



May 20, 2006

Hyundai Arrest Shakes Foundations of South Korean Industry

By [MARTIN FACKLER](#)

ASAN, South Korea, May 16 — The assembly workers here are models of industrial efficiency, rolling out a gleaming new sedan once every 57 seconds.

But the ultimate test of their company's mettle comes now: their boss, the charismatic chairman of the Hyundai Motor Company, sits in a jail, accused of the old-style corruption that this rapidly modernizing Asian nation hopes to leave behind.

The chairman, Chung Mong Koo, 68, was formally indicted Tuesday. **His arrest last month has thrown the mighty Hyundai industrial group into near paralysis, forcing it to postpone construction of factories in West Point, Ga., and the Czech Republic.**

Even more important, the corruption charges at Hyundai and a similar investigation earlier this year at the Samsung group are raising new **questions about the management of Korean companies,** just as some are joining the top ranks of global corporate players.

The government's indictment of Mr. Chung on bribery charges is also casting doubt on how much South Korea has actually changed its once-closed and collusive economy, spotlighting one of the most controversial legacies of the nation's economic miracle: the **control of huge swaths of the economy by a few wealthy and secretive families.**

"Samsung and Hyundai are the crown jewels in the Korean economy," said Lee Dong Gull, former vice chairman of the Financial Supervisory Commission, the nation's financial watchdog. "They are too precious just to be in the hands of single families."

South Korea has watched transfixed as the heads of the Hyundai and Samsung groups have come under investigation in recent months on suspicions of buying political influence and inventing **elaborate schemes to retain family control of their business empires.** While prosecutors dropped the case against Samsung's chief for inadequate evidence, they charged Mr. Chung on Tuesday with misappropriating

hundreds of millions of dollars from group companies, some of it reportedly to pay bribes. Mr. Chung is in police custody awaiting trial.

Mr. Chung's arrest has clearly left the group in disarray, a testimony to his strong personal control over operations. Routine operations are continuing, and the company has appointed a vice chairman as Mr. Chung's stand-in.

Employees and analysts say, however, that big decisions, like plans to develop hybrid vehicles, are stalled as managers wonder what to do. More ominously for Hyundai, Mr. Chung could be out of action for some time. If found guilty, he faces a life sentence, though experts say a four- or five-year sentence is more likely.

"He is the Moses who brought us where we are today," said Oles Gadacz, a Hyundai Motor spokesman. "We don't know who could replace him. His removal risks the future of this potentially great company right when we're on the verge of rivaling [Toyota](#)."

Employees see Mr. Chung as the visionary leader who has led them to the promised land of industrial greatness with his **single-minded focus on quality**. Under his stewardship, the group's two carmakers, Hyundai and Kia Motors, have grown to form together the world's **seventh-largest auto company**, with plants in half a dozen countries including the United States, in Montgomery, Ala.

A workaholic, Mr. Chung assembled group executives in his office every morning at 6:30. Hyundai officials said Mr. Chung was being held in a cell and permitted only one 15-minute phone call a day, making it impossible to run the company. But in a letter he wrote from jail, sent to employees via e-mail on May 12, he called on employees to toil on without him.

"What's most difficult is that your honor and your pride, which you worked so hard to build up, have been damaged," said the letter, shown to a [New York Times](#) reporter. "Make our best effort for the rebirth of the Hyundai Kia Automotive Group to give it a new face."

Analysts said the Hyundai group's reliance on Mr. Chung reflected the extent to which its companies rely on family leadership, and the failure to groom a cadre of professional managers or an independent board able to make big decisions. Asked if the group could keep functioning without Mr. Chung, analysts were adamantly pessimistic.

"It is impossible," said Lim Chai Gu, an analyst at Kyobo Securities in Seoul. **"These companies don't run on professional management.** Even now, important decisions have to be run by Mr. Chung as he sits in

jail."

Nor is Hyundai the only one. Earlier scandals at Samsung and other groups have highlighted the paradox of South Korean companies boasting cutting-edge products and efficient daily operations but being run as the private assets of powerful families.

