What to Shed and What to Keep: the Divestiture and Consolidation Decisions of Korean *Chaebol* Groups after the Asian Crisis

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ABSTRACT

To better understand the impact of the Asian economic crisis on Korean *Chaebol* groups, this study examines various factors that may have influenced the group's decision on which members firm to eliminate from its portfolio of business units and how to eliminate them. Our results indicate that Korean business groups that survived the crisis have been transformed into more focused business systems. Also, it appears that the divestiture activities played a more significant role than the consolidation activities in facilitating their corporate transformation.

Key words: Business Group, Economic Crisis, Corporate Transformation

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INTROUDCTION

Business groups are important economic institutions especially in the Asian context (Richter, 1999; Matthews, 2002, Khana & Palepu, 1997). The recent Asian economic crisis, however, has raised some questions about their legitimacy (McLeod & Garnaut, 1998; Katz, 2002). Korean business groups faced a stronger challenge concerning their efficacy. Her large business groups—so called *Chaebols* in Korean, faced with the Asian financial crisis, have all been forced to fundamentally rethink the value of each of the various diversified business units in their organization (Graham, 2000). Understanding the rationale behind their strategic decisions for business units, therefore**,** is important for the insights it offers into the nature of the Korean business system and of Asian management.

The *Chaebol* decisions also present a clear and well-defined set of business decisions which can be used to better understand two more universal issues: what factors do firms use when they decide to change the scope of the set of the business units that comprise the firm? And what forms do these take to implement their decisions? Firms constantly make decisions about the size and organizational composition of their business unit organization (Coase, 1937). We seldom have a large set of these decisions to study. The response of Korean firms to the Asian crisis, however, gives us an ideal set of organizational changes, since most Korean *Chaebols* faced an extremely intense and unexpected form of environmental change, and had to undertake radical organizational change in a short period of time.

In this study, therefore, we choose to examine the *Chaebol*'s strategy to adjust its portfolio of diversified business units, focusing on its decisions on which members to eliminate from its portfolio of business units and how to eliminate them. Those groups have actively divested and consolidated their affiliated firms after the crisis, to curtail their overextended business scopes. Furthermore, the structure of the group as a whole resembles a type of hierarchy (i.e., the M-form), since the management of the affiliated firms is closely supervised by the group's central office (Shin & Kwon, 1999). Thus, we expect that our study would help us understand not only the future of the Asian business system, but also the role of restructuring activities in facilitating corporate transformation.

The paper proceeds as follows: the next section briefly reviews the background literature relevant to our study. Then, we present specific hypotheses pertaining to the restructuring activities of the *Chaebol* groups for their affiliated firms in the crisis. Next, we explain the methodology with elaboration of dependent and independent variables. Following this, we present the results, and in the final section we discuss the findings.

THE ASIAN CRISIS AND KOREAN CAHEBOL GROUPS

The *Chaebol* form of business is defined as a large business group consisting of formally independent firms which operate in diverse set of industries and which are controlled by family stock ownership of the founding families (Yoo & Lee, 1987). These large groups—such as Samsung, Hyundai, LG—had long enjoyed remarkable success in both domestic and international markets (Steers, Shin & Ungson, 1989; Ungson, Steers & Park, 1997). The prominence of *Chaebols* in the Korean economy was ascribed to two factors.

First, this form of organization was an efficient mode for organizing economic activities in developing countries like Korea (Khanna & Palepu, 1997). In those countries, the markets for critical resources—such as capital, key components, skilled labor, and competent managers—tend to be imperfect due to the lack of supporting institutions (Khanna & Palepu, 1997, Chang & Choi, 1988). Transaction cost theory posits that in this situation firms would pursue internalization to avoid contractual difficulties and reduce transaction costs (Williamson, 1985). In this respect, the managers of *Chaebols* found it necessary and desirable to diversify into different industries to secure key parts and services as well as to efficiently exploit their intangible assets (Chang & Hong, 2000).

Second, government policies gave firms the profitability and sometimes the right to diversify into new industries. Specifically, the growth of *Chaebols* was further facilitated by the Korean government's export-driven economic development policies (Kim, 1997). The government set *export growth* as the paramount national economic goal until the late 1980s. To increase the nation's exports, it annually evaluated the export performance of large Korean firms. Then, it offered huge rewards to the successful exporters in the form of low-rate long-term loans, export subsidies, and sometimes a special political favor such as permissions to enter into other promising industries (Sakong, 1993; Song, 1990). Backed by strong government support, these favored firms grew much faster than others and diversified into many other industries (Amsden, 1989; Hamilton & Orru 1989), and many of them ultimately emerged as *Chaebols* (Yoo & Lee, 1987).

