
A Study on the Failure of Merchant Banks: Based on Questionnaire and Interviews¹⁾

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Abstract

This paper presents a case of the failure of Korea's merchant banks in the wake of the 1997 Korean financial crisis, based on both questionnaire and interviews analysis undertaken in April 2002. The survey was carried out to get information and opinion from sources in the closely related areas, including staff of merchant banks, professors, scholars, government officials and journalists. Various malpractice and negative factors in both individual institutions and financial system were perceived through the survey analysis, such as lack of appropriate supervision over financial industry, reckless business by financial institutions, etc. In the process of financial reform following the crisis, various measures have been taken to rectify factors likely to deteriorate financial institutions, including strengthened prudential regulation and supervision, and enhanced accounting standards, although there is something to be desired. [C81, G21, G33, N25]

1) This study was carried out as part of PhD thesis at Newcastle University. I would like to thank seminar participants at Komaba Campus of Tokyo University held on 19 Dec. 2006 for helpful discussions.

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I. Introduction

Since the financial crisis broke out in 1997, a number of Korean financial institutions were closed.¹⁾ Especially, merchant banking sector suffered most severely from the crisis. Currently, only two merchant banks are doing business while 28 out of 30 merchant banks were liquidated or merged in the light of the government's decisive reform of the financial sector. The Korean financial crisis is considered to have been triggered by liquidity problems in the country's financial sector.²⁾ The financial sector, which had got used to regulation and government intervention, exploited the deregulation and business autonomy in the course of financial liberalisation for their maximum profit, but also with maximum risks.

Although Korea's merchant banks have been blamed for inviting the devastating financial crisis into the country, there have been rare studies on these institutions. Choi and Lee (2006) recently investigated the ineffective regulation and supervision surrounding the merchant banks. They argued that financial regulation and supervision over the merchant banking industry before the outbreak of the crisis was outdated and ineffective. However, regulation and supervision was not ineffective because of being outdated. Rather the ineffectiveness lied in moral hazard within the industry, asymmetric application of the regulation and fragmented financial supervision system.³⁾ This paper illustrates these problems leading to the failure of the merchant banking sector, based on the survey carried out in April 2002 to get information and opinion from sources in related areas, including staff of merchant banks, economists in universities and economic research institutes, government officials, and journalists. Follow-up interviews with some of respondents were also undertaken to help complement findings of the questionnaire survey. The rest of the paper is organised as follows. Section II discusses historical development and change of merchant banks. Section III provides survey methodology while section IV describes results of questionnaire. Section V

1) s many as 1,322 financial institutions have since disappear until the end of 2006. For more details, see Yoon (2007a)

2) plethora of studies on the crisis have been made. Among them, see Yoon and Kang (2006) for the Asian financial crisis, Yoon (2007b) for the diagnosis of the 1997 Korean financial crisis, and Choi and Lee (2006) for the discussion of merchant banks.

3) these problems have been rectified in the process of post-crisis financial reform by the authority in cooperation with the IMF (see Yoon (2005, pp. 190-194) and Yoon (2006, p.135)

investigates follow-up interviews before concluding.

II. Merchant Banks

Korea's merchant banks, which have similar functions to those of merchant banks in the UK and investment banks in the US, underwent the most severe restructuring in the course of the 1997 financial crisis as the number of merchant banks was reduced to just two at the end of 2003 from 30 before the crisis.⁴⁾ The number of merchant banks was six until 1993, but rose to 30 at the end of 1997 as 24 Investment and Finance Companies (IFCs), which specialised in short-term financing business such as the discount and sale of commercial paper and cash management accounts (CMAs), converted into merchant banks due to their reduced business growth in the wake of financial liberalisation.

1. Establishment of Merchant Banks

Merchant banks was first introduced in 1976 under the Merchant Banking Corporation Act (MBCA) in order to diversify the channels for foreign capital borrowings to remedy shortages of foreign exchange reserves due to the oil crisis in 1973-74 and also to provide diversified and comprehensive financial services to enterprises, modelled after the UK merchant banks.⁵⁾

The Korea Merchant Banking Corporation (KMBC) was opened on 1 April 1976, which was followed by the establishment of Korea Kuwait Banking Corporation (KKBC 1977.2.15), Korean French Banking Corporation (KFBC, 1977.7.13), Saehan Merchant Banking Corporation (SMBC, 1977.11.7) Asian Banking Corporation (ABC, 1977.11.2) and Korea International Merchant Bank (KIMB 1979.5.28). All of the six merchant banks were launched in the form of joint ventures with foreign financial institutions in order to support the inducement of foreign capital to the private sector and offer comprehensive financial services, thereby compensating for the weakness of the financial system's

4) Merchant banks in Korea are also called merchant banking corporations

5) Law No. 2825 (31 December 1975).

strict compartmentalisation into banks and securities companies (BOK (2002)).⁶⁾ According to MBCA, merchant banks carry on a wide range of financial services from banking to securities services: (1) short-term financing business such as the discount, sale, purchase, acceptance and guarantee of commercial papers (CPs) issued by business forms, and the issuance of their own papers; (2) loans for operation and equipment funds; (3) underwriting and selling of securities; (4) brokerage of foreign capital inducement, overseas investment and international financing, or direct borrowing from foreign countries; (5) issuance of debentures; (6) consulting services; and (7) payment guarantee. The MBCA also allows them to deal with other concurrent businesses subject to prior approval according to relevant laws, which include leasing, securities investment trust, trust business (except for money in trusts), dealing and brokering of securities, and foreign exchange business (MBCA (2000) 7(1) and (2)).⁷⁾

Merchant banks chiefly raise funds through the issuance of their own paper, CMAs, borrowings and the issuance of debentures, and operate their funds in the form of securities, loans and leasing assets. CMAs and borrowings made up the major proportion until 1995. However, as the demand for CMAs, which were mainly invested in CP whose credit risk increased, and borrowings from abroad declined sharply after the currency crisis, the issuance of paper became the main source of funds. As of the end of June 2001, paper issued accounted for 56.4 per cent of total fund raising and the share of borrowings stood at a mere 6.0 per cent. In terms of the operation of funds, loans, which are mainly operated through the discount of CP, accounted for the biggest share with 41.2 per cent of the total funds operated as of the end of June 2001, followed by investment in securities with 21.1 per cent (BOK (2002)).

2. Expansion of Merchant Banks

Since the six merchant banks were established in late 1970s, additional entry into the merchant banking sector was prohibited due to the government's policy aim of avoiding excessive competition. Thus merchant banks were able to enjoy the high-yield business under the protective environment until 1994, when investment and finance companies (IFCs) began to be allowed to convert into merchant banks following the financial liberalisation.

6) The six were jointed by the financial institutions of the UK, Kuwait, France, the US, Saudi Arabia and Germany, respectively.

7) Amended on 28 January 2000 (Law No. 6205).

Investment and Finance Companies

IFCs, or short-term finance companies (SFCs), were first introduced in 1972 under the Short-term Financing Business Act of 1972, in order to absorb the curb market funds into the organised financial market, to promote the development of the money market, and to supply short-term financing to business firms.⁸⁾ Following the establishment of 10 IFCs in Seoul and regions in 1972 to 1974, 22 IFCs continued to be opened in the regions for the purpose of promotion of local economy and also in Seoul until 1983.

