

## Effect of Ownership Structure on Corporate Performance and Internal Decision-making Mechanism in Mutual Savings Banks

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### Abstract

*This study aims to focus on mutual savings banks in financial sector and explore different corporate performances and internal decision-making mechanism based on ownership structure. Especially, mutual savings banks have unique characteristics different from general corporations and financial institution. In this paper, we analyze deciding factors for management performance of mutual savings banks as financial corporations and, through this, to elucidate causes of their bankruptcy or ultimate failure. For case study, Hankook Savings Bank and Dongbu Savings Bank were selected as representative listed large saving banks with assets over 1 trillion won. This study also selected comparison group which can support indexes that caused insolvency of savings banks with assets of over 1 trillion won and investigated industry average and average of healthy and unhealthy savings banks. The results of case study and analysis on group cases in this study are as follows; Unhealthy savings banks tend to have higher asset ratio against capital than healthy ones and under the circumstances without risk management (system) and internal control system, moral hazard occurred by major stockholders who tried to take advantage of expanded asset for their own personal interests. In addition, lax laws and regulations on capital and ownership structure and relaxation policy on operation regulations produced vulnerable capital structure and abnormal asset structure.*

**Keywords:** Agent theory, mutual saving banks, decision making, corporate governance

### 1. Introduction

A corporation produces different management performances depending on internal decision-making process and corporate governance based on the ownership and management structure [1]. Especially, the problem of hired CEO and agency which can take place in an organization with separated ownership and management in financial industry is still an important matter today and research on resultant decision-making structure and internal mechanism is also crucial. Principal-agent theory developed from the separation of ownership and management of corporations was systemized by [2], dealing with conflict of interests arising from the difference between the owner (stockholders) and agent (CEO or manager).

It is none other than corporate ownership structure, or corporate governance which is suggested as a device to reduce agency problem arising out of incongruence of interests of this kind between the owner (stockholders) and CEO and various opinions have been suggested. [2] maintained that stockholders' participating in management reduces agency cost by considering their own interests and, in a study on small and medium-sized corporations of the US, [3] claimed that, in management directly operated by stockholders, the higher the shareholding ratio, the lower the agency cost.

On the other hand, [4] contended that managers who hold stocks may engage in behaviors which run counter to the interest of corporations as they tend to pursue goals of private interests and growth of their corporations. In addition, [5] asserted that increase of shareholding ratio of CEO raises its tendency to settle for status quo since the utility arising from the pursuit of private interest becomes higher than that arising from increase in the value of shares. In their study on corporate value, CEO's shareholding ratio and reward for CEO, [6] argued that the higher the shareholding ratio becomes, the lower the corporate value and that CEO demands rewards more than state of equilibrium by using his managerial clout. As seen, there are many contradictory studies on shareholding ratio and decision on which model is most suitable depends on industry and environmental factors. In relation to this, this study aims to focus on mutual savings banks in financial sector and explore different corporate performances and internal decision-making mechanism based on ownership structure.

The cause of problems for saving bank lies in vulnerable capital structure. According to Mutual Savings Bank Law, the capital required to establish a savings bank is 12 billion won for special cities, 8 billion for metropolitan cities and 4 billion won for other regions. Scale of capital and asset of savings banks has kept changing. Although their total assets increased around 4-fold from 24 trillion won in 2002 to 86 trillion in 2010, their capitals increased slightly over 2-fold from 1.4 trillion in 2002 only to 3.2 trillion in 2010, showing that ratio of capital against asset is on the decrease. Therefore, mutual savings banks have special characteristics different from general corporations and financial institutions, and the corporate governance based on ownership and management plays much greater role and exerts bigger influence on managerial decision-making, ethical management and corporate performance, which requires careful examination. Therefore, the purpose of this study is to analyze deciding factors for management performance of mutual savings banks as financial corporations and, through this, to elucidate causes of their bankruptcy or ultimate failure.

