A tale of two tigers: employee financial participation in Korea and Taiwan

Beom-cheol Cin*, Tzu-Shian Han and Stephen C. Smith

Stephen C. Smith, George Washington University, Department of Economics, 624 Funger Hall,2201 G St NW, Washington, DC 20052, USA (e-mail: scsmith@gwu.edu).
Beom-cheol Cin,Kyonggi University, South Korea. Tzu-Shian Han, National ChengChi University, Taiwan.

Abstract This paper examines the structure and evolution of programmes for exmployee financial participation in South Korea and Taiwan. Reasons for the changing incidence of these programs over the post-World War II period are examined. These case studies are then placed in comparative perspective. In Taiwan, several programmes play important roles: year end bonuses in proportion to salary, profit sharing, employee ownership plans, and combination stock and profit-sharing programmes. The latter are more effective in employee retention and in reflecting genuine sharing of net income than other plans, but have been perceived as contrary to outside shareholder interests, have attracted attention in trade dumping disputes because of their non-taxed status, and function less effectively in unprofitable firms. In South Korea, ESOPs are the most prominent form of financial participation, having risen strongly in the decades prior to the 1997 financial cirsis but falling at that time, due both to the crisis and to unfavorable tax law changes. Taiwan has embraced stock options and other programmes associated with a more entrepreneurial, risk-taking culture, in common with high tech US firms. Korea's ESOP programme has more in common with those of large, established firms in the US. These differences reflect the contrast in corporate culture between the two economies, with Taiwans's economy dominated by smaller and more flexible firms, and Korea's by large conglomerates enjoying benefits of market share.

Keywords Korea; Taiwan; human resource management; bonus systems; incentive stock options; profit sharing; employee ownership; Employee Stock Ownership Plans (ESOPs).

Introduction

Since 1960, East Asia has had by far the highest rate of growth of any region of the world. Explanations for this success have proliferated with the growth of these economies. For, in Asia, as in the West, 'success has a thousand fathers, while failure is an orphan'. Indeed, explanations for rapid growth in Taiwan and Korea have included both the effectiveness of state intervention (Amsden, 1989; Wade, 1990) and the presence of free markets (World Bank, 1987); loyalty to one employer and a determination to save enough to start one's own business; the exigencies of Cold War emergency and the safety provided by a guaranteed source of American aid; and cultural attitudes of respect for tradition and of risk taking (see Aoki and Dore, 1994).

The role of human resource management and labour relations has received less attention, but here too there has been some debate (Aoki, 1989). Much of the attention has centred on Japan and its workplace culture of teamwork, long tenure and loyalty to a single employer, pay by seniority, with relatively steep seniority-based pay grades, and company unions with a general acceptance of management – employee co-operation. In particular, the Japanese model of labour relations has been trumpeted as a model for achieving high-quality production (Ouchi, 1982). In addition, the bonus system has been viewed as a type of share system, with elements both of a wage supplement and of a profit-sharing mechanism (Freeman and Weitzman, 1987), that could have both employment-stabilizing properties and incentive effects.

Certainly, experience since the collapse of the bubble economy of the 1980s has not been kind to international perceptions of the value of the Japanese economic model. However, policies best suited to starting modern economic growth and reaching the world technology frontier may well differ from those suited to pushing out the frontier once it has been reached; and the fact that Japan has apparently had a difficult time in making this transition does not mean it will be equally difficult for the economies that have, in a sense, followed in Japan's footsteps, notably Taiwan and South Korea. While, as of mid-2001, Japan is showing signs of finally addressing reform issues under Prime Minister Koizumi, both Korea and Taiwan have been taking a much more proactive policy stance towards managing this transition than Japan did at a comparable stage of its development (Business Week, 2000).

Human resource management practices in Taiwan and South Korea exhibit some differences from and some similarities to each other and to and from practices in Japan. The average firm size in Taiwan is much smaller than that in South Korea. Correspondingly, the former has had a much more entrepreneurial culture; the latter has more resembled Japan in its conglomerate structure and pattern of long and loyal tenure with the firm. Finally, while unions have been suppressed in both Taiwan and South Korea in their periods of rapid growth under authoritarian regimes, in recent years unions have become a powerful force in the Korean economy and a growing presence in Taiwan.