Their principal purpose is to provide short-term financing to firms by discounting commercial papers issued by business firms. They raise funds through issuing their own papers, selling the papers discounted, and receiving money through the cash management accounts (CMAs). In addition, they may conduct securities business, such as underwriting and selling securities or acting as a broker in the sale and purchase of securities, under the authorisation of the Minister of Finance and Economy. The securities business of IFCs is restricted to underwriting and selling of government and public bonds, particularly treasury bills. IFCs also handle such business as factoring, payment guarantees of notes issued by business firms, and sales of CDs issued by banks.

Conversion of IFCs into Merchant Banks

The diversification and expansion of the scope of business of banking institutions through financial liberalisation has been an increasing threat to short-term finance companies. Moreover, the openness of financial market is demanding large-scale financial institutions in order to tackle severe competition among financial institutions. In 1991, the Financial Institution Merge and Conversion Act was enacted to help IFCs convert into banking institutions or securities companies, or merge with other financial institutions in preparation for the financial market opening by pursuing large-sized financial institutions. Accordingly, three IFCs converted into banks and five IFCs were transformed

8) On 3 August 1972, the government announced the "Presidential Emergency Decree For Economic Development and Stability" as one of measures to reorganise the (unofficial and unregulated) curb market and to lessen the financial burdens of curb market loan-ridden business enterprises. Relating to this Decree, the Short-term Financing Business Act, The Mutual Savings and Finance Company Act and the Credit Union Act were enacted.

into securities companies in 1991.

Eight Seoul-based IFCs and 16 local IFCs had since been doing business before 9 short-term finance companies were allowed to become merchant banks in 1994 and 15 companies converted into merchant banks in 1996. As all of the IFCs converted into merchant banks on 1 July 1996, the number of merchant banks increased to 30 from six and assets of the merchant banks amounted to 45.6 per cent of those of the banks at the end of 1996, before the outbreak of the financial crisis (see Table 1).

Table 1: Assets and Capital Change of Merchant Banks

(Unit: billion won)

Year ¹⁾	Assets of MBs ²⁾	Capital of MBs	Assets of banks ³⁾	Capital of banks
1990	48,308	2,440	135,519	12,339
1991	54,720	2,035	161,516	13,781
1992	61,590	2,246	180,615	14,891
1993	75,261	2,544	194,988	16,223
1994	88,973	3,181	228,961	18,917
1995	123,878	3,657	288,687	21,380
1996	155,910	3,969	341,558	23,237
1997	166,771	3,884	483,498	22,290

Notes: 1) As of the end of year

2) Inclusive of IFCs turned merchant banks

3) Commercial banks, local banks and foreign banks branches are included.

Source: The Bank of Korea

3. Fall of Merchant Banks

Existing merchant banks had conducted business in relatively conservative way, mainly due to control on the business of foreign joint-venture companies. However, with the advent of a growing number of IFCs-turned merchant banks, which were well known for their aggressive business style, merchant banks changed their business style, which had traditionally been focused on the loans to big business groups and to companies with healthy financial status. Merchant banks began to extend their credit to less healthy business groups and take risks for the maximum profit by making long-term loans/investment in both domestic and foreign currency with short-term foreign currency borrowings, as is evidenced by the survey analysis in sections ahead.

As a series of bankruptcies in the big business groups took place in early 1997, non-performing loans of merchant banks increased dramatically.⁹⁾ As the Asian financial crisis broke out in mid 1997 and it was difficult to roll over short-term foreign currency borrowings, merchant banks faced liquidity problems in won and foreign currency, and these triggered the liquidity crisis of the country.

9) Among Korean top 30 big business groups (orchaebo), big business groups such as Hanbo (January), Sammi (March), Jinro (April), Daenong (May), Kia (July), Haitai and New Core group (November) went bankrupt in 1997.

In the course of the financial crisis, merchant banks suffered the first and the most severe restructuring in financial sector after the outbreak of the crisis. Sixteen merchant banks were liquidated in 1998. In 1999, one merchant bank had its licence revoked while three merchant banks were acquired by banks and a securities company. In 2000, the government suspended the operation of six merchant banks, which were suffering a flight of deposits due to the worsening of their credibility in the wake of Daewoo's financial problems. Among them, one was stripped of its licence in May and four merchant banks were merged into Hanaro Merchant Banking Corporation in December while the other suspended merchant bank merged in 2001 into Tongyang-Hyundai Merchant Banking Corporation, which had merged with another merchant bank earlier.¹⁰⁾ This corporation merged into a securities company in November. As a result, the number of merchant banks has dwindled to three at the end of 2001, which includes KFBC, Kumho, and newly-established Woori Investment Bank, which was finally acquired by Woori Bank in August 2003.

III. Methodology

1. Data Collection Instrument

There are many methods of data collection in survey research. For example, personal interviews, telephone interviews and self-administered questionnaires have been used (Manly (1992)). Salant and Dillman (1994) presented a fourth method – the 'drop-off survey', which combines features of face-to-face interviews with mail surveys.

For a variety of reasons, people selected in a sample may not finally be included. Some will refuse to respond, others will be uncontactable. De Vaus (1996) pointed out that non-response can create two main problems: unacceptable reduction of sample size and sample selection bias. He explained that the problem of sample size can be tackled in two ways. First, it is to employ techniques designed to reduce non-response. The second way is to

10) Hanaro Merchant Banking Corporation was newly established by the Korea Deposit Insurance Corporation KDI to consolidate four troubled merchant banks (Yeungnam, KMBC, Central and H&S) on a purchase and assumption (P&A) basis, and renamed as Woori Investment Bank in September 2001

draw an initial sample that is larger than needed. In real life, however, it is difficult to get a large enough sample to make up for expected low non-response. In practice, it is better to find a way to reducing non-response and improving response rate. For that purpose, an on-line questionnaire was employed in this survey. People are flooded with unwanted spam mails every day and tend to soon delete them as they arrive. Preventive action was needed for the email containing the questionnaire not to be treated as spam and not to be deleted.

In order to counter potential difficulties and increase the response rate, a 'Total Design Method' (TDM), described by Dillman (1978), was adopted in the procedures for implementing the survey. The theory underlying the TDM is social exchange, which suggests that the likelihood that individuals will respond to a survey questionnaire is a function of how much effort is required to respond, and what they feel they are likely to get in exchange for completing the questionnaire. Based on the TDM method, several actions were taken to improve the design of the questionnaire and responses as follows.

A. Questionnaire Construction and Design

Most of the questions in the questionnaire were closed-ended with only two questions, such as age and company name, open-ended. In self-administered surveys, open-ended questions are recommended to be used as little as possible because of several potential difficulties. Answers for open-ended questions are more difficult to interpret and code than closed formats. The propensity to provide an open-ended response is often related to respondent characteristics, for example, education, which may bias the results. Those who don't mention a certain topic simply may not have thought about it when answering the question but would have answered differently if presented with response choices.¹¹⁾

Questions asking for information that the respondents might feel reluctant to answer were placed in the back of the questionnaire, and the least important questions such as demographic ones were also put in the final part. Especially e-mail address was requested along with the time they consumed to fill out the questionnaire as if necessary for enhancing on-line questionnaire technique, to relieve them of worries to be named for answering. Clear directions on answering the questions were provided on the top of each part of the

11) For further discussion of these issues, see Rodeghier (1991)

questionnaire.

