View from the Inside

The Korean CEO who managed Seoul Bank's restructuring and successful privatization in 2000–02 recounts his experience

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IN LATE 1997, when it approached the IMF for assistance, Korea was in the midst of a full-blown banking crisis, with Seoul Bank at the forefront. The crisis was brought on by the bankruptcies of several large industrial conglomerates and contagion from the financial crises that had begun in Thailand. But Seoul Bank was in bad shape even before the onset of the Asian crisis. Its difficulties were attributable to weak management following two decades of infighting since a merger in 1976; the tradition for Korean banks, at the government's direction, to provide credit for industrial development, leaving them with weak commercial orientation and limited risk-management discipline; and generally lax prudential regulations.

As part of the banking sector restructuring, the IMF identified Seoul Bank and Korea First Bank as the country's most distressed commercial banks. To prepare Seoul Bank for early sale to foreign investors, the government recapitalized it in January 1998, thereby assuming control; removed its management; and appointed a financial advisor to develop a privatization strategy. This initial plan included obtaining bids for the bank's sale by mid-November 1998. With each subsequent IMF review of the restructuring, the IMF and the government set tight deadlines for reprivatization, making management's job more difficult.

Although Seoul Bank sold its training center, halved the number of overseas branches, and reduced the workforce by 35 percent by the end of 1998, its ratio of loans (assets) to employees remained among the lowest in the industry. And unfavorable market conditions delayed the government's plan. By June 1999, Seoul Bank was again insolvent, and, in September, the government injected a second round of new capital. With no interested buyers, Seoul Bank drifted into a fix-and-sell mode. In contrast, the government sold Korea First "as is" to Newbridge Consortium. Although it was generally recognized that Seoul Bank required more extensive restructuring than Korea First Bank, the latter took more public money because the "put-back" option, which lasted until the end of 2002, required the government to cover any unexpected losses on preexisting commitments.

In April 2000, Deutsche Bank was appointed financial and restructuring advisor, and, in May, the government hired me to prepare Seoul Bank for privatization. Although a Korean banker, I was the first from a non-Korean bank to be appointed CEO of a government-controlled bank. My challenge was to bring in quickly as many professionals as possible with the necessary expertise to build a new corporate culture centered on international best practices in banking. By June 2002, Seoul Bank was successfully restructured (see table), resulting in its sale and privatization in December 2002. The road we traveled offers insights into fixing up distressed banks in crisis situations.

Downsizing

When I joined Seoul Bank, it was organized by seniority rather than by function. Functional responsibilities were assigned without regard for the incumbents' expertise, which, in any case, was in short supply. A week after taking over, I asked for the resignation of all but one director, whom I retained for the sake of continuity.

The bank had 4,643 employees in June 2000, about 80 percent of whom were union members. The leader of Seoul Bank's labor union was a key member of the Korean Federation of Financial Unions, and it became obvious that we had to deal with this internal political force to effect change quickly. Despite the 1998 layoffs, the bank remained top-heavy, and a further reduction in staff was generally expected. The only remaining questions, to be negotiated with the labor union, were how many to let go, who, when, and how.

In my first meeting with the union leader, I was encouraged that we agreed on the need for drastic change. But the Federation of Financial Unions, whose agenda included seeking a guarantee of stable employment, stopping government intervention in bank management, and opposing the government's plan to form a financial holding company, was organizing a general strike and rally. To my surprise and frustration, Seoul Bank's union participated in the strike.

A few days later, the new management team, adopting a medical metaphor, announced to senior managers that it was prepared to operate on the bank—"a sick patient"—but would not begin until the patient demonstrated the will to live. The next day, the union leader confirmed his support for the restructuring, and we agreed to implement an early retirement program. The program included an informal arrangement, designed to avoid difficult personnel decisions, whereby all employees born in or before 1948—most head office general managers and regional managers—would retire. By October 2000, 640 positions had been eliminated, and 2 staff members had been promoted to management positions. A new functional organization chart was drawn up, and, by December 2000, responsibilities had been delegated to the management team.

