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**Research Report**

## Business Groups in Korea: Overall Concentration, Market Dominance and Diversification

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# Business Groups in Korea: Overall Concentration, Market Dominance and Diversification

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- This study attempts a statistical examination and analysis of the characteristics and situation surrounding business groups (Chaebol) in Korea in order to provide basic information for corporation policy and the ongoing business group debate.
  - Business groups have continued to account for an overwhelming share of the Korean economy, even after the intense restructuring of the late 1990s foreign exchange crisis.
  
- The 55 business groups subject to cross-investment restrictions in 2010 accounted for 29.1 percent of all sales and 8.0 percent of all workers in the national economy.
  - In terms of broader industry categories, business groups represent an overwhelming portion of manufacturing sector and relatively low percentage of services sector.
  - As a long-term pattern of change, the top 30 business groups in manufacturing sector have accounted for a rapidly growing share since the late 2000s. This phenomenon is the result of continued rapid growth by a small number of very large companies amid a general drop-off in growth for the economy as a whole.

\* This is translated version of *KDI Policy Forum* released on September 29, 2014.

\*\* This issue of Forum is a revised summary of Ch. 9, "Concentration of Economic Power: Business Groups Today" in Jaehyung Lee, *South Korean Industry Organization and Market Structure*, Research Report 2013-06, Korea Development Institute, 2013. For details, please refer to that report. Statistical values may differ, as this version incorporated revised figures and basic statistics added after the previous report's publication.

- For manufacturing sector, business groups account for a generally large share of the country's mainstay industries, but not an especially large share of its smaller-scale ones.
- **Business groups have moved into a wide range of industries and frequently hold monopoly or oligopoly status in those markets.**
  - For industries where large business groups ranked among the top three performing companies, the average concentration rate for the three companies (CR<sub>3</sub>) was 51.8 percent.
    - For industries where large business groups were not present, the CR<sub>3</sub> averaged 43.9 percent.
  - Business groups typically have strong market control in large-scale industries or industries with large markets.
    - Numerically, business group affiliates ranked first for market share in 23.7 percent of cases, but accounted for 48.5 percent of industry sales.

## 1. Introduction: Issues of Economic Concentration

Few issues have been as contentious in the Korean economy as that of business groups. Even after intensive restructuring during the response to the foreign exchange crisis of the 1990s, these groups (commonly known as Chaebol) continue to account for an overwhelming share of the national economy, and many of the issues faced by the economy are commonly traced to issues related to business groups. The idea of “economic democracy” was hotly disputed in the 2012 presidential election, and the issue of business groups continues to lurk as one of the key concerns in the national economy.

Korean perspectives on the business group issue cover a broad spectrum. Some argue that it is not especially problematic for business groups to hold so much economic power, since it is the result of market principles operating. Others approach the issue in terms of economic efficiency (i.e. the efficient distribution of national resources), while still others perceive it in terms of a larger category of economic issues that encompasses the nation of distribution (or equity). Another perspective places the issue in the context of the more general political/social issue of monopolization of societal decision-making—that is, the monopolization of power.

Yet even as the topic of business groups is subjected to such keen debate, accurate information about its nature is surprisingly scarce. Through the mid-1990s, researchers

at KDI attempted a statistical analysis of the business group model with the support of the National Statistical Office (Statistics Korea, today), but ultimately abandoned the project due to a lack of basic data.<sup>1</sup> Thanks to the efforts of Statistics Korea, conditions have recently improved to the point that they allow for the compilation of figures on business groups. This study attempts a statistical examination and analysis of the characteristics and situation of business groups in order to provide basic information regarding corporate policy and the ongoing business group debate.

## 2. Measurement and Statistics

The concentration of economic power in Korea, or the share of the national economy represented by business groups, has been subjected to statistical analysis by numerous researchers in the past. Many of these studies, however, have been plagued with serious risks of statistical error. While statistics on economic power concentration have focused on comparing the performance of business groups (the numerator) to that of the economy as a whole (the denominator), these standards for comparison have not been applied consistently. The measurement issue stems from two general factors.