The *Chaebol*, however, has had to rethink its strategy and even its very organizational form as a result of the challenge of the Asian economic crisis. Within several months after the crisis erupted in November 1997, many *Chaebols* faltered badly and some groups such as Kia, Hanbo, Halla, Sammi went bankrupt. Thus, each of the Chaebol groups had to hurriedly implement a series of reform programs to restore their viability (Beck, 2000; Hamlin, 2000; Smith, 1998). Among them, the most prominent was the elimination of many affiliated firms. To curtail its business scope and refocus on its core business, the *Chaebol* carried out this change through divestitures (i.e., liquidations or sales of controlling equity) or consolidations (i.e., mergers with another affiliated firm (Graham, 2000). The restructuring activities were most intense during the two years after the crisis (i.e., 1998-1999). In the end, the total number of firms affiliated with the top 30 *Chaebol* groups reduced from 819 in 1997 to 544 in 2000. Before the Asian crisis, Korean *Chaebols* has long continued to diversify into many industries by setting up new affiliated firms, but they rarely divested affiliates (Kim, 1997; Hwang, 1999). Thus, the massive restructuring of affiliate firms was a phenomenal change in strategy that well illustrated their efforts to achieve radical transformation to increase their survival chances in the crisis.

THEORIES AND HYPOTHESES

Central to the *Chaebol* strategy to reduce the number of affiliates were the decisions of which units to retain, and which to sell or close. These decisions would have been made not only to rectify the past problems, but also to achieve the intended transformation (Graham, 2000). If we are to learn from the increased focus of the *Chaebol* in response to the crisis, we need to understand the strategic justification for the decisions concerning each of the units. For this reason, in this paper we focus on the two interrelated key decisions—*which affiliate to eliminate* and *in which mode*—in the group's restructuring of affiliated firms.

These decisions are also of interest from at least three general theoretical perspectives. First, they present an exemplary case of radical organizational change, and such a change has been an important subject in organization theory (Tushman & Romanelli, 1985; Hannan & Freeman, 1984). Thus, it provides an opportunity to analyze how a crisis allows large diversified organizations to break down the strong grip of organizational inertia and make radical organizational change. Second, researchers in strategic management have studied strategic restructuring that aimed to restore the viability of the organization (Singh, 1993; Dranikoff, Koller & Schneider, 2002). The governance structure of the *Chaebol* is thought to be a variation of hierarchy (M-form) in which affiliated firms are in effect business units within a diversified firm (Shin & Kwon, 1999; Chang & Hong, 2000). Therefore, the experience of Korean *Chaebols* can give us some insights about how organizations restructure their business units (i.e., divestitures or consolidations) to refocus on their core competencies (Markides, 1992; Duhaime & Grant, 1984). Lastly, the theory of complex organization has emphasized the loose-coupling (or near decomposability) of subunits as an important trait of complex systems that increase the chance of its survival (Simon, 1973; Orton & Weick, 1990). Loosely-coupled units can absorb the disturbances from the external environment, ensuring the core of the organization to function well as planned (Thompson, 1967; Weick, 1976). Thus, Simon (1973) argued that the near decomposability of subunits is one of universal organizing principles that operate in any complex systems. This seminal view suggests that a business group would have a tendency to remove peripheral members rather than core members, to diminish the negative effects of the economic crisis.

These three theoretical perspectives are complementary to one another in explaining the changes in complex organizations such as business groups. Even though it is difficult to draw clear lines between them, the organizational theory generally focuses on the external or internal pressures that initiate radical corporate transformation, and on the eventful nature of organizational change (Tushman & Romanelli, 1985; Gersick, 1991). On the other hand, the strategic restructuring theory views a firm's restructuring activities as a rational move to reestablish the match between its resource configurations and its business scope (Singh, 1993; Dranikoff, Koller & Schneider, 2002). Built on the resource-based view of the firm, this approach posits that the need for restructuring usually arises due to the inappropriate diversification pursued in the past (Hoskisson, Johnson & Moesel, 1994; Hoskisson & Turk, 1990). Thus, it is argued that programs of strategic restructuring help the firm to resolve the performance problems caused by the inappropriate diversification strategy, and refocus on its core competencies (Montgomery & Thomas, 1988; Markides, 1992). Lastly, the theory of complex organization implies that a key consideration in the decision on whether to eliminate a subunit is its relations with the whole organization and with other subunits. The loosely coupled units would not have many negative effects on the system even if they were separated (Simon, 1973; Orton & Weick, 1990). Thus, those units can be more easily altered or removed to naturalize the external pressures (Thompson, 1967; Scott, 1998). In sum, each of those approaches points to some important factors as the determinants of a firm's decision on whether and how to eliminate a subunit. A business group, too, is likely to take into account those factors simultaneously in restructuring its affiliated firms. Thus, in the section below, we present a series of hypotheses that were drawn from those theories.

