Case study

Political and economic processes in the privatization of the Korea telecommunications industry: A case study of Korea Telecom, 1987–2003

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Abstract

The Korean government completed its privatization of Korea Telecom (KT) in May 2002. Privatization was undertaken at a gradual pace at first mainly because the Korean government did not want to hand over its managerial power to the privatized telecommunications service company, although it announced its plan in 1987. However, the inauguration of the World Trade Organization (WTO) system and the Korean economic crisis of 1997 forced the government to accelerate its full privatization plan. During this process, several main players such as the Korean government, transnational corporations, international organizations, and large domestic conglomerates played important roles. The full privatization of KT is the result of the political, social, and economic demands of these players.

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Keywords: Korea; Korea Telecom (KT); Chaebol; Privatization; SK Telecom

1. Introduction

Korea Telecom, the Korean government owned telecommunications service industry, was privatized in May 2002. The Korean government sold off its remaining 28.36% stake in Korea Telecom (KT) at that time, putting the final touches on the privatization of the telecommunications giant. The Korean government was able to complete the privatization of KT about 15 years after it first announced the plan in 1987 because privatization was not undertaken in a once-and-for-all manner, but at a gradual pace.

The Korean government initiated the privatization as well as the liberalization of the telecommunications industry because of pressures from both national and international players in the late 1980s. There has been an increasing demand for participation in the Korean telecommunications industry. The pressure for the privatization of KT first came from foreign players, in particular the US government, and thereafter, international organizations such as the World Trade Organization (WTO) and the International Monetary Fund (IMF), as well as transnational corporations (TNCs). The Korean conglomerates (chaebol), as main
users and equipment manufacturers, have also pressed hard to enter the diverse telecommunications services sectors, including the local phone carrier service.

These domestic and international bodies eagerly wished to participate in the privatization of KT because telecommunications had become a core industry as well as a very lucrative business in Korea. In fact, telecommunications became a crucial part of the country’s infrastructure as well as a necessary ingredient for the information society elsewhere. In the new global economy focusing on information technology, the Korean government and business have developed telecommunications as the country’s new strategic industry to replace falling demand for steel and automobiles, so foreign players and domestic-based transnational capital had been planning to be part of a privatized KT since the late 1980s (McClelland, Weiss, & Sujarto, 1997).

This paper provides an examination of the privatization of KT between 1987 and 2003. It constitutes a study of the history and process of telecommunication privatization in Korea, which led to significant change in the ownership structure of KT and Korea’s first public share offering among major public enterprises. This paper investigates the main role of the Korean government in privatization by examining how the government formulated its telecommunications policy. In particular, it discusses the impact of the privatization of KT on a three-way competition policy; the government has long espoused a telecom structure in which KT, SK Telecom and a third force led by LG Telecom compete with each other. It also examines the involvement of domestic and foreign capital as well as international organizations in the telecommunications industry to ascertain their roles and impacts on the privatization of KT. The paper employs a historical approach, with a focus on economic and policy dimensions, which is particularly useful for ferreting out the causes behind the changing process of the KT privatization because it provides a tool for explaining structural change and continuity in the telecommunications industry.

2. Stakeholders in the Korean telecom privatization

The privatization of KT entailed active interaction among several main stakeholders, including the Korean government, domestic capital (chaebol), and foreign players such as the US government, international organizations, and transnational capital. These major stakeholders had different interests and needs with regard to the privatization of KT. Transnational telecommunication companies were interested in entering the local phone market and in making a profit. The chaebol planned to enter the telecommunication business to increase their values, including profits, revenues, and image, as well as to reduce their operating costs. Telecommunication policy makers in Korea have had to respond to this variety of different interests over the last 15 years. For better understanding of the privatization of KT, therefore, it is essential to more closely examine the main stakeholders and their roles in the process of the privatization of KT.

