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Korea Inc. struggling to restore reputation

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SEOUL A year after Chey Tae Won, the chairman of the South Korean oil refiner SK Corp., staved off an acrimonious challenge to his board seat from a disgruntled foreign investor, the company's shareholder meetings are harmonious and self-congratulatory affairs.

The only murmur of dissent amid a chorus of praise for management at SK's annual general meeting on March 10 came from a lone shareholder, who had traveled from the countryside to ask why SK's share price was not higher.

At 72,800 won, or $76.95, on Thursday, SK's share price has improved in the past month, but the stock is still trading at about half the South Korean market's average of about 11 times earnings per share.

The scene was vastly different at the annual meeting a year ago. Chey, convicted of fraud by a South Korean court in 2003, won another three-year term as chairman of SK. But it came only after a bitter fight with the company's then-largest shareholder, Sovereign Asset Management, which is based in Monaco, to remove him and his allies on the board because of Chey's criminal record.

Chey, who served a brief prison sentence before being released on bail, was re-elected, but 40 percent of shareholders at the meeting voted against him.

SK, once a symbol of all that was wrong with corporate Korea, is nowadays more often cited as evidence of the capacity for the country's big family-owned conglomerates, or chaebol, to reform in the face of institutional corruption.

One of SK's proudest boasts is the quality of its governance reforms. The Korea Corporate Governance Service, an agency set up by securities-related organizations, listed SK as one of its top 10 corporate governance performers in 2005.

"I give high marks to SK right now," said Kim Joongi, executive director of the Hills Governance Center and an associate professor of law at Yonsei University. "I think they have made a dramatic turnaround. I think everybody is happy right now. Controlling shareholders are happy, Korean institutional investors are happy and foreign investors are happy. That is the bottom line."

As the South Korean economy has increasingly opened to foreign investors, and the government strives to reform the chaebol, corporate Korea has been under immense pressure to improve its internal governance.

Just as in public institutions, good governance in the corporate sector is seen as an antidote to the corruption and malpractice that helped trigger the 1997 economic crisis that brought down half of the 30 biggest chaebols.

Since then, successive governments have introduced a raft of reforms to enhance and protect the integrity of company audits, increase scrutiny of management decision-making, particularly over intra-conglomerate transactions, reduce the powers of controlling shareholders and protect the rights of minority shareholders.

But how many of these reforms, at SK and elsewhere in South Korea, are cosmetic and how many are real is open to question. Surveys of the perceptions of experts, like securities analysts,

accountants and financial supervisory body officials, confirm widespread suspicions that management and boards often embrace the letter of legal reforms intended to increase transparency and accountability but neglect the spirit.

"There is a sentiment that this is a Western invention imposed upon Korea," said Kim, the law professor. "There are questions that it is too shareholder- oriented, that it is too short-term-focused and that it is not compatible with Korean or Asian governance practices."

One survey by the Korea Corporate Governance Service showed that 43.7 percent of respondents in 2005 thought that chaebol owners still effectively appointed outside board members, despite the existence of supposedly independent nomination committees. The perceived independence of outside board members was low to start with when the survey was first carried out in 2003 and has since deteriorated.

Other recent perception surveys give corporate Korea credit for improving governance standards. But an annual report released last November by CLSA Asia Pacific Markets and the Asian Corporate Governance Association noted that South Korea had slipped to 6th place in the 10 countries assessed, behind Taiwan, although it saw some signs of an "ongoing improvement in the governance environment in Korea."

The report was critical of a lack of regulatory consistency and it also noted that many companies engage in "box- checking" that did not "reflect a genuine change of mind-set towards the spirit of corporate governance."

To some, SK Corp. typifies that problem. Chey has claimed in corporate governance blueprints that SK has been able "to pioneer corporate governance policies and procedures that are unprecedented in Korea."

The list of governance reforms at SK include the appointment of a majority of independent directors to the board, nominated by outside advisers, an audit committee comprising only independent directors and a "transparent management committee" to review transactions with affiliated companies.

But it retains a chairman who was convicted for his part in a 1.55 trillion won fraud at the company's trading affiliate SK Global, now named SK Networks. In one of the anomalies of corporate governance regulation in Korea, no one convicted of a criminal offense can run for election as an outside director, but that restraint does not apply to executive directors.

Jamie Allen, secretary general of the Asian Corporate Governance Association, said the sincerity of SK's efforts to improve governance would remain in question as long as Chey remained chairman.

"The chairman who was convicted of fraud is still the chairman," Allen said, "and I do believe that in most organizations that the guy at the top sets the tone."

Allen added that as long as Chey stayed, it was "very doubtful that real change is occurring in SK."

South Korean companies usually trade at a discount compared with companies in other markets, a gap that is largely attributed to weaknesses of corporate governance. The average price to earnings ratio on South Korea's share market is 11.3, compared with 14.2 in Taiwan and 13.2 in Hong Kong. Analysts largely attribute the weakness in the share price of SK to its previous governance problems.

But the "Korea discount" has been narrowing because of the flood of investment into equity markets. Allen said he feared that stronger regional share markets, and more risk taking by investors on companies with poorer governance standards, would ease the pressure for reform in South Korea and elsewhere in Asia.

"We have noticed a definite lessening of the pressure for corporate governance because of the booming market," he said. "Politicians and companies think that 'our share price is doing well, the market has boomed, therefore we are not under as much corporate governance pressure.'"

To those who were close to the effort to remove Chey, the tactics used in his defense by SK Corp. also add to doubts over whether the progress in restructuring the company's mechanisms of governance reflects a real change of mind-set or whether the company might slip back into bad habits.

During the height of the conflict over Chey's leadership, advisers to Sovereign say major daily newspapers refused to publish a series of open-letter advertisements to SK shareholders because SK Corp. had pledged to buy up any space Sovereign tried to purchase.

When Sovereign wanted to have an open letter to the board published after Chey's re-election, one newspaper replied that the ad would only appear if the text was softened, according to these advisers.

"Basically, the paper was conveying the message that SK says, 'This is no good, you have to dilute it,'" said Kim Young Joon, a lawyer who represented Sovereign.

Katharine Junghae Kho, a spokeswoman for SK, said in a written response to questions that Sovereign's assertions about SK's actions during the contest over the board positions "are not true.'

But problems over advertising were not Sovereign's only worries. Sovereign found it extremely difficult to find candidates to run in elections for six board vacancies during the same annual meeting in which it tried to remove Chey last year. Kim said he approached some 50 people, "a who's who of Korean society," but could find only 5 who were willing to run.

"We couldn't find the sixth person," he said, although a large number privately expressed support for Sovereign's cause. "One of the biggest impediments to improving governance is the willingness to stand up and be counted."

One of those who did stand up was Kim Joongi, the law professor. He was one of the five to agree to seek election as an independent director. But Kim said he had come under stressful lobbying to pull out from a variety of people, some of whom were personal friends of Chey.

"Their entire network was definitely activated and utilized," Kim said. "None of the major law firms, accounting firms or advertising firms would touch Sovereign."

Kho, the SK spokeswoman, said the process for electing board members had been fair.

"The opponents did not succeed in persuading the majority of investors that change was in their best interests," she said. "And they did not succeed in persuading some potential candidates to compete for a place on SK Corp.'s board."

Indeed, Kim, the professor, does give SK credit for the reforms it has made. The quality of governance in the company has changed "from night to day," he said.

But he added: "Once the spotlight is off, will they revert to things that they shouldn't be doing? That is the big question mark."

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