The emphasis on continuous process innovation in Japan, and more recently in Korea and to some extent also in Taiwan, has naturally led to an emphasis on employee participation. In this field, the best-known contribution has been in quality circles, emphasizing consideration of employee ideas on innovative work practices as well as on measures for improving quality standards. This kind of employee participation in decision making and decision implementation can be helpful in itself without financial participation. However, as the extensive research on this question in the 1980s revealed, financial participation can reinforce and magnify the value of general decision-making participation (see, e.g., Levine and Tyson, 1990). The bonus system in Japan has been shown to award bonuses that vary to at least some degree with the economic conditions of the firm (Freeman and Weitzman, 1987). Beyond this, as the research of Jones and Kato (1993, 1995) has documented, Japan has made extensive and effective use of Employee Stock Ownership Plans (ESOPs) as a part of its total industrial relations package, with substantial positive effects on productivity. Using industry-level data, Morton (1998) presents some evidence that bonus payments in Taiwan may be tied to greater employment stability and higher productivity. However, not much has been known about the incidence of share schemes in East Asia.

In the aftermath of the Asian financial crisis of 1997–8, there has been renewed attention to the need for the tiger economies to shift from a corporate strategy of imitation to one of original innovation: in the lexicon of Michael Porter (1990), to manage the shift from an investment-driven stage of international competitiveness to an innovation-driven stage. Here, too, employee participation is likely to prove critical. As the success of the firm depends on innovation, there is a growing need to tap into employee creativity and innovation, and to encourage the most innovative employees to stay with the firm, rather than be hired away or to strike out as entrepreneurs without retaining ties to the firm (Smith, 1988), and this is a growing challenge for the tiger economies of East Asia (see Business Week, cover story, 30 November, 2000).

The first purpose of this paper is to document the extent of employee financial participation in the leading tiger economies of Taiwan and South Korea up to the recent financial crisis and its aftermath. We show that not only the well-known Asian bonus systems, but also fairly sophisticated systems of employee ownership plans have existed in both economies for decades. However, we also show that the incidence of these systems has not grown rapidly, and that, if anything, the recent financial crisis has caused them to be somewhat reduced in extent. Nevertheless, the recent emergence in both countries of new systems of broad-based stock options, and the very active policy debate in 2000 and 2001 in South Korea on reforms to encourage more employee ownership, suggest that both economies are poised for renewed growth in employee financial participation. Second, we consider the role of these systems in recovering from crisis and in helping to manage the transition to innovation-led economies. Third, we analyse the current policy debate on employee financial participation in these economies. Finally, we offer some comparisons between the two cases.

The remainder of the paper is organized as follows. In Section 2, we consider the history and incidence of financial participation plans in Taiwan. In Section 3, we offer an in-depth analysis of the employee stock ownership associations in South Korea. Finally, in Section 4, we compare the cases and offer some concluding remarks.

Employee financial participation in Taiwan

Broadly speaking, there are five major employee financial participation schemes currently used by enterprises in Taiwan: the conventional year-end bonus system, profit-sharing plans, stock-holding plans, schemes that combine profit sharing and employee ownership (the combination schemes) and Employee Stock Option Plans. The year-end bonus system is the traditional employee financial participation scheme in Taiwan and elsewhere in East Asia. Profit-sharing plans and employee stockholding plans have also existed in Taiwan at least since the end of World War II (Lee, 1992). The latter two schemes represent more recently established incentive schemes in Taiwanese enterprises, which have been especially popular in more high-tech firms.

The year-end bonus system

A majority of Taiwanese enterprises have adopted a conventional year-end bonus system. This scheme owes at least some of its popularity to its significant tax advantages (Wang, 1998). The bonus system dates back to pre-modern agricultural society in Taiwan, which emphasized gift exchange between the owner/manager and the employees of the firm at the end of each year. This tradition has been broadly accepted and has continued into the industrialized era. Given its widespread presence in Taiwanese workplaces and its high cultural standing, it seems likely that the year-end bonus system will remain a deeply entrenched part of the total compensation scheme for the foreseeable future.

Table 1 *Summary of the extent of year-end bonuses in Taiwan by industry, 2000*

Industry	*Value of payment (month of salary per year)*
Cement	1–4 months
Plastics	1–5 months
Electronics	1.5–3 months
Textile	Less than 1–2 months
Paper & pulp	1–2 months
Auto	2–10 months
Construction	1–4 months
Housing	0–2 months
Food	1–2 months
Banking & insurance	2–4.5 months
Telecommunications	4–11 months
Semi-conductor	5–6 months
Printed-circuit board	2–3 months
Optical	1–2 months
Retailing channel	0–2 months
Internet service provider	2–4.5 months
Securities	Up to 12 months
Miscellaneous	1.5 to 3 months

Source: Adapted from United Evening News, 3rd edn, 27 December 2000.