2.1. The Korean government

The Korean government, as one of the most important players in privatization because of its legal power and its ownership of KT, has played a key role in privatization. The government directly or indirectly controlled the process of privatization, including its method of selling the government’s share of KT, the price of its shares and timing, investment limitations for both domestic and foreign investors, and other aspects of the Korean telecommunications industry. While pushing the telecom market toward privatization, however, the government wanted to preserve its main role as the regulatory agency over KT because the government needed KT as a vehicle for implementing important telecom policies, including universal services (Choi, 1999). The government also feared that the domestic industry would be wiped out and communications networks would be taken over by foreigners to the detriment of their national sovereignty, if domestic service suppliers had to compete with foreign entities that had advanced technology (Choi, 1997). Moreover, national security considerations were another element impinging on the privatization process in Korea. Security, public confidence, and unity were seen as basic needs of the country, and the division of the nation into North and South Korea had accentuated such concerns at least until the early 1990s (Larson, 1994). This government approach resulted in a lack of progress in the privatization of KT until the mid-1990s.
The role of the Korean government, however, has changed since it embraced the global trend of competition, deregulation, liberalization, and privatization as a matter of principle. In particular, the government has rapidly expedited the privatization of KT beginning in the mid-1990s with initiation of the Segyehwa (globalization) of Korea. In late 1994, the Kim Young-Sam government (1993–1997) adopted the Segyehwa of Korea as its main political goal after Kim attended the Asia-Pacific Economic Cooperation (APEC) Summit in Sydney, Australia, in 1994 (Oh, 1995). The purpose of the Segyehwa was to encourage Korea to open up trade, adopt a more outward-looking approach in its foreign policy, and secure Korea an international role commensurate with its growing economic status (McClelland et al., 1997). The Kim government had pushed privatization of government-owned public enterprise, including KT, as well as financial liberalization, as part of the Segyehwa policy. In accordance with the Segyehwa of Korea, the inauguration of the WTO system in 1995 also drove the Korean government to promote the rapid privatization of KT. Indeed, the pace of privatization has been accelerated because the government made market access commitments, under the auspices of the WTO, which relaxed or eliminated bars to foreign ownership in telecommunications.

2.2. Conglomerates

Chaebol became increasingly interested in entering the telecommunications industry as suppliers, business users, and equipment manufacturers. Almost all chaebol started to review their master plans to enter the telecom service market beginning in the early 1980s. Chaebol, as business users whose daily economic operations were ever-increasingly information dependent, needed to enter the telecom industry as business dependence on telecommunications had deepened. Telecommunications constituted a considerable operating cost for them. For example, Samsung Electronics (2001), one of the largest companies in the Samsung Group, paid system-wide telephone bills of $28 million in 2001, a 14.6% increase over the previous year. Hyundai Motor Company (2001), the holding company in the Hyundai Group, also spent $28 million on telecommunications in 2000. As Dan Schiller points out (Schiller, 1982), business users in Korea wanted to participate in and have an influence on crucial telecommunications regulatory decisions to reduce their operating costs. Mueller (1996) also argued, “the existence of large users with their own distance communications needs and information equipment put pressure on regulators to open up the telecommunications marketplace.”

As telecommunications equipment manufacturers, chaebol also wanted to participate in the telecommunications service market. A foothold was gained by the four top chaebol: Hyundai, Samsung, LG, and Daewoo, when they started to produce the time division exchange (TDX) system in the early 1980s as a result of the government-induced joint public–private research consortium. The TDX was a crucial technology for putting the telephone network in place, because the development of TDX required a high level of sophistication in the related fields of semiconductors, computer software, and electronics (Larson, 1994). Under the government initiative to develop TDX with its investment of $40 million, top conglomerates were deeply involved in the project in the 1980s. This resulted in considerable economic benefits for domestic markets. In economic terms, these conglomerates not only saved Korea the cost of importing switching systems from such industry giants as AT&T, but their inventions also gave the country’s industry the capability of exporting the underlying technology. Korea’s four main telecom equipment producers controlled about 70% of the domestic market for switching equipment in 1997. (McClelland et al., 1997). Several chaebol, which had already entered the mobile phone and international phone service market as main users and equipment manufacturers in the early 1990s, believed that the privatization of KT gave them a great opportunity to invest in a lucrative local phone service business, because KT was a monopoly fixed-line local telephone service carrier until the second local phone company, Hanaro Telecom, became a player in 1999.