## **2. Research on Shareholding Ratio of Financial Industry**

[7] maintained that traditionally, when ownership of a financial institution is dispersed, it is difficult for shareholders to effectively control management. In the same context, [8] argued that the higher the concentration of ownership, the stronger the inducement to supervise management. On the contrary, [9] contended that in the case of financial industry for which strong governmental regulation is accompanied, degree of regulation has greater effect on management performance than the degree of ownership concentration. In a more recent study, [10] claimed that strengthening regulation on financial institutions can replace monitoring function on major stockholders. Meanwhile, [11] conducted research on 800 banks in around 50 countries on the hypothesis that the higher the ownership concentration of banks, the lower the non-performing loans and the higher the capital adequacy, and they found out that although higher ownership concentration has positive effect on capital adequacy, capital concentration of over 50% has negative effect on the ratio of non-performing loans. Through a study to elucidate that degree of risk-taking of banks differs depending on corporate governance based on the agency theory which is the problem between stockholders and hired CEO, [12] emphasized that in the case when the governing power of major stockholders is strong, stockholders are more inclined to pursue risks than hired CEOs. Like this, general opinions of scholars on ownership structure in financial institutions are different from one another. In particular, since most studies on mutual savings banks in Korea have used data before 2008 financial crisis, they have not dealt with bank insolvency after 2008 and case studies also remained as comprehensive and abstract on overall savings banks rather than focusing on detailed cases of specific savings banks. Therefore, it is essential to conduct empirical case studies on savings banks in Korea after 2008. Based on this background,

the reasons why ownership structure is important in mutual savings banks can be summarized as follows; first, mutual savings banks are relatively much riskier than general banks as they have simple profit structure originating from characteristics of local financial institutions; second, there are no regulations on major stockholders as regulations on mutual savings banks were repealed; third, it is difficult to conduct empirical study on mutual savings banks since there are less than 10 listed savings banks in Korea and there is lack of case studies on savings banks which went bankrupt under changing financial environment and on those that have practiced sustainable management after 2008 financial meltdown.

### 3. Methods of Study

According to the standard of Korea Deposit Insurance Corporation, mutual savings banks are classified into 3 categories based on asset, which are 1) over 1 trillion won which is classified as large savings bank, 2) 300 billion through less than 1 trillion won and 3) less than 300 billion won. Hankook Savings Bank was selected as a typical example of insolvent savings bank which had been counted as the 2nd largest savings bank in 2010 but had its operation suspended by the government and finally went bankrupt. Dongbu Savings Bank was chosen as a typical healthy savings bank as it has been in stable operation for 40 years without the change of major stockholder and classified as a member of '88 Club' for the last 12 consecutive years, practicing sustainable management. 88 Club refers to healthy savings banks with BIS ratio of over 8% and substandard & below Loans ratio of less than 8%.

In order to conduct objective analysis, this study also selected comparison group which can support indexes that caused insolvency of savings banks with assets of over 1 trillion won and investigated industry average and average of healthy and unhealthy savings banks. As unhealthy large savings banks which went bankrupt, Hankook Savings Bank, Solomon Savings Bank of which the operation was suspended in 2011 and 2012 and finally went bankrupt, Tomato Savings Bank, Busan Savings Bank and Jeil Savings Bank were selected while as healthy savings banks, Dongbu Savings Banks, Korea Investment Savings Bank which have practiced sustainable management without change of major stockholders since 2008 financial crisis, HK Savings Bank, Pureun Mutual Savings Bank and Moa Savings Bank, and difference between the two groups were examined.

This study selected and compared Hankook Savings Bank as the typical unhealthy case and Dongbu Savings Bank as prime healthy case and, among savings banks with assets over 1 trillion won, for unhealthy savings bank group, Hankook Savings Bank, Solomon Savings Bank, Tomato Savings Bank, Busan Savings Bank and Jeil Savings Bank were selected (operation for all of which were suspended which led to their ultimate bankruptcy) while, for healthy savings banks, Dongbu Savings Banks, Korea Investment Savings Bank, HK Savings Bank, Pureun Mutual Savings Bank and Moa Savings Bank were selected. Data for comparison were collected from statistical data of Financial Supervisory Service, business reports, audit reports and home page of each savings bank and court decisions from 2006 through 2011. Means of each savings bank were calculated from collected data by applying respective calculation method for each savings bank and in turn means for healthy group and unhealthy group were calculated and compared.

#### 4.1. Representative Case Analysis

**4.1.1. Hankook Savings Bank :** Hankook Savings Bank had 2 main offices and 8 branches with 115 employees. It was established in December 1982 with the name Shin Hanil Mutual Savings Bank, listed as a corporation in March 1996 and finally had the name Hankook Savings Bank after many name changes. Hankook Savings Bank grew with mergers and acquisitions. In 1999, it acquired Shinshin Mutual Savings (current

Hankook Savings Bank), acquired Jinhueng Mutual Savings Bank in 2000 and changed its name into Jinheung Savings Bank, which established Gyeonggi Commit Mutual Savings and Finance Co. in November 2000 through contract transfer to Dong Ah Mutual Savings and Finance Co. and changed its name into Gyeonggi Mutual Savings Corp. (current Gyeonggi Savings Bank) in 2002. In October 2007, it acquired Bumin Mutual Savings Bank and changed its name into Youngnam Mutual Savings Bank Corp (current Youngnam Savings Bank), forming a group of affiliated savings banks.