Though longitudinal data concerning this practice are not readily available and need to be assembled from different sources across time, Table 1 gives us some picture regarding the recent practices of the year-end bonus system in different sectors in Taiwan's economy. In this table, a variety of practices can be found across industries, ranging from no bonus sharing to a twelve-month salary payment. The bonus system is typically organized either as a 'normative' or a 'flexible' system. The normative system is based on the compensation norms of the industrial sector of the firm. The majority of Taiwanese enterprises pay year-end bonuses of two months' worth of salary to their employees each year on average. However, there are some deviations from this common norm. In the banking industry, for instance, many former government-run banks paid year-end bonuses to their employees, which amounted to four-and-a-half-months' worth of salary each year. In the public sector, the majority of employees are paid one-and-a half- months' worth of salary each year for their year-end bonuses. Normative bonus payments are essentially part of an employee's regular, expected total compensation package, and generally may be omitted only when the firm is in dire financial circumstances.

The flexible bonus system, as its name would imply, is more variable according to the financial condition, and is thus closer in nature to a profit-sharing scheme. In some Taiwanese enterprises, year-end bonuses vary according to the annual profitability of the firm. In addition to their regular twelve-month salaries, some enterprises have paid more than an additional six months' worth of salary to their employees as year-end bonuses when the firms yielded high returns on their investments. While reported on anecdotally in the press, unfortunately there are no systematic data available on the incidence of these flexible bonus schemes, or representative statistics on the extent to which the bonus varies. This would be a valuable area for future research on human resource management in Taiwan.

Profit sharing (fenhong)

Profit-sharing (or fenhong) schemes are regulated under three Taiwanese laws. Under Provision 40 of the Factory Law, manufacturing plants should reward employees with bonuses or profits if the plants are profitable and employees meet requirements set by employers at the end of each fiscal year. The Factory Law was first established in mainland China by the Nationalist Government in 1930. When Japan surrendered in 1945, the Nationalist Government assumed control in Taiwan after a fifty-year period of colonial rule by the Japanese military government; and at this time the Factory Law was first extended to Taiwan.

The Factory Law was succeeded by the Fair Labor Standards Act, which came into effect on 30 July 1984. Like the Factory Law, Provision 29 of the Fair Labor Standards Act stipulates that, besides income tax payments, compensation for financial losses and employers' contributions to public funds, employers should reward qualified employees with bonuses or profits at the end of each year. However, this provision does not stipulate the extent of profit employers should share with employees. Rather than improving labour relations, this ambiguity has often led to labour disputes over the shares employees should receive at the end of each year.

In addition, Provision 235 of the Corporate Law stipulates that corporate by-laws should promulgate the extent of employees'profit sharing. These laws have provided the legal rules for Taiwanese enterprises adopting profit-sharing plans.

In practice, companies adopting profit-sharing plans typically share profits with their employees annually after fiscal budgeting, auditing of accounts and board meetings. The profit-sharing bonus that each employee receives is usually based on his or her salary level, seniority, position (or job type) and individual performance rating. In large part because there are no tax advantages for companies in adopting profit-sharing schemes, only a minority of firms in Taiwan practice profit sharing; this stands in sharp contrast to the tax advantages available for traditional bonus pay arrangements.

Data on the incidence of the profit-sharing programmes are available for the period 1989 to 2000. As seen in Table 2, Column 1, the average incidence of this programme shows no clear trend over the period: there were 546 plans in 1989 and 545 in 2000.

Table 2 *Numbers of profit-sharing and employee stock ownership plans in Taiwan (Unit: Establishment)*

Year	*Profit sharing*	*Employee stock ownership plans*	*Combination plans*
End of 1989	546	186	NA
End of 1990	539	268	122
End of 1991	589	293	132
End of 1992	647	343	141
End of 1993	663	355	144
End of 1994	678	363	146
End of 1995	501	362	142
End of 1996	511	371	146
End of 1997	528	384	155
End of 1998	524	421	174
End of 1999	545	430	175
2nd quarter of 2000	545	430	175

Sources: Monthly Bulletin of Labor Statistics, Taiwan Area, Republic of China, June 1997, p 50; Monthly Bulletin of Labor Statistics, Taiwan Area, Republic of China, September 2000, pp. 58–9.