2.3. Foreign players

Foreign players such as the US government, TNCs, and international organizations had significant roles in the privatization of KT. It was mainly foreign pressures that set the KT market on the journey to a series of reforms, including privatization. The most notable demand was identified with foreign value-added service
(VAS) suppliers, international organizations such as the WTO and IMF, and transnational telecommunications companies. Among these, the major driving force for opening the Korean telecommunications market and privatizing KT was the US government. The US government had a disproportionately heavy influence on telecommunications reform in Korea because Korea was such a lucrative market and a large trading partner (Larson, 1995). In the late 1980s, the US government had requested that Korea liberalize and privatize its telecommunications markets. Given Korea’s export dependency on the US market, a possible trade conflict with the US would have resulted in a disastrous situation for the country’s economy. Under such heavy pressure, the Korean government was forced to begin market liberalization and privatization. Several international organizations such as the WTO and IMF also strongly demanded that the government expedite its privatization in the telecommunications industry as part of the structural reform in the post-1997 Korean economic crisis. For instance, the launch of WTO negotiations on basic telecom services in May 1995 compelled Korea to expedite privatization as well as liberalization in telecommunications, as elsewhere.

3. Privatization of Korea Telecom

The government-owned telecommunications operator, KT, evolved into a privatized telecommunications service company in May 2002. The privatization of KT has been noticeable not only due to its crucial role in the country’s infrastructure for the information society and economic development but also due to its complicate and unique process, i.e., the extraordinarily prolonged process and the relationship between the government and the chaebol. Indeed, KT was a dominant fixed-line local telephone service carrier, which accounted for 96.9% of the market in March 2002, while the second local phone service company, Hanaro Telecom, comprised only 3.1% of the market at that time. At the same time, KT had an 86% share in the long-distance market and a 64% share in the international telephone market. The impact of the privatization of KT on the domestic telecommunications market would be enormously dependent on who could be the major stakeholder of a privatized KT, which had already become a telecom giant in the several service markets (Kim, D. H., 2002b).

In addition, the privatization of KT has brought two significant changes in the telecommunications industry. On the one hand, the privatization of KT involved a change in the legal status of an existing carrier from public to private ownership, as elsewhere. On the other, the privatization of KT has resulted in a change in the three-way telecommunication competition policy, which the Korean government has maintained during the last decade. As noted, the Korean government has espoused a three-way telecom structure since the early 1990s because the government did not want one or two conglomerates or public enterprises dominating telecommunications service markets. For example, the government issues the licence for the second local phone service to Hanaro Telecom, which the LG Group manages through DACOM, in 1999 as part of this three-way competition policy. The government wanted LG to expand its share in the telecommunication market to compete with KT and SK Telecom. The government intended for the three major groups to compete with others, while it (the government) maintained its managerial power over the telecommunications industry (The Korea Herald, 2002a). However, the three-way competition policy has been challenged with the completion of KT’s privatization.

In order to clarify the main players and issues in the prolonged privatization of KT, the paper divides KT’s privatization into three stages according to different political-economic situations and their impact on privatization. The first stage can be identified by its original plan and motive as well as the role of the US government between 1987 and 1994. The second stage would be characterized by the significant roles of international organizations such as the WTO and IMF as well as the Korean economic crisis between 1995 and 2001. The third and final stage between 2002 and 2003 could be characterized by change in the ownership structure and the three-way competition policy.

3.1. First stage in privatization: original plan and motives

In the first stage in the privatization of KT between 1987 and 1994, privatization could be characterized by its unique motive. To begin with, in 1987 the government initiated the privatization of KT because of several significant demands from both domestic and international players. The major driving force for the
privatization of KT in the first stage was the US government. As noted, the US government had a disproportionately heavy influence on telecommunications reform in Korea because Korea was such a lucrative market and a large trading partner. Besides, the US government wanted its nationally based telecommunication industry to be an internationally based business with rapid technological development, and thus demanded the Korean government privatize KT. That is, the US government and telecommunications industries needed to sell their new equipment in both domestic and international markets; therefore, the US demanded that foreign countries, including Korea, should have privatized telecommunications companies in order to ease its sale of new equipment. In this regard, Schiller (1983) points out, “privatization is the fruit of at least a quarter-century of technical advance, and the skyrocketing business demand for specific new technologies, which began in the US domestic markets.” Hills (1998) also argues, “the declining cost of technology has afforded opportunities for the telecommunications sector to move from being predominantly nationally based to becoming international.”