Although Hankook Savings Bank expanded its volume and assets through acquisitions and formed a savings bank group, its poor management practices and performances gradually came out into open after 2nd financial crisis in 2008 and finally had its business suspended with management improvement order and insolvent financial transfer decision issued by Financial Services Commission in 2012 and the company was ultimately delisted on July 25, 2012.

### 1) Major Shareholder's Ownership and Governance

Chairman of Hankook Savings Bank Hyun Soo Yoon is the major shareholder of Hankook Savings Bank which changed its name from Shinshin Mutual Saving and Finance Co. Shareholding ratio of Chairman Yoon and his specially-related persons for Hankook Savings Bank are as follows;

**Table 1. Shareholding Ratio of Major Shareholders for Hankook Savings Bank**

|                        | 2012 | 2011  | 2010  | 2009  | 2008 | 2007 | 2006 |
|------------------------|------|-------|-------|-------|------|------|------|
| Shareholding ratio (%) | 68.4 | 42.94 | 39.91 | 39.91 | 39.6 | 39.6 | 39.6 |

-Business Report of Hankook Savings Bank-

As investigations on Hankook Savings Bank continued by Financial Supervisory Service, it is judged that Chairman Yoon and his family changed shareholding ratio through paid-in capital increase as a way to avoid suspension of business.

Chairman Yoon was involved in overall management of savings bank (deposits, loans) and following reports indicate that he exerted a very powerful management control; 1) monthly profit and loss meeting: report on deposit and profit & loss status by teams under financial departments and branches; 2) daily operation status: mail reports by each bank's working-level employees on new loans and repayment details of Hankook Savings Bank and affiliated banks (Hinheung, Gyeonggi, Youngnam Savings Banks); 3) weekly executives' meeting: meeting of chairman and CEOs of affiliated savings banks to discuss issues of the time; 4) report of Integrated Risk Review Commission: integrated risk report by president of Integrated Risk Review Commission Doo Young Lee (CEO of Jinhueng Savings Bank) for all savings banks affiliated to Hankook Savings Bank. Major shareholder chairman Hyun Soo Yoon received overall reports on company's deposits and loans with these 4 methods everyday and made management decisions in person. Especially, large loans could not be implemented without approval of chairman Yoon. Although major shareholder and chairman Yoon was involved in overall management of each bank, he was not registered as an executive. And yet, according to business reports of Hankook, Hinheung, Gyeonggi and Youngnam Savings Banks, even though he was not registered, he signed advisor contracts with the affiliated savings banks and received advisor payment from them.

Mutual Savings Bank Act has the regulation that in case executives and oligopolistic shareholders cause damage to a mutual savings bank and other people, they are responsible for making compensation for the damage in solidum. Here, oligopolistic shareholders mean the major shareholder and specially-related persons with over 50% of

shares (Clause 3, Article 37 of Mutual Savings Bank Act, Article 39 of Framework Act on National Tax). As seen in above [Table -1], chairman Yoon had less than 50% of shares in the savings banks before 2012 when Hankook Savings Bank had its operation suspended, he was excluded from the responsibility in solidum even in case of business suspension or bankruptcy of the company due to nonperforming loans and other management failures. That is, while Yoon had all the rights as chairman, he was in a position to escape from being held responsible of faults and failures due mainly to the discrepancy between rights and responsibilities of related laws.

### **3) Control and Inspection by CEO and Full-Time Auditor**

CEO of Hankook Savings Bank Tong Cheon Lee (since 2006) was an elder alumnus of chairman Yoon and, due to school ties, he was in a position in which we cannot deny chairman Yoon's orders. In particular, he facilitated bankruptcy of Hankook Savings Bank by approving chairman Yoon's illegal acts as CEO without any checks and inspections. Meanwhile, according to its business report, Hankook Savings Bank introduced audit system and appointed as full-time auditor a retired official from Financial Services Commission who worked for the institution for 27 years. Parachute appointment of full-time auditor formed back-scratching relationship between inspecting institution and inspected company and brought negligence of auditor's responsibilities. This means that financial company recruits an auditor to use him/her as a shield or a tool for lobbying activities while the appointed auditor is immersed in lobbying instead of its own works [13]. In the end, owing to parachute appointment of the full-time auditor, Hankook Savings Bank was in difficult position for internal control on major shareholder's various irregularities (malpractice of loans, violation of Mutual Saving Bank Act).