However, despite the absence of a trend, there have been considerable fluctuations in the incidence of these plans, which rose to 678 in 1994, dropped precipitously to just 501 in 1995, and then slowly recovered to pre-1990 levels. The 1995 drop has never been satisfactorily explained and is a valuable topic for future research.

Employee stock ownership plans (rugu)

The legal underpinning for employee stock ownership plans is Provision 267 of the Company Law stipulating that, when the company issues new stock, it should reserve 10 to 15 per cent of the newly issued company stock for its employees to purchase in advance. In contrast to profit-sharing systems, there has been a growing incidence of employee stock ownership plans in Taiwan in recent years. As seen in Table 2, Column 2, the number of ESOPs in Taiwan more than doubled from 186 to 430 over the 1989 to 2000 period (about a 130 per cent increase). Despite this dramatic increase, it is likely that these government statistics actually underestimate the growing incidence of employee stock ownership plans because the surveys on which the numbers are based were not comprehensive.

The first ESOP in Taiwan dates back to 1946 when Da-Tung Co., a local electric appliance manufacturer, first adopted an ESOP programme to facilitate co-operation between workers and management (Council of Labor Affairs, 1993). When the company issued new shares, it reserved part of the newly issued stock for employees, which was either provided free of charge or through no-interest company loans. The employee benefits committee was in charge of the ESOP in the company. If employees wanted to purchase company stock, they could borrow money from the committee. The loans would be repaid without interest from the earnings of their stock and from year-end bonuses. Before the loans were repaid, employees' shares were retained by the committee as collateral.

Eventually, a few large-sized companies in Taiwan began to adopt profit-sharing plans and/or ESOPs. From 1965, for instance, the Pacific Electric Wire Co. amended its bylaws to provide for company contributions of 10 per cent of its total revenues to be shared with its employees. In addition, when it issued new stock, the company reserved 10 per cent of newly issued shares for employees to purchase at book value. Pacific's ESOP covered all permanent employees with at least three months' tenure in the company, excluding temporary staff. In the early years of the ESOP, the company required that employees should not sell their shares within one year. However, the Corporate Law stipulates that stockholders have ultimate rights to sell their shares at any time and without any restrictions. Since employees possessed the status of stockholders after owning company stock, Pacific finally abolished the restriction of no transfer within one year to allow employees to sell their shares at their convenience. The company was selected as the firm with the best labour-management relations in 1978, due to its profit-sharing and employee stock ownership plan.

In 1970, Wei-Chuan Food Co., a local food producer, adopted its combined profit-sharing and employee stock ownership plan. Its plan was based upon the value of bonuses employees earned. If the bonuses were less than three thousand Taiwanese dollars, the company paid cash to employees. When the bonuses exceeded three thousand dollars, the company allowed employees to purchase company stock at a below-market rate. The company's by-laws required that the shares owned by employees be centrally managed by the company. Employees were allowed to sell their shares only under certain circumstances, including illness, death, retirement or other worker separations. The company's pioneering participation programme is well known in Taiwan, which makes it a useful reference point. Table 3 shows the historic statistics for Wei-Chuan's profit-sharing and employee stock ownership plan for available years in the 1970s (for unexplained reasons the company was not able to provide data after 1979). During the 1972–8 period, profit sharing as a percentage of net profits ranged substantially from 10.1 per cent to 23 per cent, and stock shares ranged by an order of magnitude from 335,400 to 3,340,000. The data shows that, although profit sharing as a percentage of net profit varied across years, employee stock shares rose considerably during this period.

Table 3 *Historic statistics of profit sharing and employee stock ownership plan at Wei-Chuan Food Co.*

	Net profit (unit: NT$)	*Profit shared (unit: NT$)*	*Profit shared as percentage of net profit*	*Stock ownership (unit: share)*
	96,089,000	9,980,000	10.4	335,400
1972	132,580,000	13,630,000	10.1	496,360
1973	142,166,000	19,853,000	14.0	550,950
1974	132,119,000	26,810,000	20.2	866,210
1975	55,060,000	18,549,000	23.7	2,681,100
1976	68,163,000	13,248,000	19.4	2,922,390
1977	100,278,000	16,103,000	16.1	3,156,500
1978	168,646,000	19,243,000	11.4	3,340,000

Sources: Wei-Chuan Food Co. (1977) Report on Profit Sharing and Employee Stock Ownership. 24 June; Wei-Chuan Food Co. (1978) Report on Profit Sharing and Employee Stock Ownership. 28 March; Chen, Jin-fu (1982) Profit Sharing and Employee Stock Ownership Plan in Taiwan. Chinese Culture University Press, p. 105.