Needless to say, the Korean government had its own agenda for privatization. The government thought of the privatization of KT as a major means for raising government revenue. Although a possible positive effect on the management of KT through privatization was cited as one of many reasons behind privatization, it was not the main issue for Korea. Usually, privatization is supposed to improve managerial efficiency and the performance of firms. As Duch (1991) points out, it is often the case that governments need more flexible structures when the telecommunications industries are very large, because the efficiency and performance of the telecommunications firms are unsatisfactory under government-owned monopoly control. In the absence of profit motives public enterprises do not create efficient company structures and cannot respond to consumer demands effectively. Ignoring such economic theorizing, the government was not much interested in improving managerial efficiency in the first stage. Indeed, the government’s original plan was to sell up to 49% of shares to the public (Choi, 1999). Under such a scheme, government ownership of KT would continue; therefore, managerial efficiency was not the main agenda for the privatization of KT, unlike many other countries.

Again, the main issue for the privatization of KT was financial, but this was again different from the situation in other countries. Many countries began privatizing telecommunications companies because they had severe financial deficits during the period of government’s monopoly, driven by the US and international organizations starting in the late 1980s. For instance, faced with escalating debt in the 1980s, a number of major Latin American countries sold their telecommunication operations to consortia made up of US banks and US or Spanish operators (Hills, 1998). However, KT had been enjoying large net profits over the last few decades before the full-scale privatization plan of KT. As Table 1 shows, the total net profit in 1996 was $142 million. After a significant dip in 1997 in the middle of the economic crisis, a net profit again rose and was as much as $778 million in 2000 (Korea Telecom, 2001). As this example indicates, what the government focused on from the first was increasing revenues by selling its shares of KT instead of debt consolidation.

The privatization of KT, however, was delayed until 1991 because of fluctuations in the Korean stock market in the late 1980s. Between late 1988 and 1990, Korea experienced relatively low economic growth mainly because of decreased exports, and thereafter stagnation of the stock market. The government was able to commence the sale of its shares of KT with the recovery of the Korean economy beginning in 1991. The government sold 20% of its shares of KT between 1991 and 1994 (Singh, 2000). The first stage in the privatization process was undertaken at a gradual pace because the government was afraid of losing its managerial power. The Korean government also feared that the domestic telecommunications industry would be taken over by foreigners because it represents a crucial part of the country’s infrastructure and economic development.

Table 1
Korea Telecom net profits (unit: million dollars)

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<tr>
<td>Revenues</td>
<td>5683</td>
<td>6392</td>
<td>8031</td>
<td>9302</td>
<td>10,685</td>
</tr>
<tr>
<td>Net profits</td>
<td>142</td>
<td>68</td>
<td>157</td>
<td>232</td>
<td>778</td>
</tr>
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</table>

Source: Korea Telecom (July 2001).
The government’s approach to the privatization of KT swiftly changed in the second stage between 1995 and 2001. The inauguration of the WTO system in 1995, the 1997 Korean economic crisis, and the inauguration of the Kim Dae Jung government drove the government to accelerate the full-scale privatization of KT as the US government and the WTO hoped it would. To begin with, under the auspices of the WTO, which would relax or eliminate bars to foreign ownership, the Korean government had to promote the privatization of KT. In addition, the Korean economic crisis of 1997 demanded structural reform of the Korean telecommunications industry as part of the systematic restructuring of the Korean economy. From the middle of 1997, Korea began experiencing its worst economic recession in modern history, which was brought about by a sharp slowdown in exports. The Korean government had to apply for IMF Emergency Financing Mechanism funds, and the IMF agreed to arrange for a package of $21 billion. The IMF bailout program was crucial for privatization because the IMF urged the Korean government to deregulate foreign ownership restraints as well as trade and competition-distorting policies in exchange for their financial support (United States Trade Representative, 2000). In fact, international organizations such as the IMF and the WTO and global telecom giants urged Korea to eliminate all investment restrictions in this sector, which limited Korea’s ability to introduce the infrastructure necessary to develop its telecommunications sector. The financial crisis brought about the full-scale privatization of KT.