### **1) Assets and Integration of Hankook Savings Bank**

After 2007, Hankook Savings Bank grew into a super large savings bank with assets over 3 trillion won. Chairman Hyun Soo Yoon of Hankook Savings Bank was known as an M&A expert before the acquisition of Hankook Savings Bank and formed Hankook Savings Bank Group by successively acquiring Hinheung, Gyeonggi and Youngnam Savings Banks and Hankook Total Capital Corp.

Hankook Savings Bank's total assets increased radically by the formation of a group of savings banks. As of June, 2012, assets of Hinheung Savings Bank recorded 1.5123 trillion won and assets of Gyeonggi Savings Banks marked 1.89 trillion won and Youngnam Savings Banks reached 603 billion won. Total combined assets of Hankook, Jinheung, Gyeonggi and Youngnam Savings banks were over 6 trillion won, making it a super large savings bank group. On the other hand, Large size and integration of saving banks brought the problem of sharing of credit risks. Especially, as loans in large amounts were made by forming a consortium by 4 savings banks in the group, risks from the loans are also shared by 4 savings banks at the same time. Although loans were screened by the Integrated Risk Review Commission, screening was made based on the data submitted by the branch of the savings bank proposing the loan for consortium and thus, no risk reviews were made by each savings bank. Ultimately, all 4 savings banks sharing credit risks had their business suspended and were liquidated and kicked out of the market.

Deposit asset of Hankook Savings Bank had continuously increased since 2001 and exceed over 2.5 trillion won as of June 2009. Major source of profit of Hankook Savings Bank was the spread between deposits and loans. Loan to deposit ratio (ratio of loan balance against deposit balance) of Hankook Savings Bank was 93.31% in 2006, 92.49% in 2007, 94.40% in 2008 and 88.87% in 2009, showing that the savings bank depended on the interest for its operation. In particular, the proportion of Project Financing (PF) in total loan amount was 51.28% in 2006, 40.73% in 2007 and 30% in 2008.

Project financing means providing funds by financial institutions based on such collaterals as profitability or cash flow of projects, not on credit of specified persons or companies. In particular, project financing dealt with by mutual savings banks are mainly for real estate development projects which try to sell ownership of developed lots. Savings banks lend loans for real estate developers to buy lands (contract amount or remaining balance) and the developers earn authorization or business licenses from government, after which they draw out loans from the 1st banking sector to pay back the loan from the savings banks. Unlike general loans, this kind of short bridge loans has the profit structure to take fees (development profits) by savings banks in advance in addition to interest for the loan. Hence, although loans for project financing are a high-profit product, risk involved is higher to the degree that profit-taking depends on the quality of business analysis and business cycles of construction industry.

#### **4) Risk Management and Ethical Management of Hankook Savings Bank**

Hankook Savings Bank had Loan Review Committee and Integrated Risk Review Commission. Loan Review Committee was chaired by an executive in charge of loans and a sales manager in crossed manner and attended by 1st and 2nd managers of 1st and 2nd Finance Departments as review members while Integrated Risk Review Commission was chaired by an executive in charge of loans and attended by a risk manager, 1 staff, finance manager, an administrative manager, a sales manager and staff in charge of loans.

Integrated Risk Review Commission was chaired by CEO of Jinheung Savings Bank Doo Young Lee who was the alumnus of Chairman Hyun Soo Yoo and raised no objections to 'loans ordered by the chairman' and executed them. Major shareholders, executives and overall employees had very low sense of ethical (compliance) management and were imposed of 15 times of sanctions (from 2010 through 2012) and finally chairman Yoon and CEOs of affiliated savings banks of Hankook Savings Bank were charged and sentenced to heavy punishments after suspension of business for Hankook Savings Bank.

Total loans by chairman Yoon's malpractice (from 4 saving banks affiliated to Hankook Savings Bank) amounted to 177.6 billion won and total credit loans to major shareholders (Taihan Electric Wire Co. and companies related to Yoon) in violation of Mutual Savings Bank Act reached 67.5 billion won while personal embezzlement and malpractice recorded 6.8 billion won and price manipulation for stocks owned by Hankook Savings Bank reached 51.8 billion won. CEOs of each savings bank were also punished for malpractice in making loans.