Since 1971, the number of enterprises adopting profit sharing and/or ESOPs started to rise (see Cheng, 1990: 407). Unfortunately, there are no publicly available comprehensive statistics on the extent of these employee financial participation programmes in Taiwan in earlier years. However the percentage of enterprises adopting

ESOPs during the 1981–7 period is publicly available, and has the advantage of being disaggregated by sector. Table 4 indicates the percentage of companies adopting ESOPs in eight industries during this period, covering the broad spectrum of the Taiwanese economy. The percentages tend to decline for all industries at the end of this period, which indicates that recent increases in the incidence of the programmes do not represent a new breakthrough, and offers evidence that there is substantial churning in these plans, even when overall averages show no trend.

Table 4 *Percentage of enterprises in Taiwan adopting ESOPs in eight industries during the 1981–7 period*

	1981	*1982*	*1983*	*1984*	*1985*	*1986*	*1987*
Mining	7.54	5.52	3.63	3.70	2.03	3.38	2.84
Manufacturing	11.41	11.31	10.71	9.26	5.05	3.99	4.13
Construction	18.52	18.52	20.69	25.93	32.14	23.08	15.38
Electric & gas	5.65	4.91	4.39	5.75	4.43	2.74	1.01
Commerce	6.75	n.a.	n.a.	n.a.	n.a.	n.a.	.84
Transportation	7.28	6.54	6.58	3.98	4.85	3.52	3.18
Banking & insurance	19.70	n.a.	n.a.	n.a.	n.a.	n.a.	2.52
Service	4.12	n.a.	n.a.	n.a.	n.a.	n.a.	7.27

Sources: Executive Yuan: Surveys of Employees in All Industries in Taiwan, 1982–1984, 1985–1987, 1988. (From 1988, the survey was discontinued by the government.)

Another employee stock ownership plan in Taiwan resembles the US 401k plan, in which employees contribute part of their monthly salary to purchase company stock. In return, the company matches a percentage of their salaries to be used as subsidies for these stock purchases. In 1998 China Steel Co., for example, adopted such an employee stock purchase plan. Under the plan, employees contribute 10 per cent of their salaries; the company then provides a partial match of 20 per cent of employees' contributions to purchase company stock through a trustee. This type of plan stipulates that employees are not allowed to sell their stock until they retire or otherwise leave the company.

The earlier experiments with employee financial participation in Taiwan were by consensus relatively ineffective, for several reasons. First and foremost, there were no tax advantages for companies in adopting profit sharing and/or ESOPs. Second, because firms, by law, could obtain tax benefits from the adoption of year-end bonuses, employers tended to substitute year-end bonuses for formal profit-sharing and ESOP plans. Further, the valuations of many ESOPs were based on the price of company shares in the stock market. Taiwan has had a highly volatile stock market over the last two decades. As a result, employees tended to bear a relatively high risk if they purchased company shares at market prices. This was one of the major reasons why employees were less willing to purchase company stock. Additionally, most ESOPs had restrictions on the transfer of employee shares. These restrictions further lowered employees' interest in owning company stock. Finally, the Taiwanese economy was full of small and medium-sized family-owned firms. These enterprises were usually conventional and conservative concerning the adoption of innovative work practices, such as profit sharing and ESOPs. Partly out of fear of losing managerial control of their businesses, they were reluctant to share their profits and ownership with employees.

Combination plans

Combination plans feature elements of both profit sharing and employee ownership. The legal framework for the combination plans is based on Provision 240 of the Company Law stipulating that, when the company transfers net profits to be the capital investment, according to company by-laws, the firm can give employees newly issued stock or cash as their shares of these profits. In the past two decades, combination plans have been popular in some high-tech industries, in particular the semi-conductor industry.

Since the mid-1980s, employee financial participation taking the form of the combined programmes has gained some popularity in Taiwan's economy. Not only have many high-tech firms adopted these programmes, but some enterprises in traditional industries have also followed their lead or considered the implementation of this participation scheme in the near future. This recently growing phenomenon can be viewed as a new milestone in the developments of employee financial participation in Taiwan in terms of motivational effects. Some high-tech companies have shared a significant fraction of profits in stock form with their employees in recent years, which was rarely observed in the earlier experiments in employee financial sharing in Taiwan. UMC, a Taiwan-based semi-conductor firm located in Sin-Chu Science Park, was among the first to launch the combination plan in 1983. Except for omitting sharing in 1985, and again in 1991 due to the financial losses incurred in 1990, UMC has paid out under the combination plan every year since its founding. To stockholders, the percentage of stock sharing relative to revenues ranges from 15 to 93 per cent (Tsao, 1999: 22). Table 5 illustrates the historical records of percentages of stock sharing at UMC from 1984 to 1998.