The pressures for organizational change

Organization theorists have long been interested in the fact that well-established organizations have a tendency to resist any changes except incremental ones (Tushman & Romanelli, 1985). From the evolutionary perspective, Hannan & Freeman (1984) pointed out that this organizational trait—so-called, *structural inertia*—comes as a result of an organization's successful adaptation to its given environment. As the received environment favors the organization that can provide its products/services in predictable manners in terms of quality, quantity, and costs, it strives to increase the reproducibility of its structure by institutionalizing work rules and standardizing task procedures. Over time, those rules and procedures are taken for granted by the members through repeated use and interactions between members (Meyer & Rowan, 1977). Through the institutionalization process, the organization comes to take on norms and values beyond their technical requirements (Selznick, 1957). Any attempt to change *the status quo* meets strong resistance in an organization (Gersick, 1991). Therefore, an organization needs to face a strong internal or external pressure for change, to break the strong grip of organizational inertia and initiate a fundamental transformation, (Tushman & Romanelli, 1985; Romanelli & Tushman, 1994).

This theoretical framework of organizational change provides a good explanation for the changed strategies of the business groups in Korea. It helps us understand why the business groups in Korea have suddenly started to actively restructure their diversified business units after the economic crisis. Those groups have long aggressively expanded into many industries, and thus it is thought that the pursuit of ‘diversified growth’ is one of their important strategic orientations (Kim, 1997). Even in the 1990s, they pursued the strategy actively, significantly increasing the number of affiliated firms (Hwang, 1999). As a result, however, their financial performance had already deteriorated for several years prior to the crisis, due partly to many unproductive affiliated firms (Smith, 1998). The impact of the crisis broke the shackle of their organizational inertia. Only then did *Chaebols* reconsider their past strategy in order to survive in the new economic environment.

However, the crisis did not affect the business groups equally (Lieberman, 2000). Some groups suffered more from financial hardship, and often could not turn around their business situations. On the other hand, some other groups relatively easily overcame the predicament with their own adjustment programs. Thus, they were able to adjust within their existing organizational structure, being better prepared for change. In general, a group in greater financial trouble will have a higher chance to overcome the organizational inertia and make the necessary reform efforts. Thus, the group facing more severe financial difficulties in crisis is more likely to actively divest or consolidate its subunits to restore the viability of its business system.

> Hypothesis 1: An affiliated firm is more likely to be either divested (i.e., sold/dissolved) or consolidated with another affiliated firm rather than is sustained, if its group experiences more severe financial difficulties.

The business unit's financial condition and its industry

The resource-based theory of the firm suggests that a firm's capability to expand into different businesses is limited by its existing resource configurations (Rumelt, 1982). Firm-specific resources are sticky for the owning organization and not perfectly tradable (Teece, Pisano & Shuen, 1997; Barney, 1991). Thus a firm cannot easily secure the requisite resources that are needed to enter a new industry, unless the resources are already available in the current pool of its firm-specific resources. Following this critical view, the previous research on business restructuring generally viewed the divestment activity as an effort to rectify the problems that take place because of the inappropriate diversification strategy pursued in the past (Hoskisson, Johnson & Moesel, 1994; Hoskisson & Turk, 1990).

The inappropriate diversification in the past causes a mismatch between a firm's resource profile and its business scope. In this situation, the business units that operate beyond the firm's core competencies are likely to perform poorly, compared to other units at the whose strategies are consistent with the core (Bettis, 1981). In this regard, the elimination of an underperforming business line is considered to be one of the important objectives of business restructuring (Duhaime & Grant, 1984; Montgomery & Thomas, 1988; Porter, 1976). Thus, we can initially reason that a business group, too, have a tendency to divest an affiliated firm whose financial performance is poor. Yet, the business groups may also attempt to resolve the performance problems by consolidating underperforming business units with other units. By combining the business units, the group can slash the overhead costs and surplus manpower. This will increase the chance to turn around the troubled units. Thus,

> Hypothesis 2: An affiliated firm is more likely to be either divested (i.e., sold/dissolved) or consolidated with another affiliated firm rather than is sustained, if its financial condition is in poorer.