More importantly, domestic politics drove the government to take the main steps toward the full privatization of KT because the Kim Dae Jung government had promoted privatization in public promises during the presidential election campaign in 1997. During the campaign, Kim promised full privatization of state-owned enterprises as a way both to raise government revenues through selling its shares and to avoid criticism from several parts of society regarding its corrupt relationship with public enterprises. For these reasons, the government sought the privatization of giant state corporations such as telecommunications, electricity and gas. As Manzetti (1999) argued, a political rationale finally became an important issue for the Korean government to promote the privatization of KT, although economic reasons played significant roles. Due to the swift change in both the domestic and the international political-economic environments, the Korean government had to make important strides in the privatization of KT. As a result, it increased foreign ownership in facility-based service providers to boost privatization beginning in the late 1990s. Foreign ownership in facility-based service providers had been upgraded from 33% to 49% excluding KT, as of April 1999. In KT, the aggregate foreign ownership limitation was upgraded from 20% to 33% in September 1999 (United States Trade Representative, 2000). The Korean government also put the KT shares on the Korean Stock Exchange Market in December 1998 as part of the full-scale privatization programme.

During the late 1990s, the Korean government needed to further ease the limits on foreign ownership to facilitate the complete privatization of KT because there was not enough domestic capital to buy government shares in KT. At that time, in the middle of the 1997 economic crisis, domestic-based TNCs suffered from severe financial difficulties, and they needed to focus on structural reform of their constituent parts. In addition, the government prevented any single chaebol from owning over 5% of KT’s shares in order to maintain its managerial power and three-way competition policy.

The government also could not put further KT shares on the domestic stock exchange because it feared the negative impact of the privatization of KT on the stock market. As of November 1999, the market share of KT in the Korean stock market reached almost 10%, just behind Samsung Electronics Co., which comprised a 10.7% share in the stock market (Lee, 1999). The government worried that the stock market, which was escaping from its worst economic crisis, would plummet again if the government listed more KT shares in the stock market.

Against this backdrop, the government turned its eyes to foreign capital, and it revised the Telecommunications Business Act in September 2000 to increase the foreign ownership ceiling from 33% to 49% of KT (The Korea Herald, 2000). With this change of the foreign ownership ceiling, the government could sell 43.64% of its shares in foreign markets, mainly in the US. As a result, the government’s stake in KT fell to 28.36% (The Korea Herald, 2001). Foreigners had 49% of the KT stock in January 2002, because KT was one of the most lucrative companies in Korea.
3.3. Third stage in privatization: change of ownership structure

The Korean government completed the privatization of KT when it sold off its remaining 28.36% stake in KT to domestic investors in May 2002. The last sale of KT shares was the most important stage of privatization because it changed the ownership structure in KT. In the last stage of the privatization of KT, the government considered two important factors: a successful sale of all the remaining shares and a balanced distribution of KT stakes. To fulfill its purposes, the government separated the buyers in the 28.36% float of KT into three groups: top conglomerates, individual and institutional buyers, and KT employees. Accordingly, a 15% stake was available for the chaebol. The government floated a 7.66% stake for individual and institutional investors, and the remaining 5.7% went to KT employees (Kim, D. H., 2002b).

In this final stage, the government surprisingly changed its 5% barrier policy and welcomed top chaebol participation for its sell-off because top conglomerates had capital to buy the major stake of KT. As noted previously, the government had prevented any single chaebol from owning over 5% of KT shares; however, the government removed the 5% barrier to spur chaebol interest in the planned auction to fully privatize KT in April 2002 (Kim, D. H., 2002a). Kim Dae Jung, as the first opposition political leader of the country to win the presidential election, was relatively free from the influence of dominant groups in society, in particular the chaebol, because he received comparatively little political funding from the chaebol, as opposed to previous governments. The Kim government, therefore, pursued a relatively consistent counter-chaebol tendency, i.e., asking chaebol to focus on core manufacturing industries. However, the Kim government finally admitted that top conglomerates were indispensable for completing the full privatization of KT. The government estimated that only a few top conglomerates had $2.3 billion in cash needed to buy the government shares of KT.