Since UMC first initiated the combination plan in 1983, companies in Taiwan's information and other related high-tech industries, as well as some companies in financial and other sectors have followed these trends and implemented their own combination plans. The amount of employee stock ownership among firms in Taiwan increased substantially from 1998 to 2000. A ranking of publicly traded companies in Taiwan by the scale of their combination plan contributions over the 1998–2000 period was generated utilizing a comprehensive database similar to the COMPUSTAT data set in the US, and is available from the authors upon request as an appendix. The results show that the top-ranking firm in 2000 gave its employees stock bonuses worth NT$ 6,116,595 per person in that year, while the top-ranking firm in 1998 shared only NT$2,977,088 per employee in stock. The data reveal that a majority of ESOP companies sharing large stock bonuses are usually profitable firms in high-tech industries. Some firms allow their employees to sell their stock immediately upon receiving it.

The combination plans have, to certain extent, generated several advantages from both employers' and employees' perspectives. It is reported that they have been an effective mechanism for attracting and retaining employees (Tien-Hsia Magazine, 1997; Today Weekly, 1998). Many foreign multinational corporations in Taiwan (e.g. IBM, HP, Phillips, Texas Instruments, etc.), previously viewed by job applicants as the best firms to work for, are now confronted with 'fierce warfare' with local high-tech firms for the talented. And many foreign companies also lost some of their most valued employees when some local high-tech firms recruited them with highly valued stock bonuses. In some companies, profit sharing and employee stock ownership represent large shares of their total payroll costs (Fong, 1998); this parallels the experience in US high-tech firms (Smith, 1988).

Table 5 *Percentage of stock sharing relative to revenues at UMC, 1984–98*

Year	*Percentage of stock sharing*	*Employee shares*
1984	34.6	n.a.
1985	No sharing	n.a.
1986	15.0	n.a.
1987	37.0	n.a.
1988	28.0	n.a.
1989	27.0	n.a.
1990	25.0	n.a.
1991	No sharing	n.a.
1992	21.0	n.a.
1993	15.0	n.a.
1994	25.0	n.a.
1995	50.0	n.a.
1996	93.0	n.a.
1997	30.0	n.a.
1998	29.0	n.a.
1999	n.a.	365,819,879

Source: Tsao (1999: 22).

Despite the advantages the combination plans possess, the plans have also brought out several problems. First and foremost, the combination plans dilute the interests of outside stockholders to a great extent. And this dilution of interests has led to severe criticisms among outside stockholders as well as some academics.

Second, because of their plans, some of Taiwan's semi-conductor firms manufacturing SRAM chips were sued by American SRAM firms for 'dumping' practices in 1998. Owing to differences in accounting systems between Taiwan and the US, stock bonuses in Taiwan are not counted as payroll cost. In the American system, these bonuses should be counted as payroll cost. Thus, American SRAM firms claimed that Taiwan's counterparts 'dumped' their products on the US market because the selling prices were lower than unit production costs. This dramatic development suggests potentially far-reaching implications of globalization for national practices of employee financial participation, perhaps eventually bringing some of these practices, at the very least their tax treatments, under the umbrella of trade agreements.

Third, the combination plans operate effectively in profitable firms, but not in less profitable ones, showing their limited role in stabilization and expanding workplace incentives. Moreover, as the plans reward employees for previous performance, but not for future performance, this also reduces their long-term incentive effects.

Privatization and employee ownership in Taiwan

Employee ownership has played an important role in privatization in developing as well as transition economies over the last two decades (Smith, 1994), and Taiwan is no exception. Since Taiwan's privatization policy was initiated in 1989, twenty-one state-owned firms have been privatized. According to the latest statistics released by the government, covering the period through June 1999, there were still eighty-two state-owned firms in operation, employing 221,616 workers. Though privatization of additional firms has been one of the major economic reform policies under discussion in Taiwan in recent years, progress has been slow due to such barriers as workers' resistance to privatization and the blocking of privatization by some pro-labour legislators. In late 1996, the National Development Conference was held and the participants reached agreements on the acceleration of privatization within the next five years. Timetables of privatization for forty-seven state-owned firms were rescheduled and laws governing privatization were revised. Taiwan's government has enacted some laws and regulations governing the privatizing enterprises. As in many other countries, employee ownership plans have been designed and enacted as part of privatization in Taiwan. Interestingly, the regulations both put limits on the proportion of shares that can be owned by employees under the programmes and also provide incentives for employees to hold these stocks for longer periods by allowing additional discounted share purchases after specified holding periods have been reached.