Beyond the performance considerations mentioned above, the firm may attempt to recover the match between its resources and business scope by divesting unrelated business lines (Singh, 1993; Dranikoff, Koller & Schneider, 2002). With this approach, the firm can streamline its organization and better coordinate the business activities between the remaining business units. This would allow the firm to concentrate its resources and efforts to strengthen its core competencies in the long run (Ito, 1995). These benefits of focused diversification would also be great to a large business groups, such as the *Chaebol* in Korea. By divesting unrelated affiliated firms, the group can mitigate the organizational complexity in supervising its diversified business units and better utilize the group resources in cooperation with the remaining units.

> Hypothesis 3: An affiliated firm is more likely to be divested (i.e., sold/dissolved) rather than consolidated with another affiliated firm or sustained, if it does not operate in its group's major industries.

The decomposability of the unit

As mentioned above, the degree of coupling between business units can influence the firm's decision on the fortune of a unit. The theory of complex organization suggests that, if all other things are equal, the firm will prefer to remove a unit that is loosely-coupled with others to minimize the negative impact of the divestiture (Simon, 1973; Orton & Weick, 1990). Extending this stream of ideas, we propose that an affiliated firm would have a high chance to be divested if it was established as an international joint venture, if it was acquired rather than newly established, if it participated in the group for short period of time, and if it does not have close buyer-supplier relations with other members. These four conditions are likely to commonly make the firm in question more detached from the remaining part of the group.

A considerable number of *Chaebol*'s affiliates took the form of joint ventures (JV hereafter), and in most cases the JV partners were foreign multinationals. Some *Chaebol* groups had actively undertaken such ventures (e.g., LG group), as a way to gain access to foreign capital and technology (Kim, 1997). In those international JVs, the ownership is shared between two independent firms. Thus, it is difficult for the domestic partner to dominate the management decisions (Kogut, 1988). As a result, the JV is likely to secure some degree of independence in their management. This means that they would be less integrated to the parent group's management system (Scott, 1998). Related to this issue, some authors even argued that the JVs should be given a breathing space to develop their own core competences (Bleeke & Ernst, 1991). In addition, a firm that acquires an independent firm often finds it challenging to integrate the acquired unit into its organization. The differences in organizational culture, work practices, and technology make it difficult for the acquired firm to assimilate the newly transplanted employees into its system (Haspeslagh & Jemison, 1991). Such difficulties in post-integration may increase the probability that the acquired unites will be resold subsequently (Kaplan & Weischbach, 1992; Porter, 1987). Thus, the acquired firms are likely to stay less integrated to the acquiring group's business system.

Hypothesis 4: An affiliated firm is more likely to be divested (i.e., sold/dissolved) rather than consolidated with another affiliated firm or sustained, if it was established as an international JV.

Hypothesis 5: An affiliated firm is more likely to be divested (i.e., sold/dissolved) rather than consolidated with another affiliated firm or sustained, if it was acquired rather than newly established.

In addition, firms that maintained their presence in the group for a longer period of time are likely to accumulate more relationship-specific assets and skills such as idiosyncratic information and specialized technology (Asanuma, 1989; Fichman and Levinthal, 1991). Long-lasting relationships often promote interorganizational trust (Granovetter, 1985; Gulati, 1995), and create both interfirm capabilities and interfirm dependence (Martin, Mitchell, and Swaminathan, 1995; Weick, 1979). Thus, the group can be reluctant to divest the firms that have been in the group for a long time. In a similar vein, firms that have close buyer-supplier relations with other members could develop these kinds of idiosyncratic capabilities through repeated transactions (Asanuma, 1989; Fichman and Levinthal, 1991). Those capabilities are valuable for the group, since they help better integrate the activities of the member firms in a commercial relationship (Williamson, 1979). With these capabilities, the parties can reduce the transaction costs, and improve their economic performance. Consequently, the member firms with such relationship-specific assets are less likely to be replaced by the independent suppliers outside the group (Martin, Mitchell, and Swaminathan, 1995).

> Hypothesis 6: An affiliated firm is more likely to be divested (i.e., sold/dissolved) rather than consolidated with another affiliated firm or sustained, if it has participated in its group for a longer period.

Hypothesis 7: An affiliated firm is more likely to be divested (i.e., sold/dissolved) rather than consolidated with another affiliated firm or sustained, it mains closer buyer-supplier relations with other members.