**4.2.2. Dongbu Savings Bank:** Dongbu Savings Bank began its operation with authorization of operation for Mutual Savings and Finance Company in December 1972 and changed its name from Dongbu Mutual Savings and Finance Company to Dongbu Mutual Savings Bank in March 2002 and finally to Dongbu Savings Bank in September 2010. From the establishment of Gangnam branch in April 1984, Dongbu Savings Bank installed a total of 8 branches (except for Headquarters) and has provided financial services to all areas of Seoul, forming a structure of large savings bank.

Since earning its membership to World Savings Banks Institute (WSBI), Dongbu Savings Bank has established close cooperative relationships with advanced European and Asian savings banks in areas such as employee training, sharing of management knowhow and product development and maintained excellent soundness even in financial crisis by achieving standards for excellent savings banks such as substandard & below loans ratio of less than 8% and BIS ratio of over 8%.

Meanwhile, Dongbu Savings Bank is an affiliated company of Dongbu Group which has 56 domestic affiliated companies including Dongbu Savings Bank and 33 overseas affiliated companies according to the Monopoly Regulation and Fair Trade Act. Dongbu Savings Bank has a Headquarters, 4 branches and 8 local offices and 143 employees.

Dongbu Savings Bank is the only savings bank which has maintained stable operation without the change of major shareholder for 40 years since its foundation and has enjoyed sustained growth in spite of financial crisis in 2008. It was awarded 'Financial Grand Prize for Low-income Citizens' in both 2006 and 2007, Korea Grand Prize for Global CEO in 2011 and Creative Management Grand Prize Glorifying Korea in 2012 for sustainable management category. It also received Grand Prize for Ethical management, Grand Prize for Social Responsibility Management and Grand Prize for Best Savings Banks.

### 1) Ownership of Major Shareholders and CEO

Dongbu Savings Bank is an affiliated company of Dongbu Group which belongs to industrial capital group. Largest shareholder of Dongbu Savings Bank is Dongbu securities and Dongbu Cultural Foundation and founder Joon Gi Kim and shareholding ratio of major shareholders and specially-related persons (largest shareholder Dongbu Securities, large shareholders Dongbu Cultural Foundation and Joon Gi Kim) are presented in the table below;

Born from Dongbu Construction Corp., Dongbu Group is a conglomerate (founder Joon Gi Kim) which has affiliates in 7 areas such as construction, finance, information & communications and food & beverage and was recorded as the 20th largest group based on asset as of April 2010.

**Table 2. Shareholding Ratio of Major Shareholders of Dongbu Savings Bank**

|                        | 2012  | 2011  | 2010  | 2009  | 2008  | 2007  | 2006  |
|------------------------|-------|-------|-------|-------|-------|-------|-------|
| Shareholding ratio (%) | 89.15 | 89.13 | 89.13 | 89.13 | 87.27 | 87.27 | 87.27 |

-Source: Business reports of Dongbu Savings Bank

Meanwhile, major shareholders of Dongbu Savings Bank have supported the savings bank to grow into a healthy one by retaining earnings and not receiving dividends since its foundation. CEO Ha Joong Kim is the CEO with longest record of working period among domestic savings bank since appointment in 1997. Since entering Hanil Bank in 1976, he worked in Hanyang Investment Bank, Dongbu Investment Bank and Dongbu Securities and eventually became CEO of Dongbu Savings Bank. He achieved 4-fold external growth by 2011 from 400 billion won in 1997 when appointed as CEO. Major shareholders and CEO of Dongbu Savings Bank have pursued soundness-centered management. According to leader of Strategic Planning Team Hoon Jae Lim, "Major shareholders of Dongbu Savings Bank have the management philosophy that for a financial company, 1st principle of importance is security, 2nd is security and 3rd is security as well. CEO of our company keeps strict management principle and focus on sound management under the control and inspection of independent Loan Review Committee."

### 2) Sustainable Management by an Employed Professional CEO

Since employed CEO Ha Joong Kim was inaugurated in 1997, numerous savings banks have gone through the process of restructuring and liquidation with the crisis such as IMF bailout in 1997, credit card crisis and global financial meltdown in 2008. Focusing on the very basics in management, CEO Kim has tried to minimize effects of external environment on the management by being faithful to management principles rather than expanding its business.

He achieved 4-fold growth of assets with 1.7 trillion won as of 2011 from 400 billion won in 1997 when he was appointed as CEO. Under his leadership, Dongbu Savings Bank satisfied 88 qualification (BIS ratio of over 8% and substandard and below loan ratio of less than 8%) for 12 consecutive years and acquired corporate credit rating of A-

as well. In addition, various awards for management have raised trustworthiness of the company and especially, even in difficult economic and industrial environment in 2010, Dongbu Savings Bank was designated by Korea Deposit Insurance Corporation as the Savings Bank with Exemplar Management.