Several chaebol revealed their strong interests in the telecommunications service business and demanded the government remove the 5% barrier during the final stage in privatization. Recognizing they had the only possible domestic capital, top chaebol publicly announced that they would not invest in KT without a guarantee of more than 5% ownership (Kim, D. H., 2002a).

Under these circumstances, the government expected the three top chaebol—Samsung, LG and SK—to each take a 5% stake of the 15% stake available for chaebol. Since the government removed the 5% barrier, a single chaebol could amass 15% of KT’s ownership. However, the government also issued a restriction that all purchases by chaebol would be on a cash-only basis; meaning at least $2.3 billion in cash would be needed up front (Joong-Ang Ilbo, 2002). Although the government changed the limits on chaebol ownership to entice chaebol involvement in the bid, the government did not want one chaebol to be the largest shareholder of the privatized KT. The government hoped to create methods of corporate governance, by plausibly distributing KT shareholdings to chaebol. The Kim government’s plan was that no single investor could secure the controlling management rights in KT, a policy aimed at ensuring the separation of ownership and management. The government, however, failed to achieve a balanced distribution of the 15% stake among the chaebol, because SK Telecom, the largest mobile telephone company, acquired an 11.34% stake and became the largest shareholder of KT (The Korea Herald, 2002b). LG Electronics (2.27%) and Daelim (1.39%) also became main stockholders in KT.

The government’s misguided plan and SK Telecom’s aggressive bid at the final stage were the two main reasons for this unbalanced distribution, which resulted in SK Telecom’s dominance in a privatized KT. First, the government did not have a safe measure to force a balanced distribution. More specifically, for a balanced distribution of 15% of KT shares to chaebol, the government planned to sell the 5% stake to chaebol bidders and allow the buyers to acquire an additional 10% stake in the form of exchangeable bonds (EB). According to the KT share sales rule issued by the government in May 2002, strategic investors who purchased a stake of at least half a percent could buy EB up to twice the amount of shares they had bought. During the bid, SK Telecom bid a 5% share, while other chaebol such as Samsung, LG and Daelim only bid 1% or under. According to the rule, SK Telecom was allotted 3.78% share, and applied to purchase EB of 7.56%, so finally earned 11.34% share. As this result proves, the government did not have any specific rule to secure a balanced distribution, although it had established the sales rule. As usual, it believed conglomerates would follow the government plan.

Second, SK Telecom’s aggressive bid brought about this unbalanced distribution. What drove SK Telecom to be an aggressive bidder at that time was Samsung’s move. SK Telecom feared that Samsung, the largest
chaebol in Korea, would have KT’s managerial rights and could be a threat to SK Telecom in the telecommunications service market in the near future. SK Telecom worried that the mobile phone service market would be greatly affected if Samsung had managerial power over KT. KT held a 10% stake in the country’s top mobile carrier, SK Telecom, as of May 2002, so Samsung could control SK Telecom through its managerial rights at KT, if it became the largest stakeholder in KT (Kim, S. B., 2002). Samsung was the most likely candidate for the bidding. However, Samsung failed to acquire any shares in KT, although the group planned to acquire at least a 3% share of KT through the bid (Hwang, 2002). Samsung bid a 1% share; however, it could not buy any shares because Samsung participated in the bid as an institutional buyer instead of a strategic investor. According to the sales rule, strategic investors have had a priority in share allotment.

The aggressive movement of SK Telecom in privatization shocked Korean society, in particular the government and the business world, because nobody expected SK Telecom would contravene the government plan. This became possible, however, because the Kim government was rapidly losing power toward the end of its term. Before the presidential election in December 2002, the government had difficulty handling the country, not only because of the lame-duck phenomenon but also because the government itself was involved in several scandals, as with several previous governments. For example, the government was criticized by several elements of society, including the media, because it received money from the Hyundai Group in return for special treatment for the group’s investments in North Korea. In the middle of the political and economic turmoil, SK Telecom undertook a risky venture.

