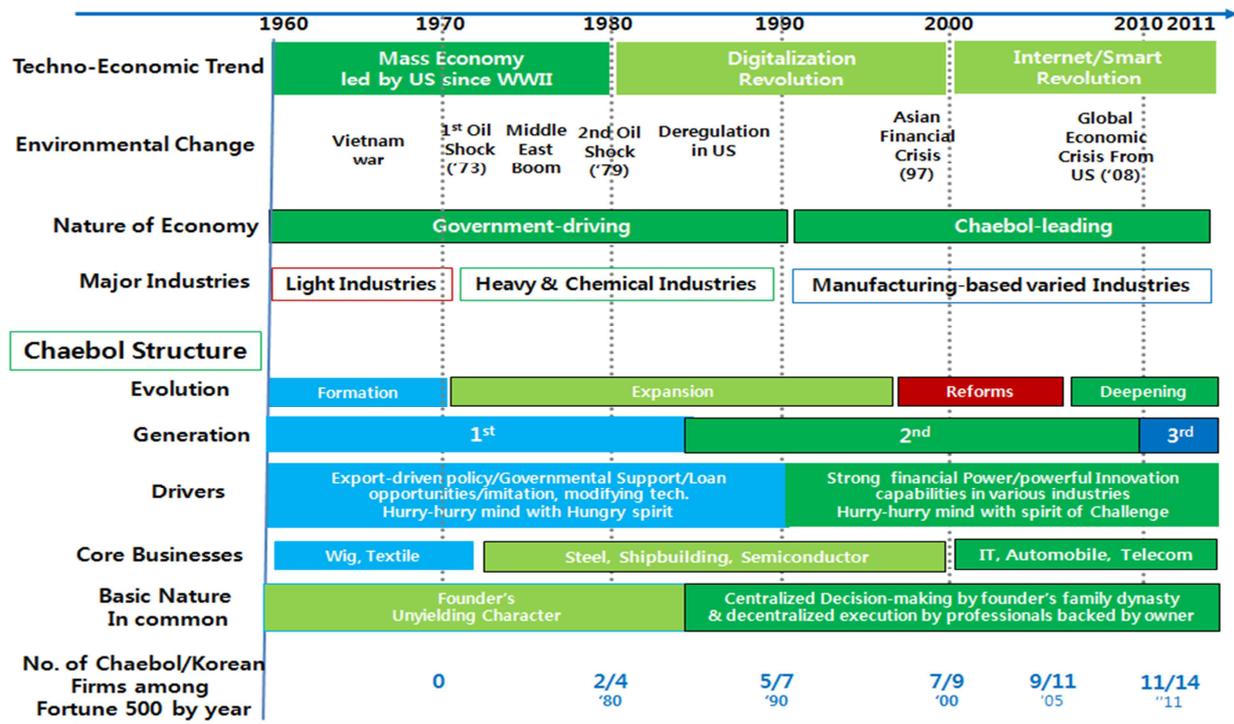


Figure 4 Key Characteristics of Chaebol Structure by Evolution Phase

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