METHODS

Sample

The sample of this study includes manufacturing firms affiliated with 26 business groups that continue to appear in the lists of top 30 largest *Chaebol* groups in 1997, 1998, and 1999. The Fair Trade Committee in Korea announces the list annually. These groups had 740 members under their roofs as of 1997: There were 293 manufacturing and 447 non-manufacturing firms (See Table I). But, the sample size is reduced to 241, due to the lack of data on some unlisted firms. Among them, 152 (63.0%) affiliates maintained their presence in the group, 44 (18.3%) were merged with other affiliate(s), 40 (16.6%) were sold to independent firms, and 5 (2.1%) were dissolved during the 1997-1999 period.

Methodology and dependent variable

We analyze the data using a multinomial logistic regression model, to simultaneously examine the determinants of two interrelated decisions—*which affiliate firms to restructure* and *in which mode*. In this model, the dependent variable is a categorical one which takes the value of 1 if the firm in question was divested (i.e., sold or dissolved), 2 if it was consolidated with another member firm, and 3 if it maintained its legal entity. In our multinomial logistic regression model, the base category was set to the last value of the dependent variable (i.e., 3). The observation period starts in 1997, and ends at the end of 1999. We chose that time period, because the Asian economic crisis most severely hit the Korean economy during the specified period. In the model, the probability of a firm being divested, consolidated, or sustained is explained by the independent variables described below.

Independent variables

The degree of financial distress experienced by a business group is measured by two variables. One is a dummy variable that is set to 1 if the core firm(s) of a group was placed in workout programs supervised by the court or lending banks, and to 0 otherwise (DISTRESS). The information on those workout programs is widely available in public sources such as newspapers and economic periodicals.[1] Another is a group's debt-to-asset ratio in 1997 (GDBR). The Fair Trade Committee in Korea annually makes public several key financial statistics—such as assets, sales, and net income—of the top 30 largest business groups, and this variable was constructed from the FTC source.

The financial condition of an affiliated firm is proxied by its debt-to-asset ratio in 1997 (FDBR). The financial data on the firm is obtained from the KIS database developed by the Korea Information Service.[2] The difference between the group and affiliated firm industries was measured by a dummy variable (DIFFIND). It takes the value of 1 if the

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[1] Among 26 Chaebol groups chosen for this study, 8 groups (Ssanyong, Dongah, Halla, Haitai, Gohap, Jinro, Anam, Sinho groups) were required to implement such workout programs during the observation period.

[2] This company is a leading credit rating agency in Korea, equivalent to Standard & Poor's or Moody's in the United States.

affiliated firm operated in an industry that was different from the group's core industries, and 0 otherwise. The information on individual *Chaebol* groups' core businesses is available in the KIS database (See Table II). Also, the database supplies the information on the major products of an affiliated firm. Using these data sources, we defined the Korean SIC 3-digit industries of the group and the affiliated firm in 1997, and then coded the variable according to whether the firm's industry matched the group's industries.

We define a variable to represent whether an affiliated firm was initially established as an international joint venture rather than as a WOS. It is denoted by a 1-0 dummy variable (IJV) that is equal to 1 if no less than 5% of the firm's equity stake is possessed by a foreign parent(s), and 0 otherwise. The data on a firm's ownership structure was obtained from the KIS database. Similarly, whether a firm was acquired or newly established was proxied by another 1-0 variable (ACQ). In creating the variable, we assumed that all firms that joined the group prior to 1981 were newly established, because the data on the establishment modes of these affiliates were extremely incomplete. We may justify this assumption by pointing out that, because many large enterprises grew and became *Chaebol* during the 1970s (Kim, 1970), the establishment mode of a firm that were included in its group prior to 1981 may not have much impact on its exit. Such a long-established acquired unit is likely to be tightly integrated into the Chaebol, which is the issue we want to measure. Consequently, the variable was coded as 1 for the firms that joined the group through acquisitions in or after 1981, and 0 for others. The KIS database reports the firm's ownership structure along with a brief history of the firm with the information on the year in which it became a member of its group. These two variables were constructed from the data source

A firm's experience in the group (NETYEAR) was measured by the time period (in years) between the year in which the firm was first classified as a member of the group and the year 1997. We measure the closeness of buyer-supplier relationship(s) a firm maintained with other member(s) by the amount of its inter-affiliated firm sales and purchase as a percentage of its total sales in 1997 (INTRADE). The data necessary to construct these two variables also come from the KIS database.

Lastly, several controlling variables are added. The first is the size of the group that was measured by the group's total assets in 1997 (GASSET). The second is the size of the affiliate firm; this was proxied by its total assets in 1997 (ASSET). The third variable measured the portion of a firm's equity stake controlled by the group (SHAREHLD). The fourth is the growth rate of the firm's industry (INDGRTH) measured by the average growth rate of shipments of the Korean three-digit SIC industry between 1994 and 1997. The last is concentration of the industry (CONC) which was proxied by the Herfindahl-Hirschman index for the industry in 1997.