The back cover of the questionnaire also contained an expression of appreciation, a request to check for any omission, a yes-or-no question of whether the respondent could be contacted later for further questions, and finally a reminder to the respondents of the importance of their participation in the survey with thanks. A 'submit' button was prepared in the last part of the questionnaire for respondents to send their answers with greater ease by just clicking it once.

B. Mailing Process

Dillman (1978) recommends mailing out in an early day of the week, and also avoiding mailings close to holidays or during the entire month of December. Based on his advice, the first e-mail was sent out on Monday, 10th of April, 2002 so that respondents received it on the first day of the week. At this stage, questionnaires were sent to a portion of samples to check how they work and to make sure there are no problems that might not be detected at the stage of pilot testing before sending out further questionnaires. Another group was given questionnaires a week later. In this manner, questionnaires were sent out to the whole set of respondents within two weeks following the first e-mail.

Dillman (1978) also argues that without follow-up mailings, response rates would be less than half those normally attained the TDM, regardless of how interesting the questionnaire or impressive the mail-out package. Although he recommended three follow-ups, as many follow-up e-mailing as necessary were made in this survey together with phone calls.

The follow-up reminder e-mail contained much stronger expressions than the initial mail appealing to the non-respondents' participation in the survey, and asked them to request the questionnaire again in case they have not received or deleted it due to being regarded as spam mail. As a result, the response rate turned out to be a highly satisfactory level of 56 per cent.

C. Sample and Pre test

The objective of the questionnaire is to get information, opinions or assessment from sources with the experience and knowledge of the topic under study. Merchant banks, blamed for triggering the 1997 Korean financial crisis, had been the victims of the crisis. For that reason, information from staff of merchant banks may be biased.

It is believed, therefore, that the survey should be expanded to the subject groups outside the merchant banks.

Merchant banks staff was chosen among both those with more than five years of job experience and assistant manager or higher ranking officers. Other than merchant banks staff, questionnaire sample groups were chosen among people who are regarded as experts in the field such as professors who majored in finance, scholars who publish books or articles in the area, government officers in charge of financial supervision, and newspaper reporters covering the financial sector. Wherever necessary, comparisons between merchant bank and non-merchant bank respondents of the results of the questionnaire have been made.

The sample for merchant banks comprised 56 from surviving banks and 99 from failed merchant banks. The other sample included 23 professors, and 40 economists from the most prestigious economic research institutes,¹²⁾ 8 government officers in charge of the national financial sector (MOFE and FSS) and 10 reporters who cover financial section in their newspapers. Great care was taken to ensure the suitability of individual respondents, in terms of knowledge about the issue under investigation.

To find problems in the questionnaire such as poor questions, incomplete directions and items that are difficult to answer, etc., pre-testing was carried out. The questionnaire has to be composed and tried out, improved and tried out again to make sure that it works as intended.

Furthermore, special care was also taken of the technical problems associated with on-line questionnaires to ensure that responses would be well received in the designated mail account once respondents click the 'submit' button after completing the questionnaire. All the responses were sorted out in order of time for the later use of assessing non-response bias.

IV. Results of Questionnaire Survey

1. Response Rates

The questionnaire was e-mailed to 236 persons who were generally considered

12) The institutes include Korea Institute of Finance, Korea Banking Institute, Korea Economic Research Institute, and Samsung Economic Research Institute.

to be important sources of intelligence on issue related to this survey. After a series of follow-up reminder e-mails and phone calls to the non-respondents, 133 samples responded to the questionnaire by the closing date of 11 May 2002, about one month after the first mail-out, which gave an overall response rate of 56.4 per cent. The response rate was considered to be highly satisfactory when compared to that typically achieved in postal surveys (see Beattie et al, 2002).¹³⁾ Table 2 shows the number of questionnaires that were distributed, the number returned (the response rate) for each group, and overall response rate.

Table 2: Subject Groups and Response Rates

Subject groups	Distributed questionnaire	Returned questionnaire	Response Rate (%)
Staff of merchant banks	155	91	58.7
Professors (universities)	23	13	56.5
Economists (Economic Research Institutes)	40	20	50.0
Journalists	10	6	60.0
Government officials	8	3	37.5
Total and overall response rate	236	133	56.4

The potential drawback of surveys is that people are not always willing or able to respond to the questionnaire. There may be a difference between respondents and non-respondents. Girden (2001) argued that a response rate of 70 per cent or better does not pose threat of bias. In order to assess any potential non-response bias amongst the sampling frame, a comparison was made between the answers received from early respondents who replied without follow-up reminders (67 respondents) and those received from late respondents who replied after the follow-up reminder e-mails or telephone calls (66 respondents), to test whether late respondents are similar to non-respondents (Oppenheim (2000)). After conducting the Mann-Whitney U test and Chi-square test on the whole closed-ended questions excluding the demographic ones, no significant difference was found between the two groups (early respondents and late respondents). Overall, these results suggest that the 56.4 per cent response was representative of the entire sample.

13) They stated that response rates for seven postal surveys ranged between 9 per cent and 35 per cent.

To further investigate the effect of any sample bias, the responses by each of the subject groups were compared and tested whether there is any significant difference in these response rates. The comparison was conducted by chi-square test. Chi-square test determines whether frequencies in certain categories differ from what would be expected on the basis of chance. The test is also known as goodness-of-fit test (Sarantakos (1994)).

The basic formula is:

$$\text{Chi-square} = \sum_i (f_i^o - f_i^e)^2 / f_i^e$$

where f_i^o stands for the observed frequencies and f_i^e stands for the expected frequencies.

Table 3 shows the results of a chi-square test applied to the returned questionnaires from the subject groups illustrated in Table 2.

Table 3: Comparison of Responses by Sampling Groups

Subject group	Distributed	Returned (Observed, fo)	Expected (fe)	fo - fe	(fo - fe) ² / fe
Merchant Bank	155	91 (58.7%)	87 (56.4%)	4	0.1830
University	23	13 (56.5%)	13 (56.4%)	0	0
Economic institutes	40	20 (50.0%)	23 (56.4%)	3	0.3989
The press	10	6 (60.0%)	6 (56.4%)	0	0
Gov't officials	8	3 (37.5%)	5 (56.4%)	2	0.8865
Total	236	133 (56.4%)	133		1.4684

Chi square: 1.4684, df: 4, Critical value of Chi square (4, 0.05): 9.4877

The computation of chi-square is presented in Table 3. Now that chi-square (1.4684) is less than the critical value (9.4877) with df (degrees of freedom) of 4 (5 less 1) and a significant level of .05. So the null hypothesis, that there is no difference in response rate in each group, cannot be rejected. The test confirmed that the responses were distributed similarly to subject groups in the sample frame.