The government, however, completed the entire sale of its stake, one of two main goals in the privatization of KT about 15 years after its announcement of the plan. With the sale of the remaining government stake, the government’s privatization plan for KT was completed. As Table 2 shows, as of the end of May 2002, foreign investors had a 49% stake in KT. The biggest foreign investors were Brandes Investment Partners, a global investment advisory firm (6.39%), and Microsoft (3%). Individual investors had 27.1%, and SK Telecom had 11.34%. KT employees had 6.1% and People’s Welfare Pensions had the remaining 2.7% stake (Chosun Ilbo, 2002).

4. Impact of privatization on the three-way competition policy

The privatization of KT has influenced the three-way competition policy, because SK Telecom became a telecom giant in both the wireline and wireless telephone service businesses. As noted, the government had pursued a three-way telecom structure in which KT, SK Telecom and a third force led by LG Telecom compete with each other. The three-way competition policy was aimed at encouraging the consolidation of several latecomers such as LG Telecom, Dacom, and Hanaro Telecom to help them better compete with the two telecom giants KT and SK Telecom. For example, Seung-Taik Yang, Minister in the Ministry of Information and Communication, indicated in 2001 that the government might regulate SK and KT until LG was capable of doubling its market share in the telecommunication service market to beyond 20% (Lee, 2001). Implicitly, the policy had also been geared toward developing an industry strong enough to resist overseas players (Kim, D. H., 2002c).

However, the privatization of KT distorted the three-way power structure because SK Telecom became KT’s largest stakeholder. That is, the KT stake sale changed the power structure in favor of a two-way competitive structure, a scenario that dealt a blow to LG Telecom and its affiliates, LG Electronics and Dacom. When SK Telecom became the privatized KT’s largest stakeholder, it acquired KT’s dominant market power in telecommunications service markets, while maintaining its dominance in the wireless telephone service market.

Table 2
Stakeholders in KT after privatization (unit: percent)

<table>
<thead>
<tr>
<th>Foreigners</th>
<th>Individual investors</th>
<th>SK Telecom</th>
<th>KT employees</th>
<th>People’s Welfare Pension</th>
<th>LG Electronics</th>
<th>Daelim</th>
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<tr>
<td>49</td>
<td>27.1</td>
<td>11.34</td>
<td>6.1</td>
<td>2.7</td>
<td>2.37</td>
<td>1.39</td>
</tr>
</tbody>
</table>

Source: SK Telecom becomes the largest stakeholder, The Chosun Ilbo (2002).
The government decided to prevent SK Telecom from gaining power for two reasons. One was that the government worried SK Telecom would have a negative impact on the three-way competition policy. Several other top conglomerates, such as Samsung and LG, also feared SK Telecom becoming a private telecommunications giant. Moreover, they were concerned that SK Telecom could control the Internet and broadband service markets with its dominant power in the telephone service industries. Therefore, KT Freetel, the country’s second largest mobile carrier and broadband service provider, and LG Telecom, ranked third, submitted a petition to the government immediately after the completion of privatization to restrict SK Telecom from engaging in marketing activities (The Korea Herald, 2002c).

The second reason was that the Korean government did not want to transfer its managerial power over KT to the private sector. The Korean government was attempting to stretch its regulatory power into the private sector. For example, the government asked SK Telecom to sell its shares of KT Corporation (the privatized KT) to the other chaebol (Kim, T. H., 2002). The government cautioned “SK Telecom might face severe disadvantages and penalties, if the demand goes unmet” (Yang, 2002). As noted earlier, KT held a 10% stake in SK Telecom, as of May 2002. Under heavy pressure from the government, SK Telecom agreed to a swap deal. SK Telecom traded its 9.64% stake in KT for KT’s 9.27% stake in SK Telecom. This was completed in January 2003 (Dong-A Ilbo, 2003). At that time, SK Telecom and KT each held small stakes in each other in order to stabilize their stock prices.

With the swap deal, the privatization of KT had been implemented according to the government’s plan, which was to create an ownerless telecom company with the government secure in its control of management. The Korean government can manage the privatized telecom giant, KT; however, it is not certain whether it can similarly maintain its three-way competition policy, because the privatized KT as well as SK Telecom could increase their dominance in the telecommunications service market in the near future.