RESULTS

Table V presents the results of the multinomial logistic regression In the first model, with the entire sample (M1), two independent variables, DISTRESS and GDBR, were highly correlated with each other (correlation coeff.>0.5). Thus we had to run the two separate regressions within the model to avoid multicollinearity problems. After that, we divided the sample into two subsets according to whether or not their core firms were placed in the aforementioned workout programs. We assume that court ordered workout program requirements are an important distinction. Then we ran similar regressions on each sub-sample. The next two models show the results of the subsequent analyses (M2 and M3).

Several important factors stand out in our results. First, the two variables measuring the financial difficulties experienced by a group (DISTRESS and GDBR) do not have much impact in M1 (all groups). In M2 (surviving groups), however, this factor has the expected effects on the group's decision on an affiliated firm. The coefficient of GDBR is significant with a positive sign in both columns in the model, providing support for hypothesis 1. Interestingly, however, the variable's coefficient is moderately significant in the first column (divestitures) in M2, whereas it is highly significant in the second column (consolidations) in the same model. Thus, our results further suggest that while more financially distressed groups had a tendency to either divest or consolidate their member firms, they strongly preferred the second option. Besides, it is also interesting to note that a group's debt ratio (GDBR) is negatively associated with its tendency to consolidate member firms in M3 (bankrupt groups). When its core firm is placed in a workout program, the group in effect goes bankrupt. Thus, the group may fail to make concerted efforts to tide itself over the crisis by consolidating their business units.

In addition, the financial condition of the firm (FDBR) is not significant in M1 and M2. But when we consider only the surviving groups (M2), the coefficients of the variable become significant with a positive sign. As predicted in hypothesis 2, therefore, the group had a strong tendency to divest or consolidate underperforming affiliated firms. Our results also show that a firm had a higher chance to be divested rather than consolidated or sustained, if it did not participate in the group's core businesses. The coefficient of DIFFIND is positive and significant in the first columns (divestitures) in M1 and M2. This provides strong evidence for hypothesis 3. Surprisingly, however, this firm characteristic is negatively associated with the group's decision to consolidate a firm at a moderate level in M3 ($p<0.1$). This indicates that the groups that virtually went bankrupt did not actively divest their non-core businesses.

Our results also indicate that the groups frequently divested international JVs. IJV has a significant coefficient with a positive sign in the first columns (divestitures) in M1 and M2. On the other hand, such a tendency was not observed for acquired units (ACQ) in those models. Our analysis also revealed that the firms that had maintained their membership in the group for a longer period of time were less likely to be divested. The coefficient of NETYEAR is significant or moderately significant in the first columns (divestitures) in M1 and M3. Also the coefficient has the expected sign. But the factor does not have a significant impact in M2 (surviving groups). This intriguing finding implies that the surviving groups were not constrained that much by the past relationships when deciding whether to divest one of their member firms. On the other hand, it appears that the inter-affiliate trade was a key determinant of an affiliate's fortune in the group's restructuring programs. In first columns (divestitures) of M1 and M2, INTRADE has a significant coefficient with a negative sign. This indicates that the firms that had closer buyer-supplier relationships with other members were less likely to be divested. This factor, however, have different effects among bankrupt groups (M3). Those groups had a tendency not to consolidate the firms that maintained close commercial relationships with other members. Instead, they seem to have actively consolidated the firms that operated relatively independently from other members.

Lastly, our results suggest that the groups preferred to consolidate the smaller-sized firms, and the firms over which they can exercise stronger control as shown in M1 and M2. Such a tendency, however, was not observed in M3.

DISCUSSION

Taken together, the results of our analysis provide good support for our argument. We can explain the decisions of the Chaebol groups on whether and how to eliminate an affiliated firm by the three categories of factors we presented—the external pressures for organizational change, an individual member's financial performance and its relation to the group's core businesses, and the firm's relations with other parts of the organization. Thus, it seems that the external pressures have made the *Chaebol* group initiate the radical transformation. In choosing a firm to divest or consolidate with another affiliate, the group takes into account the firm's performance potential and its relatedness to the group's core competencies. We also presented supporting evidence that the group often chose to sell or dissolve a loosely-coupled unit to minimize the negative effects of the divestiture on the whole organization. Failed business groups, on the other hand, showed no sign of such concerted efforts to regain the viability of their business systems. This is not surprising, since the group's viability is in doubt for bankrupt firms. Thus, these bankrupt groups would not know if they could reap the benefits in the future from any more focused set of units. They might just look for ways to divest individual units, a strategy consistent with our empirical results.