The first has to do with limitations in terms of basic data. The most frequently adopted methodology for measuring the concentration of economic power is to calculate the business group's value-added (numerator) and compare it to GDP (denominator). Theoretically, this is a reasonable methodology, since GDP is the aggregate of all value-added in the economy. Because GDP figures are inferential statistics; however, they pose significant statistical problems when used in comparison with value-added, which is a performance statistic.<sup>2</sup>

A second issue stems from the researchers' own lack of understanding of basic statistics. Conceptual differences between numerator and denominator, along with their differing scope, would seem to disqualify them from comparison, yet some researchers would still

<sup>1</sup> Compiling statistics on business groups requires the ability to distinguish whether the businesses and enterprises under examination are included in business groups. This was impossible for a long period starting in the mid-1990s because of revisions to the Statistics Korea database on business/enterprise populations.

<sup>2</sup> See Jaehyung Lee (2013) for details.

justify comparing them, resulting in statistics that deviate significantly from the reality. For example, while many of the top-ranking business groups are multinationals, international comparisons have had the worldwide business performance of a particular corporation rated against the economic performance of the home country's economy.

At root, these issues stem from a lack of statistical matching. For this study, microdata from Statistics Korea examinations—the Economic Census and Mining and Manufacturing Survey—were used as a foundation. Because all statistics and analyses operate within a single statistical framework, it is possible to rule out the aforementioned factors that potentially lead to statistical error. At the time of writing, the most recent statistical analysis for business groups extended to 2011. In order to examine comprehensive information on all industry, however, the analysis was primarily performed using general economic survey data from 2010.

### **3. Concentration of Economic Power: Business Groups and Their Characteristics**

#### **A. The Korean Economic Power Concentration Issues**

In Korea, the term “concentration of economic power” has traditionally been used to refer to the percentage of the overall economy represented by a small number of business groups. Another term, variously called “overall concentration” or “aggregated concentration”, is generally taken to describe a select few companies or business groups as a percentage of the entire economy; “concentration of economic power”, as it is commonly termed, encompasses both this concentration and the extent to which business groups dominate in both ownership and the characteristic governance structures that they possess. In strictly economic terms, the Korean business group issue (or the phenomenon of concentrated economic power) can be summarized in terms of the following components:

- ① Overall concentration: A large share of the national economy represented by a small number of groups
- ② Monopoly/oligopoly status: The monopolistic or oligopolistic control of individual markets by business groups

- ③ Diversification: The presence of business group affiliates in a substantial number of industries (also called the “octopus business approach”)
- ④ Ownership structure: The concentration of business group ownership in the hands of controlling shareholders (Chaebol heads and their family members) through complex equity relationships among affiliates
- ⑤ Governance structure: The concentration of management authority among owning family members and a basic lack of internal controls on it

Of the five issues of economic power concentration in Korea, this study addresses three: overall concentration, monopoly/oligopoly status, and diversification. The focus of the analysis is on 55 entities designated by the Fair Trade Act as business groups subject to cross-investment restrictions as of 2011.

## B. Business Groups and Their Share of the Economy

It was not until implementation of the General Economic Survey—an investigation of all businesses in all industries in Korea—that it became possible to calculate the share of the top-ranked business groups in the national economy. As of 2010, the 55 business groups subject to cross-investment restrictions accounted for 29.1 percent of sales in the Korean economy, and 8.0 percent of its workers. As <Table 1> shows, in terms of broader industry categories, business groups represented an overwhelming share of manufacturing (including mining) and a relatively low share of services (industries not including agriculture/forestry/fishing or mining/manufacturing).

Examination of long-term patterns of change in the economic share of business groups showed a rapidly growing percentage of manufacturing for the top 30 groups since the late 2000s. During the 1970s and early 1980s, the top 30 groups accounted for 35 percent of manufacturing; an across-the-board increase brought the percentage to roughly 40 percent in the mid-1990s. Between 1998 and 2000, the Korean economy underwent a change that was unprecedented in its severity. Because of a seven-year statistical gap that resulted from this period, there is currently no way of knowing how the economic share of business groups changed as a result of restructuring.