The regulation concerning employee financial participation is known as the Preferential Stock Purchase Program for Employees in Privatized Enterprises owned by the Ministry of Economy. Under the programme, regular employees in privatized firms have privileges in purchasing company stock directly (rather than through open market purchases), and at potentially discounted prices. Article 6 of the programme stipulates that, if an employee voluntarily entrusts his or her shares to a trust agency designated by the company and commits him or herself to a 'no-sale' promise for two years, the employee can purchase additional stock at 90 per cent of the regular price. Moreover, if the employee promises that he or she will not transfer or sell the stock within three years, the employee can purchase additional stock at just 80 per cent of the regular price.

Table 6 *Secondary purchase ratios for employees holding privatized company stock, by holding period, under Taiwan's Preferential Stock Purchase Program*

Purchasing price (NT$)	*Holding at least one year*	*Holding at least two years*	*Holding at least three years*
Less than NT$20	18%	25%	39%
NT$ 20–9	10%	12%	16%
NT$ 30–59	8%	9%	12%
NT$ 60 and more	6%	7%	9%

Source: The Preferential Stock Purchase Program for Employees in Privatized Enterprises owned by the Ministry of Economy, Article 9.

According to the Preferential Stock Purchase Program, employee stock purchases should not exceed 35 per cent of the company's stock (Article 5). Within this constraint, privatizing companies, under the surveillance of the Ministry of Economy, are to establish the quantities of stock each individual employee can purchase, set according to his or her seniority, rank, performance rating and other factors (Article 7). If the employee holds the company's stock for certain periods of time without selling any of it, he or she is entitled to purchase additional shares based on certain percentages of the quantity of shares she or he first purchases. Table 6 indicates the percentage of initially purchased shares that an individual employee can additionally purchase after holding the company's stock for certain periods of time, given the stock purchase price.

Considering the first row, for example, for a stock purchase price of less than NT$ 20, if an employee purchases 1,000 shares of the company's stock on 1 January 2001, and holds these shares for the full year, she or he can purchase 180 additional shares on 1 January 2002. If the shares are held for an additional two years without any shares being sold, an additional 250 shares may be purchased on 1 January 2003. If the shares are held for an additional three years without any sales, 390 additional shares may be purchased on 1 January 2004. Additional shares the employee may obtain are not counted in the base for the calculation. If the employee sells 500 of the

1,000 shares during the first year, the employee can still purchase 125 additional shares (500 [remaining shares] × 25) on 1 January 2003 and 195 additional shares (500 × 39) on 1 January 2004.

In order to maintain some horizontal equity between employees in different privatizing companies (with different stock market prices), the government allows smaller secondary purchase rates for higher stock prices. (The concern is that, otherwise, employees in privatizing companies that have higher market prices will earn much more subsidy than their counterparts in those companies with lower market prices.)

Employee stock option plans in Taiwan

In order to resolve some of the problems with employee ownership, profit-sharing and combination plans, described in the previous sections, some practitioners and academics have advocated broad-based ESOPs, a widely used employee financial participation scheme in the US, as an alternative to the combination plans.

Prior to 2000, apart from some subsidiaries of US multinational corporations in Taiwan and a few Taiwanese firms listed on foreign stock markets, very few local companies adopted broad-based stock option plans. One of the major reasons has been the lack of a legal framework for such plans. On 30 June 2000, the Legislative Yuan, the national parliament, amended the Stock Exchange Law and added several new provisions concerning regulations of employee stock option certificates. The new amendments allow the publicly traded companies to buy back their own outstanding stock and to grant employees stock option certificates (similar to US stock options) as incentives after the agreement of at least one-third of board directors. The amendments thus provide a legal foundation for the adoption of ESOPs and may be expected to lead to growth of these plans in the future.