These observations suggest that Korean business groups that survived the crisis have been transformed into more focused business systems. They have actively divested non-core business units that do not operate in the group's major industries and that do not have close business relationships with other units. Also, our results indicate that the groups that have experienced more severe financial difficulties were more active in reshuffling their affiliated firms, and their affiliated firms with poor financial performance were frequently sorted out to improve the group's financial condition. Thus, it seems that the elimination of under-performing business units was another direction of the groups' business restructuring.

Theoretically, our empirical study helps us better understand the role of business restructuring in facilitating corporate transformation. In the results, the factors that determine whether to divest a business unit are not the same as those that determine whether to consolidate a business unit. In general, the first type of decision is influenced by a wide range of group-, firm-, and relationship-specific factors. In contrast, the second type of decision is affected by a relatively limited range of factors in unsystematic ways. This difference indicates that the divestiture of business units involves much more complex calculus than does the consolidation of business units. This is probably because the divestiture of business units has much more significant effects on the business group than does the consolidations of units. Thus, our results suggest that the divestiture activities play a more important role than the consolidation activities in corporate transformation, supporting the received view that the divestiture programs can help firms to refocus on their core competencies and improve performance (Markides, 1992; Montgomery & Thomas, 1988).

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Table I Industries of *Chaebol*-Affiliated Firms in 1997

Group	INDUSTRY			Total
	Manufacturing	Finance	Services & Others	
Samsung	33	13	33	79
Hyundai	23	7	25	55
LG	22	9	18	49
Daewoo	15	5	10	30
SK	17	3	27	47
Ssangyong	10	5	10	25
Hanjin	2	4	18	24
Lotte	9	1	19	29
Hanhwa	12	4	15	31
Dong ah	1	3	15	19
Hyosung	11	0	7	18
Doosan	12	0	13	25
Kolon	9	3	12	24
Dongkuk	11	2	4	17
Kumho	8	3	15	26
Daerim	5	2	14	21
Halla	8	1	8	17
Dongbu	10	8	16	34
Dongyang	4	10	9	23
Haitai	9	0	6	15
Gohap	6	2	5	13
Daesang	16	1	9	26
Jinro	7	2	15	24
Hansol	9	4	10	23
Anam	10	1	10	21
Shinho	14	4	7	25
Total	293	97	350	740

Table II The Core firm and Major Industries of *Chaebol* Groups in 1997

Group	Core Firm	Major Industries
Samsung	Samsung Electronics	Trade, Broadcasting Equipment, A/V Equipment, Life Insurance, Shipbuilding
Hyundai	Hyundai Construction	Trade, Autos, Shipbuilding, Construction
LG	LG Electric	Trade, Broadcasting Equipment, A/V Equipment, Oil-refining, Synthetic rubber
Daewoo	Daewoo Co., Ltd.	Trade, Construction, Machine Equipment, Autos, Broadcasting Equipment
SK	SK	Petroleum, Trade, Fuel Sale,
Ssangyong	Ssangyong Cement	Trade, Petroleum, Fuel Sale, Construction
Hanjin	Korean Air	Transportation, Marine Transport, Construction, Insurance
Lotte	Lotte Confectionery	Retail sale, Confectionery, Hotel
Hanhwa	Hanhwa Co., Ltd.	Petroleum, Fuel Sale
Dongah	Dongah Construction	Construction, Life Insurance, Transportation
Hyosung	Hyosung Co., Ltd.	Chemical Textiles, Chemical Compound, Machine Tools, Software
Doosan	Doosan Co., Ltd.	Alcoholic Liquors, Glass Products
Kolon	Kolon Co., Ltd.	Textiles, Chemical Textiles, Construction, Synthetic Rubber, Plastic
Dongkuk	Dongkuk Steel Co., Ltd.	Steel, Finance
Kumho	Kumho Industry	Transportation, Tire, Synthetic Rubber, Plastic, Life Insurance
Daerim	Daerim Industry	Construction, Life Insurance, Transportation
Halla	Halla Construction	Auoto Parts, Heavy Machinery, Construction
Dongbu	Dongbu Construction	Insurance, Construction, Steel, Agricultural
Dongyang	Dongyang Cement	Life Insurance, Finance, Cement, Trade
Haitai	Haitai Confectionery	Trade, Confectionery, Beverage, Broadcasting Equipment, A/V Equipment
Gohap	Gohap Co., Ltd.	Chemical Textiles, Chemical Compound, Construction, Life Insurance
Daesang	Daesang Co., Ltd.	Foods
Jinro	Jinro Co., Ltd.	Alcoholic Liquors, Construction
Hansol	Hansol Pulp	Pulp, Printing Paper, Stationery, Electronic
Anam	Anam Semiconductor	Electron Tube, Electron Products, Broadcasting Equipment, A/V Equipment, Construction
Shinho	Shinho Pulp	Trade, Steel, Pulp