<Table 1> Business Groups as a Percentage of the National Economy (2010)

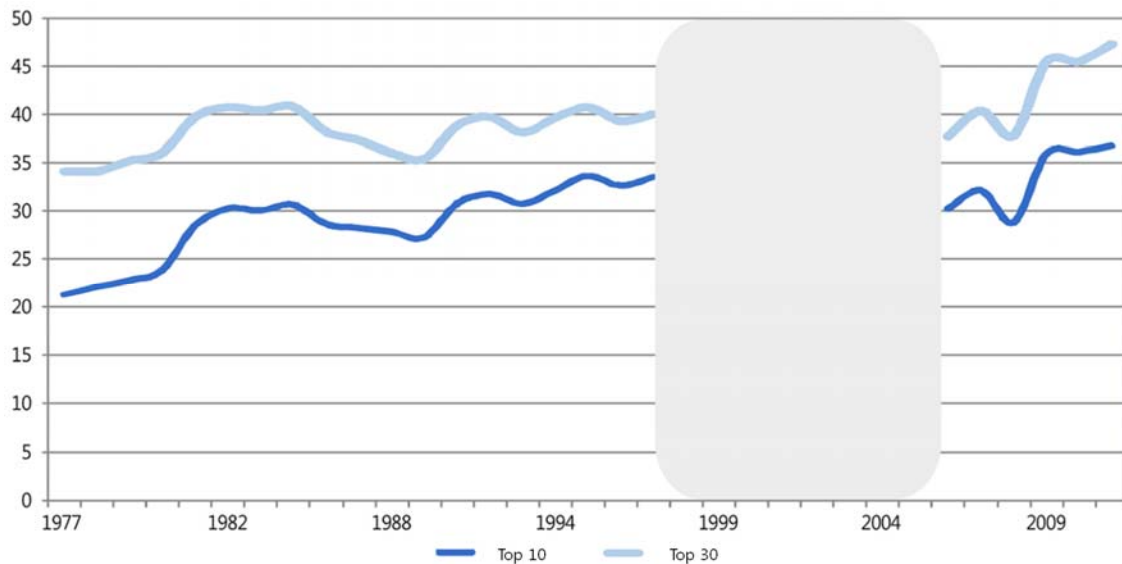
(Unit: %)

Rank	Sales			Workforce		
	All industries	Manufacturing	Services	All industries	Manufacturing	Services
Top 5	11.3	19.0	7.3	2.9	8.4	1.6
Top 10	18.8	36.1	9.9	4.7	13.7	2.5
Top 30	26.1	45.5	16.1	6.7	16.2	4.4
Top 55	29.1	49.9	18.4	8.0	18.7	5.5

Note: Data represents share for business groups out of all businesses with at least one employee.

[Figure 1] Manufacturing Share of Top Thirty Business Groups (1977~2011)

(Unit: %)



Note: To maintain statistical consistency with other years, the share for 2010 was calculated only for businesses with 10 or more employees.

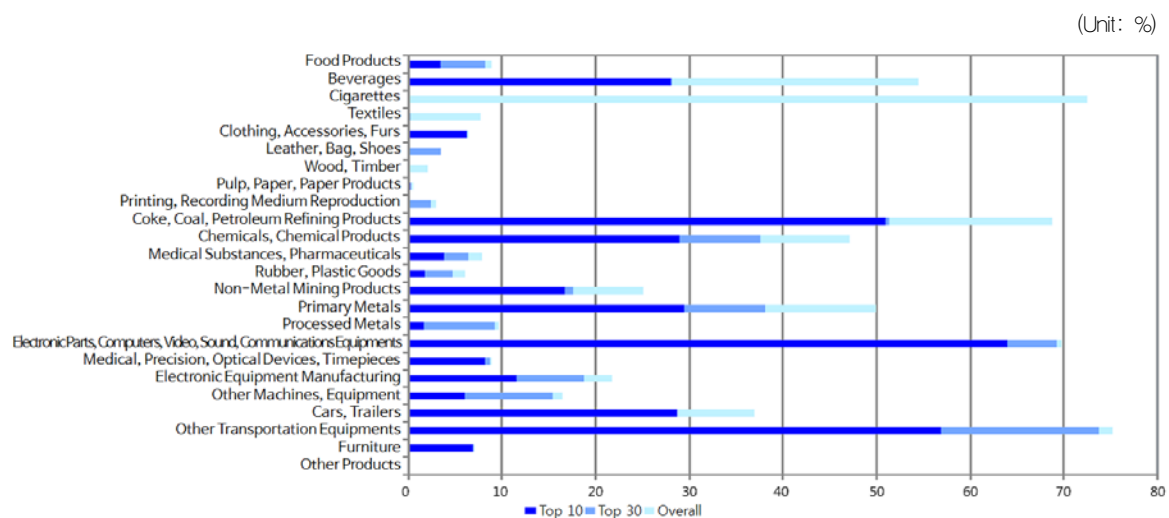
The business group restructuring process was a tumultuous period that saw many groups driven out of the market, as well new groups coming in. It is interesting to note, then, that the economic share of the top-ranking groups did not diverge much from past trends. The share of the top 30 business groups after 2006 differed little from its level in the mid-1990s. By 2009, however, it began to rise sharply to pass 45 percent. This change may be attributable to an economic trend since the late 2000s of rapid growth for a select few large corporations in mainstay industries like semiconductors, mobile phones, and automobiles, amid a general drop-off in growth for other businesses.