5. Conclusion and recommendations

Korea has completed its privatization of KT, one of the largest public enterprises in the country. The implications of the privatization in the global telecommunications market as well as the domestic market are significant because the privatization of KT had many unique characteristics which were different from the privatization processes of other countries. The distinct features of the Korean way of telecommunication privatization include its long duration, unique approaches to privatization, the international environment in which the privatization took place, and the role of the chaebol.

The privatization of KT was influenced by a sometimes cooperative and at other times conflicted relationship among the Korean government, chaebol, and foreign forces such as the US and international organizations. Government policy in KT’s privatization has greatly changed according to the relationship between the three main players. From the very beginning, the Korean government did not favor the immediate privatization of KT because it planned to preserve its managerial power over KT. Ultimately, however, the changing political and economic environment during the privatization process forced the government to alter its strategies and accelerate the privatization of KT. In particular, the US played a key role by demanding that the Korean government change and expedite its privatization of KT. The US request for privatizing the telecommunications industry also helped domestic chaebol that were trying to take part in KT’s privatization.

The relationship between the Korean government and the chaebol could also be characterized as a distinctive feature of the privatization. Several chaebol, as main users and business groups, were important players in the privatization of KT. Their capital and powerful lobbying pushed the government to change its policy, including limiting chaebol ownership. In the process, the chaebol established a bridgehead to enter the telecom service market through deft use of capital and technical superiority.

The main reason for the privatization of KT was also unusual. Many other countries, including those in Latin America, privatized their government-run telecommunications monopolies because they had severe financial deficits. These countries privatized their telecommunications companies in order to improve managerial efficiency, since they believed that the absence of a profit motive for public enterprises did not create an efficient company structure.

Unlike telecommunications companies in these countries, KT had enjoyed large net profits over the last few decades. The Korean government therefore planned to privatize KT in order to raise government revenues
rather than as a way to improve managerial efficiency. However, this motivation delayed its privatization of KT, because the government could not sell its shares in KT during the economic recession. Between late 1988 and the early 1990s, the Korean stock market experienced an unexpected slump, and stock prices plummeted, raising concerns within the government that it would not generate sufficient new revenues, thus delaying its stock market offering.

However, the government has been criticized because of its inconsistent and opaque privatization policies during the privatization process, even though it has responded to the changing political-economic environment. For example, several times the government changed the foreign ownership ceiling and the 5% barrier for the chaebol. In the final stage of the privatization process, the government also used its excessive regulatory power to maintain its managerial control over KT as well as the telecommunications industry. What the government was most concerned was maintaining its managerial power over the telecommunications industry, rather than improving managerial efficiencies or the quality of services. In fact, the government developed a new strategy to maintain its managerial power over the telecommunication industry by implementing the concept of the ownerless telecommunications company.

In sum, the Korean telecommunications industry is experiencing a new era with a privatized local phone service carrier. It will take time to ascertain whether the privatized KT can improve its profits and managerial efficiencies through innovation like a true private enterprise. The process of building up a competitive telecommunication market among Korea’s private telecommunications companies will take time, and will depend upon the details of regulatory provisions being implemented.

Meanwhile, the government should consider changing or abolishing its policy with regard to the three-way competition policy, because KT and SK Telecom have increased their power in the changed telecommunications market environment. The three-way competition policy would have created balanced growth of the telecom sector; however, the government has failed to secure the purpose of its policy because the two telecom giants dominate the telecommunications market. Moreover, the three-way competition policy is not good for the KT market because if private capital is invested further by the three large unfettered chaebol that already dominate the Korean economy, it is certain they will be the main players in the Korean telecommunications market. As a result, the public cannot expect lower prices and better services.

The main role of the government should be changed and limited to acting as a coordinator, ensuing fair competition between telecommunications service companies. The government should also play a key role as a regulator to help the small telecom companies and to secure low service cost for the users. In addition, the government needs a more transparent management through a policy that can be more easily predicted by companies, because its impact on the telecommunication market is so significant in the Korean information society.

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**Further reading**
