



---

## Investment Insights

# Korea's changing corporate landscape - leading to a healthier market

May 2016

The Korean corporate landscape is gradually changing, with the emergence of more independent businesses, on the back of the diminishing importance of the 'chaebols'. In our view, this is an important development for the Korean economy and market. The pace of change will not be overnight, but we are confident Korea is on the right course to a healthier market.

---

### What are 'chaebols'?

'Chaebols' means 'business family' or 'monopoly' in Korean. The chaebol structure can be a single large company or several groups of companies that are owned, controlled or managed by the same family dynasty - generally being the group's founder. Chaebols have been the backbone of Korea's economy and their combined share in the economy is substantial. Today, Korea is largely driven by a few chaebols, of which the two giants, Samsung Group and HMC/KIA Motor Group, make up 30% -40% of Korea's GDP. In fact, in 2011, the five largest chaebols made up more than 55% of South Korea's GDP, while the top 20 accounted for an astonishing 85%<sup>1</sup>.

---

### Fundamentals and issues of chaebols

Many of the chaebols tend to have complicated 'cross-shareholding' structures, which often times lead to business areas being overly diversified in terms of scale and business fields, resulting in less efficient and unprofitable businesses. Samsung Group, as an example, is comprised of 74 domestic affiliates, where 17 are listed and 57 are unlisted. Samsung Electronics' consolidated subsidiaries totaled 153<sup>2</sup>. Also, chaebols tend to have less awareness of shareholder interests and lack business transparency, given the controlling shareholder often has an excessive amount of control over the firm. Furthermore, due to the size of the empires, management and labor costs are normally high, with inefficient resource allocation stemming from the bureaucratic structure of the group. For example, the four big chaebols' labor cost per person (in KRW) was 95.1m, compared to independent businesses, such as Amorepacific and Hanmi Pharmaceuticals, which had labor costs of around 71.6m and 46.3m, respectively<sup>3</sup>. In addition, the debt ratio for the four big chaebols was 60.8%, while Amorepacific had a debt ratio of only 31.1%<sup>3</sup>.

---

### Emergence of independent businesses

As earnings for chaebols have been affected more by slower global growth, what has been supporting overall earnings in Korea in recent years have been the more independent-minded companies. In fact, chaebol's dominance is gradually shrinking as the economy shifts to a more innovative economy, powered by independent companies that focus on their core businesses. Amorepacific, Hanmi Pharmaceuticals, and many food companies focus on domestic demand. We believe these companies will continue to gain ground in Korea, playing a larger role in the economy and market, which will be positive for the sustainability of growth in Korea, given their greater focus on profitability and corporate governance compared to most chaebols. The big four chaebols historically had operating margins of ~7.7%, compared to Amorepacific's operating margin of 13.0%<sup>3</sup>.

---

### Implications for bottom-up investors

In our view, Korea's economic future is more dependent on the success of independent firms, rather than the chaebols. The strong growth provided by independent companies is gradually helping to reduce the discount placed on the overall Korean equity market by the long-standing dominance of Korea's chaebols. We expect the higher ROE and healthier balance sheet these businesses have to offer will be positive for Korean equities. This should also help lift foreign investor confidence as Korea's corporate landscape changes with the diminishing importance of chaebols. Against this backdrop, as bottom-up active investors, our strategy remains unchanged in that we continue to target core quality companies with a sustainable business models, free cash flow generation, market leadership, a competitive edge, branding power, quality management and industry growth.

Companies mentioned in this page do not represent Invesco's recommendation or holding.

<sup>1</sup> Source: Globe and Mail, 24 Apr 2015

<sup>2</sup> Based on Q1 2014 Samsung Group Business Report

<sup>3</sup> Big four chaebols include Samsung Group, Hyundai Motor Group, SK Group and LG Group. Source: ERFI (Economic Reform Research Institute), data based on 2011-2013 averages.

## Important information

This document has been prepared only for those persons to whom Invesco has provided it. This document is not an offering of a financial product and is not intended for and should not be distributed to, or relied upon, by members of the public. Circulation, disclosure, or dissemination of all or any part of this document to any person without the consent of Invesco is prohibited.

This document may contain statements that are not purely historical in nature but are “forward-looking statements,” which are based on certain assumptions of future events. Forward-looking statements are based on information available on the date hereof, and Invesco does not assume any duty to update any forward-looking statement. Actual events may differ from those assumed. There can be no assurance that forward-looking statements, including any projected returns, will materialize or that actual market conditions and/or performance results will not be materially different or worse than those presented.

The information in this document has been prepared without taking into account any investor’s investment objectives, financial situation or particular needs. Before acting on the information the investor should consider its appropriateness having regard to their investment objectives, financial situation and needs.

### **You should note that this information:**

- may contain references to amounts which are not in local currencies;
- may contain financial information which is not prepared in accordance with the laws or practices of your country of residence;
- may not address risks associated with investment in foreign currency denominated investments; and
- does not address local tax issues.

All material presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. Investment involves risk. Please review all financial material carefully before investing. The opinions expressed are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals.

The distribution and offering of this document in certain jurisdictions may be restricted by law. Persons into whose possession this marketing material may come are required to inform themselves about and to comply with any relevant restrictions. This does not constitute an offer or solicitation by anyone in any jurisdiction in which such an offer is not authorised or to any person to whom it is unlawful to make such an offer or solicitation.