Although CEO Kim has consistently pursued management faithful to basics and core of savings bank with thorough risk management based on security, he also launched aggressive management with bold investments to create new growth visions, good example for which was pushing for advanced financial system through various overseas cooperation and research activities. After joining WSBI as regular member in 2003, Dongbu Savings Bank has been working hard to benchmark core competencies such as consultation-centered financial experts, scientific customer management and management administrative system which are the advantages of European savings banks through establishment of thorough alliance and cooperative relationship with German Savings Bank Association (DSGV) and Swedish Sweedbank. Furthermore, in cooperation with Southeastern Asian banks such as Philippines Postal and Savings Bank (PPSB), Governmental Savings Bank of Thailand (GSB) and National Housing Bank of Indonesia (BNT), Dongbu Savings Bank has laid foundation to advance into Southeastern countries by exchanging workforce with the savings banks and seeking out opportunities of joint marketing and investment opportunities.

### **3) CFO and Full-Time Auditor**

Dongbu Savings Bank employed and had CFO (Chief Finance Officer) take charge of accounting and finance and by employing a professional as a full-time auditor who had previously worked as the head of management support department in a investment securities company, Dongbu Savings Bank eliminated the possibility of corrupt relationship with related government authorities through parachute appointment and secured efficiency of audit functions. In order to prevent concentration of loans on certain areas, Dongbu Savings Bank established 20% limitation rule for one industry and through minimization PF loans, the bank has diversified loan portfolio by strengthening small and medium-sized loans such as sunshine loan, mortgage loan and collateral loans for small and medium-sized companies.

Introducing Sales Vitalization Program, Dongbu Savings Bank has implemented exclusive customer care program to continuously investigate and accommodate customer needs. Especially, with the introduction of innovative activities which change working methods and frame of thoughts to work in customer-centered way, the savings bank is solving tasks for innovation by using numbers and data. In addition, by developing tailored financial products that fit ever-increasingly diverse customer needs and enhancing the level of customer management, Dongbu Savings Bank are making efforts to deliver best values to the low income class of local communities.

### **4) Risk Management and Ethical (compliance) Management of Dongbu Savings Bank**

Proclaiming ethical management as top-priority management task, CEO of Dongbu Savings Bank Ha Joong Kim has operated cyber Shinmoongo (a traditional system to report complaints), enacted ethical creed and implemented code of conduct. Dongbu Savings Bank was awarded by Financial Services Commission for enacting and spreading Regulations for Legal Observance and Inspection. The savings bank has never been imposed a single sanction by Financial Services Commission since 2009 for violation of rules and regulations by its employees.

Dongbu Savings Bank maintains checks and balances among internal organizations with independent meetings and committees such as Risk Management Committee, Loan Review Committee and IT Management Committee. In particular, loans are reviewed by

Screening Team for working-level inspection and finally decided by Loan Review Committee through thorough verifications. The Committee is composed of experts in legal, credit management and real estate areas with the exception of executives and employees of sales division, securing independence to guarantee strict screening process based on principles.

#### 4.2. Results of Group Analysis with Representative Cases

For the objective study, we extracted the Compared variables with using the previous studies for the two groups of savings banks are as follows; type of major stockholders, stockholding ratio of major stockholders and management participation type which worked as important variables in the studies of [13-15]; variables regarding external environment were drawn out from the studies of Horiuch and Shimizu (2001); variables related to internal resources were drawn out from the studies of [16-19], and [20]. Important variables related to resources were type of savings bank, capital ratio, PF loan ratio and number of times supervisory agency imposed disciplinary actions, which were compared with other savings banks. In addition, as an index for variable for capital adequacy of the savings banks, capital ratio against asset was compared and as ethical and law-abiding management, the number of times Financial Supervisory Service imposed disciplinary actions for the violation of Mutual Savings Bank Act and other related laws was examined. For accurate evaluation of ethical and law-abiding management, although it is necessary to investigate whether or not savings banks have ethical platforms, number of times when will for ethical and law-abiding management was expressed in New Year Congratulatory Speeches, whether or not expenses were spent for ethical and law-abiding management and the amount spent and whether or not there are monitoring systems for ethical and law-abiding management, it was impossible to acquire those data. Financial Supervisory Service constantly inspects whether savings banks and its employees violate laws and regulations and impose disciplinary actions when there are violations and put them on public notice. Data on savings banks and savings bank industry from 2006 through 2011 were collected and means for each bank were calculated and in turn means for healthy group and unhealthy group were calculated and compared.