Spokesmen for the various groups say the controversy is unfair. They point to the groups' remarkable success as proof that the founding families are competent stewards and should not be vilified. The Chung family, for example, turned a small auto repair shop that it opened in Seoul in 1945 into what is now the Hyundai group, with 40 companies and 85 trillion won (\$91 billion) in sales last year.

But critics, led by shareholder activists, say **family-controlled groups are out of sync with the times and are far too clannish, closed and corruption-prone** as South Korea's economy and politics are striving to be more open.

The problems have their roots in the years after the 1950-53 Korean War, when successive military governments sought to lift the country out of the rubble by concentrating scarce capital and technology in a few select hands. This spawned family-run enterprises that grew along with the Korean economy into sprawling industrial combines, known as chaebol.

Today, the chaebols dominate almost every business sector in South Korea, with their names proudly displayed in places like high-rise condominiums, supertankers and cellphones. According to the Bank of Korea, the central bank, the nation's **30 largest family-owned industrial groups account for almost 40 percent of the nation's \$965 billion economy**, the world's 14th largest. The biggest, the Samsung group, which includes the consumer electronics giant Samsung Electronics, alone controls about 7.6 percent of the country's economic assets, the central bank said.

Experts say family control is not in itself the problem, noting that powerful business families like the Rockefellers and the Fords exist around the world. Rather, they say that what South Korea needs is more openness so all shareholders of these companies can see what is going on. Experts say this is probably inevitable, but family resistance could delay it for another decade.

"I have no problem with the daily operation of these companies, which is very modern," said Kim Sun Woong, a lawyer at the Center for Good Corporate Governance, a research group that monitors the chaebol. "I even have no problem with the family ownership. The problem is that there's currently no oversight of what the family does. Is the family running the companies for the interest of all shareholders, or just themselves?"

Instead of mending their ways, experts say, some **chaebol are trying to deflect criticism by stirring fears about foreign control.** They are quietly spreading the word to journalists and opinion makers that weakening the family groups would only make South Korea vulnerable to incursions by outsiders, say experts and former government officials.

[Such appeals are finding listeners in the wake of a recent scandal involving Lone Star Funds, based in Dallas. Three former Lone Star-linked executives were charged Wednesday with lining their own pockets after the fund took over an ailing Korean bank in 2003.]

"They are appealing to economic nationalism," said Mr. Lee, the former financial regulator. "Some chaebol are saying, 'Yes, we are bad. But foreigners are worse.' "

There are also questions about the timing of the current crackdown, coming as companies like Hyundai Motor and Samsung Electronics are finally gaining global recognition. While the chaebol have come under increasing scrutiny since the country's transition to democracy in the early 1990's, never before has an arrest claimed so prominent an industrialist, experts say.

But now, they say, prosecutors seem eager to demonstrate their new-won independence. They also say the South Korean president, [Roh Moo Hyun](#), is just as eager to flash his populist credentials by cracking down on the superwealthy.

Experts say another reason is concern about a looming change in the generational guard at most chaebol. The leaders like Mr. Chung at Hyundai and the Samsung group's chairman, Lee Kun Hee, 64, are members of their families' second generation, who helped build the groups and who share their fathers' work ethics. But as these men near retirement, there are rising doubts about their children, who are widely seen as untested after growing up in comfort.

Experts say the public criticism is having an impact, even at mighty Samsung. On Tuesday, the group announced that Mr. Lee, its chairman, planned to pay all inheritance tax, \$1.6 billion worth, when he hands over his stake in the group to his son. The sudden gesture was seen as a response to recent criticism that Mr. Lee was trying to transfer his assets to his children by using elaborate shareholding schemes to avoid taxes.

"The chaebol now know they have to change," said Jang Ha Sung, dean of the business school at Korea University in Seoul. "The families will try to resist as long as they can. But they have to adapt to survive."

Su Hyun Lee contributed reporting from Seoul, South Korea, for this article.

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