A. Contents and analysis of the questionnaire

After the outbreak of the crisis in late 1997, various issues about merchant banks had been raised, such as inappropriate licensing, inadequate supervision, and their risk management system, as they turned out to make enormous loans to all the ailing big

business groups which had collapsed in 1997 and also they were involved in huge risky investments in the emerging markets. For comparison, cross-tabulation analysis and Mann-Whitney U test are used.

Firstly, the question asked respondents whether they agreed that merchant banks had triggered the Korean crisis in 1997. 49 per cent of the respondents agreed and 46 per cent disagreed. Although this survey, in total, does not make any conclusion, some differences between respondents of merchant banks and other respondent groups are found. The resulting cross-tabulation is shown below in Table 4. Respondents of other groups blamed merchant banks for triggering the crisis (82 per cent) much more than those of merchant banks (34 per cent). Statistically speaking, there is significant difference in belief between the two groups in the population (chi-square = 39.01; $p = 0.000$). More than half of respondents of merchant banks disagreed the MB's responsibility for the crisis.

In the next two questions regarding the licensing of 24 merchant banks in 1994-1996, a high portion of respondents (85 per cent) believed it wrong that 24 of the Short-term Finance Companies (SFCs) were changed to merchant banks to be 30 from 6 merchant banks and 94 per cent answered that some political considerations, such as geographical disposition and lobbying, played an important role in SFCs' change to merchant banks.

Table 4: MBs to Blame for the Crisis (MB or Non-MB Cross-tabulation)

		Respondents		Total
		MB	Non MB	
Agree	Count	31	32	63
	% within MB or non MB	34.1%	82.1%	48.5%
Disagree	Count	58	2	60
	% within MB or non MB	63.7%	5.1%	46.2%
Neither	Count	2	5	7
	% within MB or non MB	2.2%	12.8%	5.4%
Total	Count	91	39	130
	% within MB or non MB	100.0%	100.0%	100.0%

Notes: MB: respondents of merchant banks, Non MB: other groups of sample

In answer to the question asking 'do you think that SFC-turned merchant banks prepared for the new type of business (esp. international business and mid/long-term investment)?', 95 per cent responded negatively. Again, it was focused on the response of the respondents of merchant banks, who were considered to be able to know better. Even a majority of respondents in merchant banks (86

out of 91) also verified a lack of preparation.

Separate subsequent three questions specifically covered problems related to licensing and ill-preparedness of merchant banks. Abrupt appearance of a large number of merchant banks led them to accumulate risky investments in so-called emerging market (e.g. Russia, Southeast Asian countries, Latin America, etc.). Not surprisingly, 91 per cent of respondents confirmed that risky outward investment was related to the increase in the number of merchant banks. As the number of banks increased from six to 30, merchant banks began to turn to the market abroad since the domestic market had been saturated. In next questions regarding new merchant banks, respondents evaluated capability of both top management and in-house experts.¹⁴⁾ The next question asked whether merchant banks had in place the risk management required to manage the new type of risks that financial liberalisation might bring. 95 per cent of respondents replied either 'no' or 'strongly no'.

In answer to the Question asking 'in making decision of investment/loan in merchant banks, do you think external parties exerted some influence?', Table 5 shows that 35 per cent of merchant bank respondents said 'yes' to the question while 49 per cent of non-merchant bank respondents believed that external influence existed. This difference was statistically significant at the 5 per cent level (Chi-Square = 6.311; $p = 0.043$). Merchant banks were considered to be less influenced by the third party than expected outside.

Table 5: Influence of the External Parties

		Respondents		Total
		MB	Non MB	
Yes	Count	32	19	51
	% within MB or non MB	35.2%	48.7%	39.2%
Don't know	Count	31	16	47
	% within MB or non MB	34.1%	41.0%	36.2%
No	Count	28	4	32
	% within MB or non MB	30.8%	10.3%	24.6%
Total	Count	91	39	130
	% within MB or non MB	100.0%	100.0%	100.0%

Notes: MB: respondents of merchant banks, Non MB: other groups of sample

Next question asked 51 respondents who answered 'yes' to the above question

14) Respondents believed that top management of the new merchant banks did not have the capability to grasp and deal with the business risks (87 per cent), and that new merchant banks were not equipped with in-house human capital and expertise necessary for managing the risks associated with foreign currency business (92 per cent).

what affected the decision-making in merchant banks. Big shareholder was seen to be the most responsible for putting pressure on decision-making of merchant banks, followed by top management, political power and government, respectively (see Table 6). Wilcoxon signed-ranks test (last column in Table 6) demonstrates that differences between big shareholder and top management's arbitrary attitude and between top management's arbitrary attitude and political power are statistically significant at the 5 per cent and 1 per cent level, respectively, while no statistical difference between political power and government is shown. As is the case, the post of top management in Korea has been taken by the big shareholder due to compliance rather than performance. Some merchant banks, which saw their big shareholders change from one to the other, went bankrupt during the crisis.

Table 6: Factors which Affect Merchant Banks in their Decision-making

	N	Mean ¹	S Wilcoxon Deviation ²	t	d	.
						sig. level
<i>(5 being highest degree, 1 being not relevant)</i>						
1. Big shareholder	50	4.08	1 -	.	0	8
2. Top management's arbitrary attitude	51	3.71	1 .043**	.	0	4
3. Political power	50	3.02	1 005***	.	2	9
4. Government	50	3.02	1 1.000	.	3	3

Notes: 1. Mean value is based on a 5 point Likert scale (1 = not relevant; 5 = highest degree).

2. Significance of the statistics for the Wilcoxon signed ranks test between factor 1 and 2; factor 2 and 3; factor 3 and 4, respectively.

3. ** and *** indicates that the result is significant at the 0.05 level and 0.01 level, respectively.

In next two questions, respondents replied that merchant banks were responsible for their failure (79 per cent) and were able to enjoy considerable autonomy in doing business comparing with banks (59 per cent).¹⁵⁾

15) In comparison with commercial banks, merchant banks might be free from intervention by the government but they were not able to avoid influence by their big shareholders. The bank

In response to the following question, 47 per cent of respondents believed there was a difference between the surviving and failed merchant banks while significant minority (32 per cent) said no difference with 11 per cent 'don't know'. The next question asked 60 respondents who answered 'different' to rank the extent of difference on the given factors. Table 7 illustrates that foreign shareholder's control of major business was the most differential factor, followed by process of investment decision-making, ability of top management to control risk, internal regulation of risk management and ability of employees to deal with daily business respectively. The Wilcoxon signed-ranks test (last column in Table 7) reveals that ability of top management to control risk and internal regulation of risk management were statistically grouped in the same category ($p = 0.671$), and that internal regulation of risk management and employees' ability did not show statistical difference at 5 per cent significance level. ($p = 0.074$).