**Table 3. Compared Variables and Method to Calculated Variables of Mutual Savings Banks**

| Compared contents   | Comparison variables                    | Calculation method   |
|---------------------|---|--|
| Ownership structure | Type of major stockholder               | Individual stockholder = 1, corporation = 0  |
|                     | Stockholding ratio of major stockholder | Stockholding ratio of largest stockholder (including related party) (%)  |
|                     | Type of participation in management     | Direct management=1<br>Indirect management=0<br>Hired management=-1  |
| Bank type           | Types                                   | Independent savings bank=1<br>Industrial capital group =0<br>Financial holding group=3<br>Savings bank group=4 |
| Bank asset          | Capital ratio                           | Capital/total asset*100(%)   |
| Internal control    | Fulltime auditor                        | Whether or not there are fulltime auditors who previously worked in supervisory agencies                       |
| Risk                | PF loan ratio                           | Total PF loan amount/total loan amount*100(%)  |

|                          |   |  |
|--------------------------|---|--|
| Utilization of asset     | Production ratio  | Net profit for the term/number of employees(million won)   |
| Utilization of resources | Ratio of expenditure to revenue                                 | Operating expenses/operating profit*100(%)   |
| Ethical management       | Number of times supervisory agency imposed disciplinary actions | Financial Supervisory Service, Number of times disciplinary actions were imposed on the bank and employees (times) supervisory agency imposed disciplinary actions |

As the result of comparison analysis on variables among Hankook Savings Bank, Dongbu Savings Bank, unhealthy savings bank group, healthy savings group and average savings bank, there were clear differences between unhealthy savings bank group and healthy savings group.

In the case of major stockholders, striking characteristic of unhealthy savings bank group was that major stockholders were all individuals. As seen in the case of Hankook Savings Bank, dominant management by an individual major stockholder cause the fall of the savings bank. As for the stockholding ratio, stocks held by a major holder for unhealthy savings bank group was less than 50% while those for healthy savings group was over 80%, showing difference in ownership concentration. This is translated as having relationship with the article of Mutual Savings Bank Act which stipulates joint responsibility of major stockholders holding over 50% of stocks. Besides, all the unhealthy savings banks had a form of indirect management by major stockholders and considering both the form of participation in management and stockholding ratio of major stockholders, moral hazard arising out of opportunistic behaviors or highest management (major stockholders, CEO) seems to cause unhealthiness of savings banks rather than agency problem between stockholders and hired CEOs.

Moreover, one of the characteristics of unhealthy savings banks was that full-time auditors are so-called 'parachute appointment (appointment by orders from the top management)' of those previously worked in related authorities. Parachute appointment of this kind is judged to ultimately lower internal control functions.

Type of savings banks also affects their unhealthiness. That is, enlargement of savings banks through integration caused the problems in diversification of risks, which eventually led to knock-on bankruptcies of affiliated savings banks. The capital ratio against asset had implications as well. That is, the capital ratio against asset turned out to be very small, which is judged that expansion of assets without increase of equity capital affected financial health of savings banks. PF ratio, which is a high-risk pursuing index, also showed big difference between healthy and unhealthy savings banks. In addition, there were apparent differences between the two groups in production ratio, ratio of expenditure to revenue and number of times which supervisory service imposed disciplinary actions.

**Table 4. Results of Status Analysis on Savings Banks**

| Variables                   | Hankook | Average of unhealthy banks | Industry average | Average of healthy banks | Dongbu |
|-----------------------------|---------|----------------------------|------------------|--------------------------|--------|
| Major stockholder           | 1       | 1                          | 0.51             | 0.4                      | 0      |
| Stockholding ratio          | 40.26   | 41.61                      | 61.1             | 80.2                     | 88.38  |
| Participation in management | 0       | 0                          | -0.15            | -0.4                     | -1     |
| Type of banks               | 4       | 4                          | 1.68             | 2.4                      | 2      |
| Capital amount              | 1.61    | 1.41                       | 4.02             | 3.01                     | 1.85   |
| Fulltime auditor            | 1       | 0.8                        | 0.34             | 0.4                      | 0      |

|   |       |        |        |        |       |
|---|-------|--------|--------|--------|-------|
| PF ratio  | 32.94 | 34.802 | 22.1   | 13.795 | 14.32 |
| Production ratio                                  | 1.12  | -609.6 | -38.09 | 72.9   | 67.34 |
| Ratio of expenditure to revenue                   | 114.2 | 137.31 | 101.99 | 90.69  | 88.54 |
| Number of times disciplinary actions were imposed | 15    | 23.8   | 8.9    | 7.5    | 0     |

