The Influence of State Ownership on the Economic Performance of Korean Public Companies

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Abstract: The property rights and agency cost theory of enterprises suggests that public ownership should perform less efficiently and profitably than private ownership. However, the existing empirical evidence provides weak support for this hypothesis. Numerous studies of Western capital markets and Chinese state enterprises have examined the relationship between ownership structure and performance. Agency theory suggests that when owners do not manage a firm themselves, a conflict of interest arises between the owners (principals) and managers (agents). Researchers have argued that government ownership is inferior to private ownership in competitive markets because it prioritizes social and political goals over value maximization, hiring decisions are often based on political influence rather than ability, and higher transaction costs are involved.

This study investigated the influence of two factors, listing on the Korea Exchange and degree of state ownership, on performance using annual data for 51 companies in Korea for 1999-2009. We found that, on average, performance (measured by productivity, profitability, and efficiency) was positively influenced by public listing and negatively influenced by the degree of state ownership.

Keywords: state-owned enterprise, performance, ownership, privatization

INTRODUCTION

No matter how a state-owned enterprise (SOE) is defined, we know what it is. It might not be necessary to emphasize the importance of SOEs in an economy, as these

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companies—such as Korea Electric Power Corporation (KEPCO), Korea Land Housing Corporation, Incheon International Airport Corporation, and Korea Water Resources Corporation—have clearly played vital roles. The proportion of SOEs in an economy is often estimated as the budget ratio of SOEs to government, the ratio of value-added to GDP, or SOE employment as a proportion of the total working-age population.

According to Yoon (1998), an SOE, like other companies, produces and sells goods and services in a market under the government’s control as an owner. The comparison of these companies in different countries is somewhat difficult, because there are no absolute criteria for SOE status in terms of ownership structure, assets, or employment. To address this, international organizations such as the Organization for Economic Co-operation and Development (OECD) have tried to collect data on the economic value of SOEs.

Privatization of SOEs is another broad issue. There has been great controversy about the role of an SOE. Some have argued that the problem of market failure should be addressed in SOEs, taking their inefficient management into consideration. Others have argued that SOEs should be privatized and the issue of market failure should be solved by regulations, taxation, or subsidies. Still others, while not calling for 100 percent privatization, have argued that SOEs should reveal the extent of government subsidization in order to ensure fair competition and transparency, and that governance should be improved.

Without substantive verification, hypotheses of privatization remain theoretical. The theoretical conflict about privatization calls sufficient empirical evidence. The impacts of privatization of SOEs appear to be diverse, as no one theory or hypothesis explains all of them. It is generally accepted that an SOE has not only a market-related but also a social purpose. However, whether the inefficiency brought by market failure outweighs the problem of accountability and transparency of state ownership (so-called government failure) is not a theoretical but an empirical problem. Abusive insider transactions are frequently reported as one of the most serious breaches of good corporate governance around the world. Such transactions are used by controlling shareholders or other company insiders as a mechanism for extracting private benefits at the cost of other shareholders. To this end, the OECD principles recommend full disclosure of insider transactions whether or not they have been executed at arm’s length principle. It is difficult to identify when parties to a transaction are effectively related when both are controlled by the state. This is particularly the case in countries where state ownership is pervasive, such as China.

The Korean government has planned and implemented privatization programs several times since the 1980s in order to bring more competition and transparency to SOEs. In 1997, the government enacted the Law on Structural Improvement in