Table 7: Factors to Differentiate Surviving MBs from Failed Ones

	N	Mean ¹	S Wilcoxon Deviation ²	t test	d sig. level
(5 being highest degree, 1 being not relevant)					
1. Foreign shareholder's control of major business	59	4.20	.	.	9 8
2. Process of investment decision making	60	3.60	.001 ***	.	2 4
3. Ability of top management to manage risk	60	3.10	.007 ***	.	1 0
4. Internal regulation on risk management	59	3.05	.671	.	2 0
5. Ability of employees to deal with daily business	60	2.77	.074 *	.	1 8

Notes: 1. Mean value is based on a 5 point Likert scale (1 = not relevant; 5 = highest degree).

2. Significance of the statistics for the Wilcoxon signed ranks test between factor 1 and 2; factor 2 and 3; factor 3 and 4; factor 4 and 5, respectively.

3. * and *** indicate that the result is significant at the 0.1 level and 0.01 level, respectively.

ownership of ceiling for a single entity, including chaebol, had been limited to 4 per cent until it was raised to 10 per cent in 2002 in order to facilitate sales of the government-held stocks (however, investors are allowed to exercise no more than 4 per cent of voting rights), while merchant banks had not been subject to the ownership limitatio

The criterion of decision to exit merchant banks from the market in Korea was the capital adequacy ratio, often referred to as BIS (Bank of International Settlement) ratio. There has been dispute in applying this ratio. The next question asked whether it was appropriate to apply the BIS ratio as a criterion to liquidate merchant banks. More than half of respondents (55 per cent) answered positively about the application of BIS ratio to close troubled merchant banks while 36 per cent believed the BIS rule application to be inappropriate. Cross-tabulation analysis was conducted to identify the difference between respondents of merchant banks and of other subject groups. Difference between respondents of surviving and failed merchant banks was also tested. Significant difference in the response between merchant bank sample and other sample groups was reported (chi-square = 18.10; p = 0.000) while, beyond expectations, no statistical difference between surviving and failed merchant banks was found (chi-square = 3.77; p = 0.152) (see Table 8 and 9). 47 per cent of respondents of the merchant banks considered application of the BIS ratio wrong and 45 per cent accepted the ratio as a standard while a high portion of respondents outside merchant banks (79 per cent) believed application of the BIS rule to be appropriate and only 8 per cent were against it. Although respondents of failed merchant banks showed more complaint about application of the BIS rule than those of surviving ones as Table 9 demonstrates (57 per cent versus 38 per cent), there was no statistical difference between the two groups.

Table 8: Application of the BIS Ratio between MBs and Non-MBs

		Respondents		Total
		MBs	Non MBs	
Inappropriate	Count	43	3	46
	%	47%	8%	36%
Don't know	Count	7	5	12
	%	8%	13%	9%
Appropriate	Count	41	30	71
	%	45%	79%	55%
Total	Count	91	38	129
	%	100%	100%	100%

Table 9: Difference between Surviving and Failed MBs

		MB staff		Total
		Failed	Surviving	
Inappropriate	Count	26	17	43
	%	57%	38%	47%
Don't know	Count	2	5	7
	%	4%	11%	8%
Appropriate	Count	18	23	41
	%	39%	51%	45%
Total	Count	46	45	91
	%	100.0%	100.0%	100.0%

In answer to the question asking ‘if a failed merchant bank had measured and managed risk properly and abided by tighter prudential regulation, could it have survived?’, 86 per cent of respondents replied ‘strongly yes (14 per cent)’ or ‘yes’ (72 per cent), while non-MB respondents answered more positively (90 per cent) than those of merchant bank respondents (85 per cent).¹⁶⁾ It suggests that the failure of merchant banks is seen as resulting from the risky management of their businesses.

The last three questions of the questionnaire were prepared only for respondents who are working for merchant banks to compare current the internal risk management system and reporting systems with the pre-crisis ones. Only half of respondents now working for merchant banks answered that their company’s risk management had improved and 30 per cent assessed ‘not much difference’ while 87 per cent believed reporting systems to supervisory organisations were much improved. The post-crisis supervisory reform is considered to be effective. However, lots of staff of merchant banks is still less confident of their internal risk management system, leading to the result that only 40 per cent of them predicted survival of their companies in the event of a similar crisis in the future in response to the separate question.

In additional questions in the demographic part, 91 per cent of the respondents working for merchant banks had not imagined before the crisis that their

¹⁶⁾ It includes 76 per cent of respondents of failed merchant banks with ‘strongly yes’ of 20 per cent and ‘yes’ of 56 per cent. Relative high portion of the respondents (20 per cent) answered ‘no difference’, compared with 4 per cent of surviving merchant bank sample and 5 per cent of non MB (merchant bank) respondents.

companies might go bankrupt and 84 per cent had not thought of being forced to quit the job against their will.

In Korea, where prior to the 1997 crisis bankruptcies of financial institutions were unprecedented, working for financial institutions was regarded as one of the most stable jobs in terms of job security. The crisis transformed Koreans' view of the job market. It was realised that there exists no lifelong employment system in the country. In the banking sector, 45,000 employees out of about 120,000 had lost their jobs between 1997 and 2000.¹⁷⁾ The case of non-bank financial institutions, including merchant banks, was more devastating because they had been more severely hit by the crisis than banking institutions.

Reflecting this unstable job security, in response to the question, none of 46 respondents replied that they will be able to stay in their company until the retirement age stipulated in the company regulation.

A. Demographic Data

The sample of the questionnaire can be separated into two groups; merchant bank and non-merchant bank respondents. The non-merchant bank groups are again broken down into four groups; respondents in universities, economic research institutes, government and newspapers (see Table 2). The validity of responses can be related to the suitability of individual respondents in terms of knowledge about the issue under investigation.

Great care was taken to ensure that the sample was rightly selected to answer to the questions that might require a high level of knowledge of the subject. To assess the suitability of the sample, all the respondents were asked to answer the questions relating to their profession, the length of their service, age, and title in case of merchant banks, respectively.

Table 10 shows that most of the respondents of the non-merchant bank groups were in an age band of 36 and 45 (69 per cent) and average period of working of all respondents was about eight years (and hence likely to be suitable to answer the survey). For merchant bank sample, on the other hand, four out of 91 respondents were clerks and had work period of less than three years, likely to be inappropriate to give suitable opinion. However, it is felt

17) See *ASIAWEE* (volume 27, number 1, 12 January 2001), 'Getting Tough' reported by Roger Dean du Mars. Available at <http://www.asiaweek.com/asiaweek/magazine/2001/0112>.

comfortable to ignore due to the small portion (4 per cent). Respondents' average period of working for merchant banks was more than 12 years and their age were 41-45 (30 per cent), 36-40 (29 per cent), 31-35 (24 per cent) 46-50 (14 per cent) and over 50 (3 per cent), respectively. As regards position, respondents are among executive director (12 per cent), general manager (15 per cent), vice general manager (22 per cent), manager (28 per cent), assistant manager (19 per cent) and clerk (4 per cent) (see Table 11). It is considered that, on the whole, the respondents were well suited to answer to this survey.

Table 10: Demographic Data for Non-MBs

Subject groups	N	Length of service		Age	
		Mean ¹	Std. dev.	Mean ²	Std. dev.
Professors (universities)	13	7.85	2.44	3.23	1.17
Economists (Economic Research Institutes)	20	8.53	6.05	3.75	1.02
Journalists	6	5.67	4.68	4.83	0.98
Government officials	3	8.33	5.51	4.00	1.00
Total	42	7.90	4.88	3.76	1.14

Notes: ¹ indicates average years of service.