Relationship among causes analyzed by case and status can be summarized as below; Savings banks in Korea are allowed with small capital (12 billion won for special cities, 8 billion for metropolitan cities and 6 billion won for other regions) and there is no limitation on stockholding ratio. Meanwhile, regulations on operation have continuously been relaxed. In 2000, governmental support was provided for M&A among, and restructuring of, savings banks and in 2001, limitation on deposit protection was increased (from 20 million won to 50 million). In 2002, the name 'mutual savings and finance company' was allowed to change into 'mutual savings bank' and in 2005, requirements for acquiring stocks were relaxed to facilitate voluntary M&A among savings banks while in 2008, expansion of branches and credit line was allowed for savings bank acquiring unhealthy savings banks. Under this financial environment, capital of Hankook Saving Bank increased 9-fold from 282 billion won in 2000 to 2 trillion won in 2007 and ultimately reached 2.678 trillion in 2010. Still, its capital increased from 20 billion in 2000 only to 35 billion in 2002 and remained the same until 2010, marking capital ratio against asset of 1%. It did not possess risk management system to manage its asset and its internal control system did not function, either. Individual major stockholder chairman Hyun Soo Yoon indirectly engaged in overall management of Hankook Savings Bank and made personal companies by using the asset of the bank. He arbitrarily received illegal loans from affiliated saving banks and ordered the saving banks to provide loans to personally-related companies and embezzled bank funds. With repeated behaviors to pursue personal interests with saving bank money like this, the savings bank finally collapsed and went bankrupt.

On the other hand, capital of Dongbu Saving Bank increased 5-fold from 335 billion won in 2000 and 886 billion won in 2007 and to 1.659 trillion won in 2010. Compared with Hankook Savings Bank, there was no rapid increase in assets of Dongbu. In addition, rejecting expansion of scale by acquiring other savings banks, Dongbu Savings Bank has continued its operation as an independent and single savings bank and it has established systematic management strategy and supervisory function of internal control system. Dongbu has been operated by hired professional CEOs and especially, even with very high stockholding ratio of major stockholder, there was no opportunistic behavior by major stockholders, which can be translated that informal social norms such as reputation and trust of Dongbu Group as an industrial capital have prevented it from taking place.

## 5. Conclusion and Implications

The results of case study and analysis on group cases in this study are as follows; Unhealthy savings banks tend to have higher asset ratio against capital than healthy ones and under the circumstances without risk management (system) and internal control system, moral hazard occurred by major stockholders who tried to take advantage of expanded asset for their own personal interests. In addition, lax laws and regulations on capital and ownership structure and relaxation policy on operation regulations produced vulnerable capital structure and abnormal asset structure.

In the case of healthy savings banks, system management techniques and internal control system have been operated properly to keep away from vulnerable capital structure and abnormal asset structure. In particular, one of their distinct characteristics is

that they have continued ethical (law-abiding) management by hired CEOs while major stockholders have been excluded from management. In addition, informal social norms such as reputation and trust as an industrial capital to which savings bank belong have prevented or controlled moral hazard. This study was conducted on the causes of unhealthiness of mutual savings banks which have stirred serious social problems. The study selected typical case of a unhealthy savings bank (Hankook Savings Bank) and a healthy savings bank (Dongbu Savings Bank) and compared them with comparison bank groups. Then, the study investigated causes of unhealthiness through status analysis. Studies on mutual savings banks have not been conducted in an in-depth way since there are less than 10 listed savings banks, which make empirical study difficult as well, and on top of that, in the case when a savings bank is liquidated from the market, it is difficult to obtain its data. Therefore, this study aimed to elucidate the causes of unhealthiness of savings banks through in-depth case analysis.

As the result of analysis on Hankook Savings Bank and Dongbu Savings Bank, it turned out that even in the same financial environment, there were clear differences in performance depending on CEO, stockholding ratio and management type. In particular, vulnerable capital structure and abnormal asset structure, weak risk management system and lack of internal control system cause by lax laws and regulations regarding capital of mutual savings banks and relaxation of regulations on operation brought about moral hazard of major stockholders and management, causing unhealthiness and eventual collapse of savings banks. This study verified variables which affect the health of savings banks and theoretically explored the importance of stockholding ratio and difference of management mechanism. In addition, this study also clearly verified moral hazard and responsibility of management through comparison of diverse cases of mutual savings banks.

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