Nitty-gritty of restructuring

Restructuring essentially required that the bank be completely overhauled. I likened the work ahead of us to transforming an old vacuum tube radio into a new transistor radio, which meant changing the control system, the circuitry, and the look and the size of the radio.

We launched the operational restructuring in July 2000 with the assistance of about twenty advisors. By mid-July, we had 13 functional project teams, each consisting of one or two advisors and three to five bank employees. The teams reviewed existing procedures and organization, mapped out new procedures and organizational structures, presented recommendations to management, and helped implement the agreed-upon recommendations. In the process, the project leaders and advisors made a point of transferring knowledge to members of the Seoul Bank restructuring team.

Until December 2000, the management team met regularly with the project leaders to update and fine-tune the work in progress, making periodic presentations to the Board of Directors and the government shareholder. By early 2001, we had implemented key concepts of international best practices in banking: we established a functional organizational structure; formed an independent and consolidated credit department; segregated the duties between the front office and the back office at headquarters and in each branch; established specialized business lines separating retail from corporate banking business and appointed separate officers for each; instituted process mapping and produced guidelines for controlled back-office operations; introduced an audit system based on systems and procedures; created a management information system; and strengthened risk management.

Restructuring the balance sheet

When I took over, Seoul Bank had insufficient reserves and the highest ratio of nonperforming loans (20 percent) of any Korean bank. To regain credibility in the market and earn customer confidence, we had to clean up the balance sheet quickly. It was essential also because the bank needed one last recapitalization by the government. We immediately liquidated 50 billion won worth of Korean stock in the trading portfolio. For the rest of 2000, we disposed of impaired assets (the first sale consisted of foreign currency loans and securities for non-Korean obligors), defined strict loan classifications, built up the bank's reserves, and increased loan loss provisions by a trillion won.

In June 2000, Seoul Bank was a main bank for five companies in voluntary workout programs, with a total exposure of 705 billion won. One of the largest was Woobang Construction, whose total borrowings were 1.2 trillion won (about $1.1 billion), with 181 billion won owed to Seoul Bank. Woobang suffered cash-flow problems in late June; in early July, it requested new loans of 155 billion won from creditor banks. The bank creditor group advanced the company 44.4 billion won and engaged an accounting firm to assess it before deciding on the

Profit and loss

Seoul Bank strengthened its balance sheet steadily before its sale in December 2002.

(billion won)

	1999.12	2000.12	2001.12	2002.3	2002.6	2002.9
Operating income before provision	329.4	91.2	283.4	78.3	162.7	238.3
Net interest income	284.9	387.1	337.2	98.6	198.7	306.0
Noninterest income	250.4	69.4	301.9	74.9	145.7	209.5
Operating expenses	363.9	365.3	355.7	95.2	181.7	277.2
Provision (new/refund)	440.2	942.1	277.3	21.2	59.0	95.8
Operating income	110.8	–850.9	6.1	57.2	103.7	142.5
Nonoperating income (including tax)	–2,343.9	331.1	54.6	0.6	4.6	6.1
Net income	–2,233.1	–519.8	101.4[1]	56.6	108.3	136.4

Source: Seoul Bank.

[1]Includes deferred tax income of 40.7 billion won.

remainder of the request. The assessment indicated that the company's estimated survival value was less than the liquidation value, and the remainder of the loan was rejected. It was the first time a company in the government-sponsored workout program was forced into bankruptcy.

In December, Seoul Bank auctioned off nonperforming loans totaling 404 billion won without incurring any loss beyond what had already been provisioned for. Still, its nonperforming loan ratio did not fall at the end of 2000 because a significant number of loans had been downgraded. In the first quarter of 2001, Seoul Bank started to write off nonperforming loans aggressively. In September 2001, it created an asset-backed securities structure to remove 447 billion won in nonperforming loans from its books.