² is based on six age categories (1 = over 50; 2 = 46 50; 3 = 41 45; 4 = 36 40; 5 = 31 35; 6 = under 30).

Table 11: Demographic Data for Merchant Banks

N	Length of service		Age		Title	
	Mean ¹	Std. dev.	Mean ²	Std. dev.	Mean ³	Std. dev.
91	12.43	5.89	3.56	1.11	3.38	1.39

Notes: ¹ indicates average years of service.

² is based on six age categories (1 = over 50; 2 = 46 50; 3 = 41 45; 4 = 36 40; 5 = 31 35; 6 = under 30).

³ is based on six title categories (1 = executive director or higher; 2 = general manager; 3 = vice general manager; 4 = manager; 5 = assistant manager; 6 = clerk).

A. Advantages and Limitations of the Questionnaire

A larger number of researchers choose questionnaires as the method of data collection because questionnaires have many advantages compared with other methods. For example, questionnaires are less expensive, and convenient to carry out since they can be completed at the respondent's convenience.

Besides, some bias or errors can be avoided, which are caused by the presence or attitudes of the interviewer. Questionnaires also have limitations. Sarantakos (1994) demonstrated common advantages and limitations thought by many writers.¹⁸⁾

This survey would be difficult to get the opinions from various professional groups without using questionnaire approach since it approached those sample groups more easily than other methods such as interviews and it offered anonymity (although the researcher can know who they are by their e-mail address).

The limitations of this approach are consistent with deficiencies associated with the nature of questionnaire, though best efforts were made to deal with the shortcomings. The identity of respondents and the conditions under which questionnaire was answered are not known, and researchers are not sure whether the right person has answered the questions. These problems, to a large extent, were solved in this survey by using on-line questionnaire method. Still, questionnaires do not provide an opportunity to collect additional information while the questions are being answered and, due to no researcher present, only partial response is available.

In order to address limitations of the questionnaire and gain a deeper investigation into some areas, the survey was supplemented by interviews with selected respondents of the questionnaire. Interviews can correct misunderstandings on the part of interviewees by interaction between interviewer and respondents. Interviewees, with greater permissible length of time, provide adequate explanation to sensitive and complex questions which cannot be asked in the questionnaire.

V. Follow up Interviews

There is a growing interest in qualitative methods in diverse fields of social science as comprehensive research tools and as important components in designing and implementing reliable research efforts (Foddy (1996); Morgan (1997)). Especially, researchers assert the importance of qualitative analysis of people's perceptions of the problem in framing their investigation (Kaplowitz (2000)). Principal qualitative research methods are focus groups and individual

18) For more details, see Sarantakos (1994), pp. 158-15.

interviews. Interviews are useful as follow-up to certain respondents to questionnaire to further investigate their responses. Interviews are particularly helpful for getting the story behind a participant's experiences since in-depth information around the topic can be pursued (McNamara (1999)).

In addition to the questionnaire survey discussed above, personal interviews were undertaken with some of respondents to the questionnaire survey in order to get further insights into the topic. Main objectives of the interviews are to address limitations of the questionnaire and gain a deeper investigation into some areas in a way two different research methods are complementary, conducting the interviews with selected respondents of the questionnaire, based on their answers to the questions and information of their expertise or experience, known from the questionnaire.

Although the interview sample was small, the results of the interviews provided valuable information which is richer than that provided by the questionnaire survey. It is not only because interviewees were not restricted either by the nature of the questions asked or by the range of possible answers permitted, but also because so-called 'elite interviewing' was employed in this research. According to Marshall and Rossman (1999), an elite interview is a specialised case of interviewing that focuses on a particular type of interviewee. 'Elite' individuals are those considered to be influential, prominent, and/or well-informed people in an organisation or community that are selected for interviews on the basis of their expertise in areas relevant to the research.

1. Selection of interviewees

The interviews focused on issues concerned with merchant banks, on which data was difficult to obtain elsewhere. Among the respondents who accepted further contact, interviewees were carefully chosen to be qualified to become 'elite' individuals for the in-depth interview survey, based on their job positions and experiences.¹⁹⁾

After the selection, e-mails and telephone calls were made in order to confirm their willingness to participate in the survey and book the actual appointments. Finally, ten peoples were interviewed, representing merchant banks (8), foreign

19) For this purpose, additional questions were prepared at the end of the questionnaire, asking respondents to answer if the researcher were able to further contact them, if necessary, as well as e-mail address and time spent to complete the questionnaire. All the respondents wrote their e-mail address and 103 respondents (77 per cent) agreed to be in further contact.

investment bank (1) and government (1), respectively. All respondents were aged from 37 to 53 and held their positions for ranging from 9 years to 24 years.

There are no rules for sample size in qualitative research. Sample size depends on 'what you want to know, the purpose of the inquiry, what is at stake, what will be useful and what can be done with available time and resources. The validity, meaningfulness and insights generated from qualitative inquiry have more to do with the information richness of the cases selected and the analytical capabilities of the researcher than with sample size' (Patton (1990)). In this study, in-depth information from a relatively small number of people, who were information-rich, was considered to be more valuable than less depth from a larger sample.

Among interviewees in merchant banks, three were in charge of credit analysis, one respondent worked for Honk Kong subsidiary of his company for offshore business, one was in accounting department for over 10 years, and one was a director dealing with company's restructuring plan to survive against the crisis. Two interviewees were heads of risk management team of surviving merchant banks and one was in charge of reporting to the supervisory body of the country. A government official was in MOFE (Ministry of Finance and Economy), which had been responsible for overseeing merchant banks until the FSS, a single unified supervisory body, took over the duties from four fragmented supervisory authorities in January 1999. An interviewee from Hong Kong-based foreign investment bank was with the 'Korean Desk', in charge of selling financial products to Korea's merchant banks.

2. Findings of the Interviews

Various issues of the behaviour of Korea's merchant banks were explored using the interviews; these are categorised into six parts: credit analysis; investment/loan decision-making process; reliability of financial information; supervision; post-crisis reporting; post-crisis risk management.

Credit Analysis

Merchant banks had been seriously involved in transactions with several big business groups that had gone bankrupt in 1997 despite the fact that these chaebols had already shown some warning signs of low performance. If normal

credit analysis had been carried out, the financial institutions would not have extended huge loans to these ailing companies. The interviewees with the experience of credit analysis commented:

Our companies tried to stick to normal credit analysis stipulated in the related regulation but found it very difficult to do business under the condition in which a large number of newly licensed merchant banks, which got used to 'brand name' lending practices (i.e. loans to companies belonging to chaebols), continued their aggressive business (even after being licensed to lend long term loans). Strict credit analysis was applied only to small and medium enterprises. Fortunately, our company avoided huge loss resulting from the bankruptcies of the chaebol groups due to the stringent credit analysis which were controlled by the foreign big shareholder.

One of them even revealed a bizarre experience that, in the process of credit analysis on a chaebol group, the foreign partner of his company asked for some information on the chairman of the group and he asked the group for the data. The clerk of the group replied that the group would not want the loan if the bank needed that kind of information.