Table III Descriptive Statistics (*N=241*)

Independent variables	Mean	S.D.	Min	Max
DISTRESS	0.22	0.42	0	1
GDBR	84.31	7.59	68.40	112.60
FDBR	93.05	121.30	13.98	1920.78
DIFFIND	0.47	0.50	0	1
IJV	0.30	0.46	0	1
ACQ	0.19	0.39	0	1
NETYEAR	17.17	12.91	1	74
INTRADE	0.32	0.40	0.00	1.73
GASSET	24508535	25667630	2842000	72415000
ASSET	1082910	2487360	587	23065517
SHAREHLD	54.39	28.18	3	100
INDGRTH	0.09	0.17	-0.56	0.74
CONC	158.82	90.27	9	575

Table IV Correlation Coefficients of Independent Variables (*N=241*)

		1	2	3	4	5	6	7	8	9	10	11	12
1	DISTRESS												
2	GDBR	0.51											
3	FDBR	0.00	0.00										
4	DIFFIND	-0.04	-0.15	0.08									
5	IJV	-0.11	0.05	-0.09	-0.12								
6	ACQ	0.16	-0.03	0.18	0.08	-0.24							
7	NETYEAR	-0.08	0.04	-0.09	-0.10	-0.10	-0.38						
8	INTRADE	0.03	0.01	0.07	-0.10	-0.09	-0.03	-0.10					
9	GASSET	-0.37	-0.23	-0.05	-0.13	0.11	-0.09	-0.04	0.15				
10	ASSET	-0.08	-0.03	-0.04	-0.21	-0.10	-0.13	0.31	0.06	0.31			
11	SHAREHLD	-0.01	-0.05	0.14	0.20	-0.13	-0.01	-0.34	0.16	-0.03	-0.25		
12	INDGRTH	-0.03	0.12	-0.05	-0.19	0.19	-0.04	-0.04	0.01	0.12	-0.01	-0.04	
13	CONC	-0.08	-0.11	0.08	-0.16	-0.06	0.05	0.07	-0.05	0.23	0.19	-0.09	-0.27

Table V The Results of Multinomial Logistic Regression

	M1 All Groups				M2 Surviving Groups		M3 Bankrupt Groups	
Independent variables	Divestiture	Consolidation	Divestiture	Consolidation	Divestiture	Consolidation	Divestiture	Consolidation
DISTRESS	0.99*	0.68						
GDBR			0.02	-0.01	0.09*	0.15***	-0.29	-0.78***
FDBR	0.01	0.01	0.01	0.01	0.02**	0.02**	0.03	0.00
DIFFIND	1.26***	0.18	1.27***	0.11	1.00**	0.28	2.41	-6.27*
IJV	1.34***	0.20	1.28***	0.16	1.18**	0.29	3.48	0.94
ACQ	-0.27	0.37	-0.13	0.43	-0.55	0.32	-2.94	-0.11
NETYEAR	-0.05*	0.02	-0.05**	0.02	-0.03	0.04*	-0.39*	-0.18
INTRADE	-1.34**	-0.38	-1.28**	-0.31	-1.38**	-0.16	-1.53	-9.73**
GASSET	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
ASSET	0.00	-0.00*	0.00	0.00	0.00	-0.00**	0.00	0.00
SHAREHLD	0.01	0.02**	0.01	0.02**	0.02**	0.02**	-0.01	0.07
INDGRTH	1.63	0.65	1.60	0.67	1.33	1.57	8.49	9.71
CONC	0.00	0.00	0.00	0.00	0.00	0.00	0.00	-0.03*
Constant	-2.83**	-2.76***	-4.34*	-1.78*	-11.91***	-17.14***	23.05	74.13**
Divesiture(sold/dissolved)	50(40/5)		50(40/5)		33(28/5)		12(12/0)	
Consolidation	44		44		31		13	
survive	152		152		124		28	
Total	241		241		188		53	
-2Log Likelihood	368.860		372.684		257.808		42.364	
Chi-sq. (d.f.)	71.944(24)		68.121(24)		71.987(24)		65.557(24)	
Model Sig.	0.000		0.000		0.000		0.000	
% correct	66.0		66.0		69.1		81.1	

(Note) The base category is “survive.” *: p<0.1 **: p<0.05 ***: p<0.01