### C. Mainstay Industry Areas for Business Groups

Manufacturing industries where business groups hold a large share include beverages (54.5 percent); cigarettes (72.4 percent); coke/coal/petroleum refining products (68.7 percent); chemicals and chemical products (47.1 percent); primary metals (49.9 percent); electronic parts, computers, and video/sound/communications equipment (69.6 percent); cars and trailers (36.9 percent); and other transportation equipment (75.2 percent). Most of these are considered mainstay industries for Korea. Business groups typically account for a large share of these industries, compared to a relatively small share for smaller-scale industries (see Figure 2).

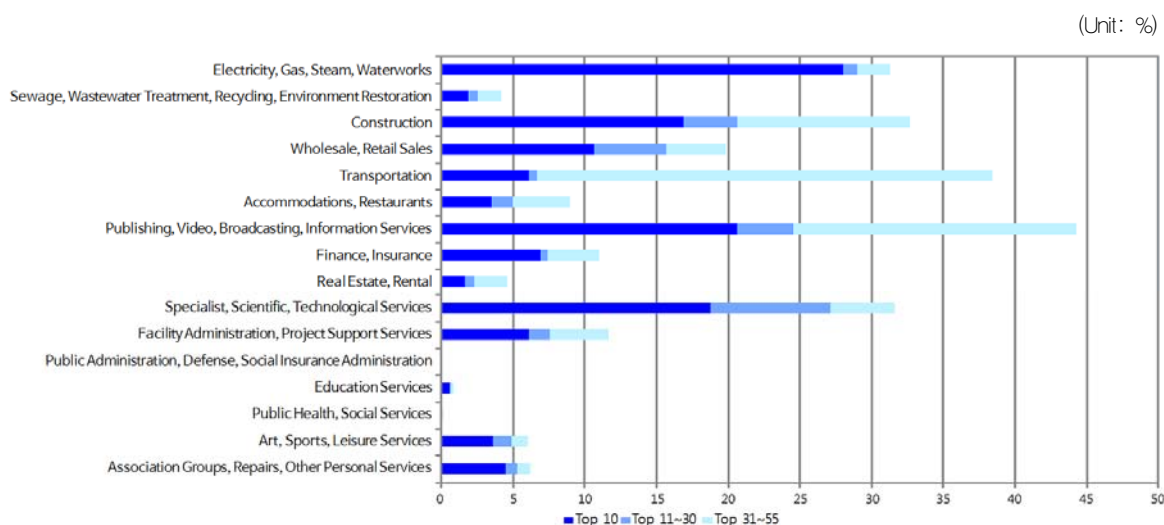
The reasons for the low percentage of business groups in the service sector are threefold: ① the presence of industries that are effectively closed off to them, such as banking; ② the large share associated with the public sector, including public administration, public health, and social services; and ③ the practical difficulties of corporate operation in areas intrinsically more suited to small-scale operators, such as restaurants/accommodations, wholesale/retail sales, and personal services. In a number of cases, service sector areas are completely inaccessible to large corporations (see Figure 3).