In a seller's market saturated with financial institutions, adequate credit analysis may have been difficult to expect especially amid prevailing moral hazard with Korea's big business groups and financial institutions perceived to be 'too big to fail'. They had not only lent to big companies without due credit analysis, but had also ignored screening and monitoring of their loans.

Investment/Loan Decision making Process

This inadequate attitude was especially witnessed in the decision-making of off-shore investment. Most of merchant banks, particularly newly-licensed merchant banks with no experience of foreign currency business, just made offshore investments according to whether well-known banks participated in the projects, not trying to analyse borrowers. This took place not least because the merchant banks had not been equipped with adequate credit analysis system to handle overseas investments. One interviewee, who was at the 'Korean desk' of a western investment bank, described his experience as follows:

I remember visiting a SFC turned merchant bank that had been trying to accumulate foreign currency assets to the level of existing merchant banks. I explained the project associated with big investment in an emerging country. I was just asked by the director in charge which banks joined the project. After confirming the participation of internationally well known banks, the director went to the president of the company. After ten minutes, the decision to invest US\$50 million was made.

The investments of the Korea's merchant banks in the emerging markets were left being non-performing as most of borrowers in the Southeast Asian countries went in default following the Asian financial crisis, while international banks had already sold their investments in the secondary market before facing more devastating market disruption. With hindsight, merchant banks without their own information networks seem to have fall prey to internationally prominent banks.

Financial Supervision

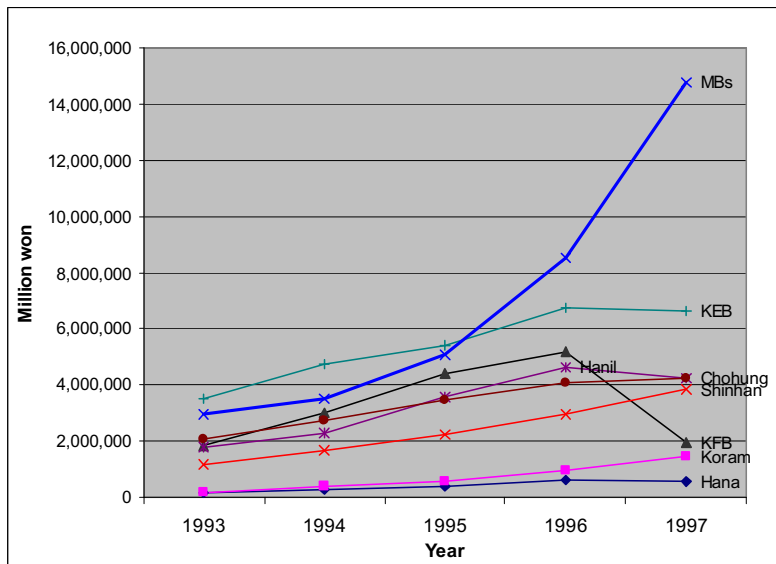
Risks of ill-prepared merchant banks, such as offshore investment, excessive foreign debts and maturity mismatches, had not been noticed until the crisis took place in late 1997. One interviewee, working for MOFE, commented that the authority did not take the risks seriously. In addition to lack of appropriate supervision by the government, one interviewee, having working for a merchant bank as an executive, stressed the misguided policy of the government on borrowing of foreign capital, saying:

Even scholars blamed the outbreak of the crisis on merchant banks, but foreign borrowing of merchant banks does not exceed that of commercial bank. Probably the government needed a scapegoat for its failure. In fact, MOFE recommended that we should borrow foreign funds on short term basis just because of being cheap, leading to maturity mismatches in merchant banks.

The government boosted incentives for short-term foreign debts by making it mandatory to provide detailed information and obtain permission from the regulatory authorities in the case of long-term borrowing, whereas short-term borrowing was regarded as trade related financing and therefore not strictly regulated under the Foreign Exchange Management Law. Thus, financial institutions, particularly merchant banks, had been operating on a long-term basis with short-term foreign borrowings.

According to balance sheets of banks, aggregate sum of foreign borrowing by merchant banks sharply increased for two years up until the outburst of the crisis, amounting to more than two times of that of Korea Exchange Bank, which traditionally specialised in foreign exchange business. Figure 1 compares foreign borrowings by merchant banks and some selected commercial banks.

Figure 1: Foreign Borrowings by Banks



Note: MBs: aggregate sum of merchant banks, KEB: Korea Exchange Bank, KFB: Korea First Bank.

Source: Annual reports of the Banks.

Problem with the mismatches was much more serious in the merchant banks with short-term foreign assets of only 25 per cent of short-term foreign liabilities despite the existing guideline of a required minimum ratio of 70 per cent, compared with 50 per cent for commercial banks (IMF (1999)). The importance of maturity matches seems to have been perceived by some existing merchant banks. Significant comment was made by one respondent of the interview, who had long worked for the Hong Kong subsidiary of an existing merchant bank:

Because it was difficult to borrow long term foreign funds in international market, merchant banks used to borrow from domestic commercial banks to cover long term assets in an effort to reduce the maturity mismatches. We also had long term borrowing of US\$30 million from a leading commercial bank to do offshore business. However, once the crisis broke out in late 1997, we were asked to repay this on the next rollover date (interest payment day), as the bank had difficulty in renewing its short term borrowings in international capital markets, which was used to make long term loans to merchant banks.

The behaviour of commercial banks, to some extent, is responsible for causing liquidity crisis in merchant banks because they fully understood that their short-term lending to merchant banks had been used for risky long-term investment

to the emerging markets.

Reliability and Transparency of Financial Information

This comment reflects the lack of reliability of financial information, which had frequently been raised by economic players. Financial crisis is claimed to be promoted by asymmetric information framework which makes foreign creditors less able to distinguish between good and bad borrowers due to uncertainty and lack of confidence. The overall loss of international confidence in the reliability and transparency of the financial statements of Korean enterprises and financial institutions is argued to have contributed to the Korean financial crisis (e.g. Kim (2000)). Following the crisis, accordingly, the 1998 amendment of Korea's Financial Accounting Standards (KFAS) introduced numerous accounting standards in accord with International Accounting Standards (IAS), including mark-to-market asset valuation, loan-loss provisions subject to revised asset classification and accounting for financial derivatives, to enhance reliability and transparency of financial information.

Regarding the accounting practices of merchant banks, an interviewee, who had long been in charge of accounting of his company, put it in this way:

When we made financial statements, the most important factor was figures of other merchant banks. Before publishing financial statements, we were busy to exchange the figures of each accounting item among merchant banks so as to compare and adjust them ...