The nonperforming loan ratio declined rapidly during the second half of the year. By the end of 2001, Seoul Bank's loan portfolio was among the cleanest in the market, and, by mid-2002, its net nonperforming loan ratio was the lowest of all Korean banks.

New image, new focus

But cleaning Seoul Bank's balance sheet and downsizing the staff were not our only challenges. We also had to change its image and focus. Even before the crisis, Seoul Bank had a bad reputation because of infighting and poor service. The fact that it received public funds during the crisis only worsened its image.

The vision I brought to the bank was of a "small but strong and clean bank" (it sounds better in Korean). Reducing Seoul Bank's size would enable it to change more quickly and improve its ability to provide personalized customer service. The bank's strength was to come from a new culture of working together toward the common goal of implementing international best practices in banking. Training to accomplish this began three months after I arrived.

During the first few months, the management team also made changes to show that informality, open communication, transparency, and a focus on work were Seoul Bank's new values. Among other changes, we instituted an open door policy for all department heads' offices and removed their televisions; prohibited stock trading and Internet surfing not related to business during office hours; freed the CEO-only elevator for general use; and opened the executive dining room to all employees.

Like most Korean banks before the crisis, Seoul Bank's main business was extending credit to corporate clients. It had also had a dominant share of the custody business for local investment trust companies and foreign investors in the Korean market. We decided that retail banking, particularly household mortgage loans, would be our primary business focus, followed by credit cards. Our goal was to minimize market risk. To address corporate banking, we hired a former foreign bank corporate banker to train our people in financial analysis and other corporate banking skills. Through 2001, Seoul Bank was the fastest-growing retail bank. By end-2001, its loan portfolio was balanced between corporate and retail exposures.

Outcome

From the first quarter of 2001, the bank's quarterly operating income, before provision for credit losses, began growing. Most of the new income came from retail business (as interest) and credit card business (as fees). In the second half of 2001, Seoul Bank took a haircut from Hynix (former Hyundai Semiconductor) and wrote off its exposure of 260 billion won.

Following a government cabinet shuffle in August 2000, a new agenda emerged. Some of the new policymakers felt that Korea's banking sector was still overbanked, that most of Seoul Bank's quality employees had left during the crisis, and that, even with a successful restructuring, Seoul Bank was too small to survive following consolidation. In this environment, Seoul Bank was in danger of being put into a financial holding company—an outcome I worked hard to avoid by seeking potential investors. In late January 2002, the Minister of Finance and Economy announced that preparations for the bank's sale would proceed simultaneously with discussions about a merger with a sound bank. In December 2002, Seoul Bank was sold to the larger Hana Bank, one of a few banks that did not need government recapitalization to weather the crisis.

What kept the bank going from late 2001 was the power of the management team to reinforce and maintain international best banking practices. Employees associated the rapid reduction in nonperforming loans and the equally rapid growth of retail and mortgage loan portfolios with best practices. But the bank was also blessed with good timing, including in beginning the restructuring and in pushing for retail and mortgage loan business, but especially in the timing of the sale.

My Seoul Bank experience yielded several lessons:

- Even under full government ownership, a professional management team can turn around a damaged bank and make it commercially attractive for privatization if the government does not interfere with the bank's management.
- Bank restructuring is essentially an exercise in building a sound risk-management infrastructure—a functional organization, proper segregation of duties, consolidated credit functions, and a management information system that produces segmented balance sheets and profit and loss statements on a timely basis.
- Key to this exercise is training employees to work within the new infrastructure, which builds a risk-sensitive culture, and providing specific training for specialized functions. ■

Before joining Seoul Bank, Chungwon Kang worked for 5 years at Citibank, 15 years at Bankers Trust Company, and 1 year at Deutsche Bank (following its acquisition of Bankers Trust in 1999). After 1996, he was chief country officer for the Korean operations of Bankers Trust and for Deutsche Bank. His selection as CEO of Seoul Bank was managed by an international human resources firm. He currently serves on the board of LG Investment & Securities Company and is a senior advisor to the law firm of Kim & Chang in Korea.

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