B. Business Diversification and Profitability Structure of Korean Banks

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1. Introduction

The entire worldwide banking industry is undergoing an unprecedented change. Leading financial institutions are focusing more heavily on the needs of the customer in order to remain competitive. Korean banks are no exception. Since the financial crisis of late-1997, most Korean banks have adopted international best practices in upgrading their operational systems. As to how successful they have been thereto may be subject to some debate, and they have yet to completely establish a corporate culture of value-based management where vision, strategy, and execution are all in congruity.

In this article, we will discuss some of the paths that Korean banks must take in order to ensure their own sustainable growth. More specifically, we will make some suggestions as to how new business portfolios can be established and profitability can be increased by focusing on core competencies.

2. Assessment

In 2011, the total volume of assets held by Korean banks was over KRW1,967 trillion, having doubled since 2001. This implies that there has been huge inflows of funds into the banking industry over the last decade. However, there is no reason to believe that the asset growth will be nearly as high. In fact, banks had to be satisfied with low single digit growth rate for the last three years. The government’s regulatory efforts to establish a “market-based financial system” have already discouraged more funds from coming into the banking sector, thereby lowering the asset growth rate. In addition, the banks themselves are not capable of...
The profitability trend of Korean banks in recent years shows that the net income greatly depends on the one-time realization of non-current revenues rather than on the earnings from the recurring business activities. Because of the lack of risk management expertise, the rise in assets causes the profitability of banks to deteriorate as a result of adverse selection.

There are several reasons why the Korean banking industry has not yet embraced value-based management. First, a chart-driven organizational structure, rather than a functional one, creates conflicts of interest among business units, thereby discouraging both management and employees from transforming their business processes. Internal skill levels are still so low that banks cannot easily provide high-quality products and services to customers. Most of the experts who have been hired from outside have failed to adapt to their new organizational environments. Even if top executives recognize the necessity for change, they cannot see their vision through to fruition in the construction of business portfolios because their tenures are relatively short. Some management teams still focus on asset growth rather than profitability. In an environment of “financial convergence,” most Korean banks have neither established value-chain networks nor actively outsourced services outside of their core competencies.

3. Searching for a New Business Model

The balance sheet growth of banks will reach the stage of maturity in the near future, so banks must find another engine of sustainable growth. As Jensen and Murphy (1990) pointed out, it would not be easy for banks to widen the net interest margin or fees they charge to customers by virtue of the fact that banking is a regulated business. This is also why we should search for other sources of profit for Korean banks. The new business strategy is for banks to enter into new financial services based on their value chains. We suggest that...