Post crisis Risk Management Systems

Interviews were carried out with heads of the risk management team in two merchant banks in their office to identify any change in their risk management after the crisis. With top management realising the importance of risk management, greater care has been taken to assess and control risks in their business, therefore a separate risk management team was created in the post-crisis merchant banks. Some difficulties were heard from people in charge:

After the crisis, as far as I know, most commercial banks have currently built new risk management systems adopting the concept of Market VaR (Value at Risk) or Credit VaR, in addition to existing ALM (Asset and Liability Management). However, merchant banks, of which business was greatly diminished from shocks of the crisis, have not been able to create their own risk management systems due to the high cost and lack of expertise. Instead, our company is trying to stick to the prudential regulation, (which has been

applied to merchant banks at the same level as commercial banks after the crisis). For instance, the credit ceiling for a single borrower has been reduced from 25 per cent of a bank's total capital to 20 per cent while total credit limit to a business group remains at 25 per cent.²⁰⁾ The credit ceiling for large shareholders should not exceed 25 per cent of total capital.²¹⁾ Aggregate sum of loans in excess of 10 per cent of total capital must be less than 500 per cent of total capital. (Head of risk management team in one merchant bank)

We are checking possible loss on the daily basis to make sure that the loss does not exceed the predetermined limit. Recently, like commercial banks, we considered developing risk management software but failed to overcome the problem of the budget and staff. (Head of risk management team in the other merchant bank)

Post crisis Reporting System

An interview was also conducted with head of a team which handles back office work and reports to supervisory agencies. In the process of financial liberalisation in the 1990s leading up to the outbreak of the 1997 crisis, supervision had not been duly implemented. Some existing prudential regulation had not been observed and properly reported by the financial institutions. The interviewee commented that:

After the crisis, the reporting system to the authorities appears to have been tighter. There are too many kinds of reports to remember. Organisations for us to report also vary: FSS, MOFE, BOK, etc. The whole team is devoted to preparing reports. Similar, not same, reports are sent to various organisations regularly or irregularly. It seems to be time wasting ...

For effective and consistent supervision, reporting systems need to be streamlined and simplified so that financial institutions avoid confusion, errors and omissions in their reports. For that purpose, it is suggested that a data base should be created in order for related authorities to share the reported information by financial institutions and also arrangement for protecting the confidentiality of such information should be in place.

20) Before the amendment to the Banking Act in May 1999, a bank's ceiling on single borrower was 15 per cent of its total capital for loans and 30 per cent for payment guarantees while credit ceiling on single group was 45 per cent of both loans and payment guarantees (FSS 2000).

21) Large shareholders are referred to as "shareholders who hold stocks in the bank exceeding 10 per cent of the total voting stocks (in the case of regional banks: 15 per cent)". According to FSS (2000), a bank's extension of credit to large shareholders may not exceed the smaller of (i) 25 per cent of the bank's total capital, and (ii) the equivalent of the bank's total capital to the proportion of investment by the large shareholder.

VI. Summary and Conclusion

This study has presented an investigation into respondents' views on the Korea's merchant banks, using two different research methodologies; questionnaire survey and qualitative interviews. Respondents have had first-hand experience of the issues under investigation or have studied the topic in the area. Despite some difficulties and limitations of each research method, the questionnaire and interview survey were complementary and helped to provide some answers to the questions that have been raised in this study.

Various subject groups, such as merchant banks staff, professors, economists of economic research institutes, government officials and journalist, were selected to respond to the survey questionnaire in order to examine their views on the issue.

Questions were asked to identify the problems Korea's merchant banks had faced until the crisis took place. The number of merchant banks has declined from 30 to only two in the aftermath of the crisis. As can be expected, merchant bank staff defended against the argument of other subject groups that merchant banks were responsible for the Korean financial crisis. Most of respondents, however, agreed that the abrupt increase in number of ill-prepared and inexperienced merchant banks, combined with weaknesses of prudential regulation and supervision, resulted in the accumulation of excessive risk-taking by merchant banks. The Korean government, traditionally, had been known to intervene in the financial system, commercial banks in particular. Merchant banks, however, relatively enjoyed business autonomy free from control of the authorities. Big shareholder and top management, if any, were considered to have affected the decision-making of the merchant banks' business. Accordingly, responsibility for failure of merchant banks should lie in top management, the survey revealed. With appropriate risk management and by abiding by the prudential regulation, merchant banks, to a great extent, could have escaped from the worst situation experienced.

A series of interviews with ten of the questionnaire respondents was undertaken in order to both confirm the survey findings and further investigate the topic. These in-depth interviews, which mainly focused on misconduct by merchant banks, did support the survey findings. Additionally, the interviews provided specific information which could not have been gotten otherwise.

The interview findings suggest that investments or loans of some (newly-licensed) merchant banks appear to have been made based on instinctive judgement of top management, not on any proper decision-making process or appropriate credit analysis, owing to both the inability to assess related risks (in case of foreign investment) and the long-standing belief that the government would protect big companies from failure (in case of loans to domestic big companies). Other negative phenomena identified in the interview analysis include inadequate supervision and unreliable/non-transparent accounting practices among merchant banks. These deep-rooted malpractices prohibited the efforts to improve financial status and also failed to gain the market confidence when desperately needed. Some survey respondents (of merchant banks) argued that aggregate foreign debts of all merchant banks was by far less than that of commercial banks and that, thus, merchant banks wrongly got the blame for the crisis. Presumably, however, international creditors found financial information of Korea's merchant banks less reliable and transparent than that of commercial banks. Long-lasting lack of supervision had left merchant banks negligent in sticking to the prudential regulation, ultimately leading to liquidity shortage problem at the onset of the financial crisis.

Various malpractice and negative factors in both individual institutions and financial system were perceived through the survey analysis, as discussed above. In the process of financial reform following the crisis, various measures have been taken to rectify factors likely to deteriorate financial institutions, for instance, including strengthened prudential regulation and supervision, and enhanced accounting standards. With lessons of the crisis, financial institutions have become aware that they are as susceptible to bankruptcy as firms in other industries. This has motivated individual financial institutions to build proper credit analysis and effective risk management system. Unlike large-sized banks, however, small-sized financial institutions such as mutual saving banks still have much to be desired. Hence, special care should be taken of these institutions to get rid of grey area for financial regulation and supervision.

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국문요약

綜合金融會社 失敗에 관한 研究: 說問照査 및 인터뷰 分析을 中心으로

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본 논문은 1997년 외환위기 발생 이후 대부분 퇴출을 당했던 종합금융회사의 실패의 사례를 종합금융회사 임직원, 대학교수, 경제학자, 정부공무원 및 신문기자를 대상으로 설문조사와 인터뷰를 통해 분석하고 한국금융기관의 문제점과 개선점을 제시하고자 한다. 특히 한국외환위기를 초래했다는 비난과 함께 외환위기의 최대의 피해자였던 중금업계에 종사하였던 임직원의 생생한 증언을 통해 당시 은행과 함께 기업의 자금조달업무를 담당해온 종합금융회사에 대한 감독 소홀, 일부 금융기관의 무분별한 영업행위가 이루어졌음을 확인한다. 또한 금융기관의 건전화를 통하여 외환위기의 재발 방지를 막고자 개별 금융기관 차원의 다양한 노력이 경주되고 있음을 보여주고 있다. 그러나 대형 시중은행과는 달리 여러 가지 제약으로 인하여 중소형 금융기관의 리스크관리 시스템은 아직 미흡하여 제2금융권에 대한 보다 세심한 금융 감독이 특히 요망된다.

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