WHO WILL CONTROL FRANKENSTEIN?

: THE KOREAN CHAEBOL’S CORPORATE GOVERNANCE

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Abstract

In a chaebol, since a dominant family exercises control with only a small equity-holding, a sharp disparity exists between cash-flow rights and voting rights. The controller reduces managerial agency costs but creates his own agency costs. Furthermore, the disparity exacerbates the controller’s agency costs. Meanwhile, outsider shareholders’ voting rights are ineffectual in eradicating this problem. Therefore, external monitoring devices over the chaebol controller are required.

Korea has relied on government regulation—including attempts to change chaebols’ ownership structures—to address this problem. Unfortunately, however, without well-functioning capital markets, the regulation has proved to be ineffective. As observed in the SK scandal, a market for corporate control could helpful in policing the chaebol controller’s mismanagement or tunneling. In this changing environment, regulators should focus on facilitating capital markets and monitoring interested party transactions in the chaebol, instead of attempting to change the chaebols’ ownership structure.
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