[Figure 2] Share of Business Groups in Subcategorized Industries, Manufacturing Sector





[Figure 3] Share of Business Groups in General Industries, Services Sector



#### D. Market Position for Business Groups

Business groups have ventured into various industries, in many cases establishing a monopoly or oligopoly there. For industries where large business groups were represented among the top three ranking companies, the average concentration rate for those three companies (CR<sub>3</sub>) was 51.8 percent compared to 43.7 percent for industries where they were not represented. In other words, market concentration was higher in industries where large business groups held more of a monopoly or oligopoly (see Table 2).

Business groups were present in 626 of the 1,131 total industries in Korea for 2010 (including all subdivisions), or 55.3 percent. In numerical terms, a business group affiliate held the top market share in 23.7 percent of all industries. These industries,

<Table 2> Market Position for Business Groups: Percentage for Participating Industry Types (2010)

(Unit: %)

Business group market position		1 <sup>st</sup>	2 <sup>nd</sup> or 3 <sup>rd</sup>	Other	Total
All industry	No. of industries	23.7	31.7	44.7	100.0
	Sales	48.5	31.1	20.3	100.0
Manufacturing	No. of industries	24.2	20.1	55.7	100.0
	Shipments	69.6	17.5	13.0	100.0
Services	No. of industries	23.6	38.6	37.9	100.0
	Sales	39.3	37.0	23.6	100.0

however, accounted for fully 48.5 percent of all industry sales. Put differently, the industries where business groups held the top market share tended to be relatively large in scale—a phenomenon that was especially noticeable in manufacturing.

## E. Business Group Diversification

Business groups include a number of affiliates, which are the actual entities that enter different industries. The issue of diversification by business groups—the so-called “octopus business approach”—has long been the subject of negative opinion in Korea. Because of the different motives for business group diversification, this negative view may not be necessary per se. Instead, it seems better to evaluate the system on a case-by-case basis, taking into account the different economic and social effects of each instance.

〈Table 3〉 shows the current diversification of business groups in terms of ranking. Generally, diversification is found to be more widespread the higher-ranked a business is. The top five business groups are participating in an average of 88 industries each, a number that declines the further one goes down the rankings. Differences in main industry specialization by business group scale were not found to be large.

〈Table 3〉 Business Group Diversification (2010)

	Avg. no. of participating industries (all industries)	Avg. no. of participating areas (mining and manufacturing)	Avg. main industry specialization <sup>1)</sup> (%)
1 <sup>st</sup> ~5 <sup>th</sup>	88.0	59.3	66.0
6 <sup>th</sup> ~10 <sup>th</sup>	80.0	87.8	56.6
11 <sup>th</sup> ~15 <sup>th</sup>	78.4	21.0	48.5
16 <sup>th</sup> ~20 <sup>th</sup>	29.6	11.0	58.7
21 <sup>st</sup> ~25 <sup>th</sup>	49.2	23.4	66.8
26 <sup>th</sup> ~30 <sup>th</sup>	31.2	10.0	61.2
31 <sup>st</sup> ~55 <sup>th</sup>	29.9	16.1	62.2

Note: 1) Indicates share of main industry (subcategory) out of all business group sales.

## 4. Summary and Conclusion

This paper presented a statistical analysis of the share of business groups in the Korean economy, their dominance in individual industries and markets, and their current diversification.

As of 2010, the 55 business groups accounted for 29.1 percent of all sales in the national economy, with especially large representation in manufacturing. Observation of long-term trends regarding change in the share of the top 30 business groups in that sector showed no major shifts despite the intensive restructuring of those groups at the time of the foreign exchange crisis in the late 1990s. Their share was also seen to enter a sudden increase in the late 2000s. This phenomenon appeared to be attributable to recent strong growth for a select few very large companies in a small number of leading industry areas, amid an overall drop-off in growth for the national economy as a whole.

Business groups were found to account for a large share of the economy, and to be present in a wide variety of areas. At the same time, the number of industries where these groups were present does not appear particularly large when the groups' share of the overall economy is taken into account. Business groups were found to be particularly concentrated in large-scale industries, and to occupy an overwhelming market position in the industries where they were present.

It is impossible to draw any general conclusions regarding how the position of business groups will impact the national economy. However, as the country pursues development under the "Korean market economy model", careful consideration should be extended to the future economic impact of the concentration of economic power with business groups, or the potential thereof. It is hoped that the findings of this study can serve as basic data in that debate.