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The impact of family ownership and capital structures on productivity performance of Korean manufacturing firms: Corporate governance and the "*chaebol* problem"

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This paper examines the relationship between corporate governance and productivity performance, focusing on family ownership and capital structure. Paying particular attention to *chaebols*, or large business groups with entrenched family control, diversified business structure, and heavy debt-dependence, we find the positive relationship between family ownership concentration and productivity performance to be much stronger in *chaebol* firms than in non-*chaebol* firms. Moreover, high debt reliance (or low equity–asset ratio) is shown to be negatively related to productivity performance in non-*chaebol* firms but positively in *chaebol* firms. *J. Japanese Int. Economies* **20** (2) (2006) 209–233. Graduate School of International Studies (GSIS), Yonsei University, 134 Shinchon-dong, Seodaemoon-ku,Seoul, 120-749, South Korea.

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1. Introduction

Since the Asian financial crisis of 1997, the issue of corporate governance has become a subject of active policy and academic debate. Many have pointed out the deficiencies in the corporate governance systems plaguing many of the crisis-stricken countries as the root cause of weakened fundamentals and poor economic performance. However, direct evidence on the effects of different governance systems on corporate performance and competitiveness is still sparse. This paper provides empirical evidence on the link between corporate governance and corporate performance.

"Corporate governance" has many different meanings. According to Shleifer and Vishny (1997), corporate governance defines the ways in which the supplier of finance to corporations is assured of getting a return on their investment in a firm. A firm includes management, capital suppliers (including debt holders, equity holders, and their representatives—i.e., boards of directors), and other stakeholders such as employees. By defining the firm's rules, incentives, and goals, these parties affect the mechanisms by which capital and resources are allocated, profits are distributed, and performance is monitored. While a number of different dimensions of corporate governance structure can be identified for the purpose of understanding their impact on firm performance, this paper emphasizes two key aspects: family ownership concentration and capital structure.[1]

There are several ways in which this study contributes to the existing literature on the relationship between corporate governance and firm performance. First, this paper focuses on the impact of governance systems on firm's productivity, rather than on firm value or profitability as typically found in other studies.[2] A firm's productivity performance can be considered a more telling indicator of efficient investment by various stakeholders of the firm and its potential for long-term growth.[3] That is, productivity is a more fundamental measure, which is what, in part, *determines* profitability. In an era of global competition where technological superiority determines the competitiveness of firms and industries, it is of critical importance to understand the ways in which different systems of corporate governance affect innovative activities and entrepreneurship of corporations.

Second, in assessing the relationship between governance variables and corporate performance, this paper pays particular attention to *chaebols*, which are family-controlled, debt-dependent, diversified business groups that dominate the Korean economy. We hypothesize that these characteristics of *chaebol* firms critically influence the way in which family ownership and capital structure impact upon corporate performance. In particular,

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1 Mayer (1996), Collin and Myers (1998), Collin and Myers (1998), and Maher and Anderson (1999) emphasize ownership and financial structures as critical elements that define a firm's corporate governance structure.

2 There are several previous studies of Korea that are related to this issue. For example, Chang and Choi (1988) focus on the impact of transaction costs on firm performance and Chang and Hong (2000) focus on performance consequences of resource sharing among group affiliated firms. Joh (2000) examines the relationship between firm profitability and corporate governance.

3 There is a strong theoretical presumption in both traditional and new growth theories that the main engine of sustained long-run economic growth is productivity growth. The new endogenous growth theories in particular show a number of different ways in which productivity advances can occur: learning by doing, human capital accumulation, and R & D. If the corporate governance system affects any of these mechanisms, it would be an important factor in determining the rate of technological progress (see Section 2).