As a result of the world economic slowdown in the first half of 2001, profits and stock prices of many high-tech manufacturing companies in Taiwan dropped dramatically. It was unlikely that the combination plans would be effective under such circumstances. In order to attract and retain talented employees, some firms in the semi-conductor industry recently began to adopt broad-based stock option plans. Shijei-Hsienjin Co., one of major semi-conductor companies in Taiwan, was the first company to adopt such a plan. On 16 February 2001, the Stock and Securities Committee permitted the company to issue stock option certificates to its employees. Through early June 2001, Shijei-Hsienjin issued 300,000 units of employee stock option certificates, representing 15 per cent of the total stock issued. One certificate unit gives an employee the right to purchase 1,000 shares of the company's common stock. According to the company's by-laws, the purchasing price should not be lower than the market price at the granting date. After two years, the certificates can then be transferred to common stock. The effective period of the certificates is ten years, within which the certificates cannot be transferred to others. Following the lead of Shijei-Hsienjin, Li-Jin Semiconductor Co. issued 150,000 units in June. In 2000, Li-Jin bought back 30,000 pieces of outstanding stock as the base for employee stock options (Commercial Times, 4 June 2001). In the computer industry, ACER, the largest computer manufacturer in Taiwan, started to adopt broad-based stock option plans in early 2001. At the end of 2000, ACER bought back 32,000 pieces of outstanding stock. To grant employees of its subsidiary, Yang-Tze Technology Co., stock options as incentives, ACER provided 4,000 pieces of its outstanding stock for Yang-Tze's employees to purchase. Since 26 June 2001, ACER has again bought back 120,000 pieces of outstanding stock to expand the coverage of the employee stock options plans.

These early experiments may be expected to provide models for other high-tech and traditional firms to consider adopting ESOPs as incentive mechanisms in Taiwan's emerging knowledge-based economy. Although broad-based ESOPs may not substitute for other employee financial participation schemes discussed in previous sections, they may become a major form of employee financial participation in years to come, given the problems confronted by other schemes.

ESOPs in Korea

The most prominent form of employee financial participation in South Korea by far is the ESOP.

Historical background

ESOPs (ulisaju in Korean) have operated in South Korea since at least 1958. Beginning in that year, Yoo-Han-Yang-Hang Corporation (a major pharmaceutical manufacturer) provided executives and workers with common stock as a wage bonus to boost work effort. Subsequently, there were several imitators, but the use of ESOPs did not become widespread until government policy initiatives began in the late 1960s.

In 1968, the government established the Capital Market Development Law which included a provision that companies listed on the Korean Stock Exchange must give their employees the right of first refusal (in the form of a type of call option, but without paying an option premium) to purchase 10 per cent of newly issued common stock. This law was revised in 1972 to stipulate that publicly traded companies should offer employees the option of purchasing 10 per cent of outstanding stocks as well as new issues, while closely held companies must provide employees with the right of first refusal on 10 per cent of initial issues.

From the standpoint of the development of ESOPs, the July 1974 amendments to this law, under the rubrick of the Measure for Enlargement and Implementation of ESOPs, were most important. The motivations were two-fold. First, government had been seeking to develop capital markets in general and equity markets in particular to facilitate the growing demand for corporate finance. In particular, ESOPs were envisioned as a method to facilitate IPOs by family-run firms. Additionally, ESOPs were explicitly viewed as a vehicle to help redress the growing and potentially destabilizing concentration of wealth by broadening employee share ownership. This law included four important stipulations: (1) publicly listed companies should establish Employee Stock Ownership Associations (ESOAs), similar to US ESOP trusts, to manage ESOP stock; (2) the government would provide employees with a tax credit equal to 5 per cent of the value of ESOP stock purchased; (3) unlisted firms must also give employees the option to purchase 10 per cent of (private placements of) newly issued stock, to be held in trust; (4) publicly held companies must hold the ESOP stock in the ESOA trustee Korea Stock and Finance Corporation (KSFC) for one year; but a closely held (or unlisted) company must hold the stock at least until the company goes public. In September 1987, as part of the Market Promotion Act the law was revised again, to define the purposes of the ESOA, provisions of eligibility for ESOA membership and legal provisions for the primary purchasing option, and to provide tax incentives. In particular, the amendments increased the primary purchase option to 20 per cent; and increased the tax deduction rate from 5 per cent to 15 per cent of the cost of the ESOP purchase.

Another impetus for expanded employee ownership in Korea came through privatization, which gathered steam in the late 1980s. As with most other developing and transition economies (Smith, 1994), Korea’s privatization programme provided incentives for employees of state-owned firms to participate in share ownership of privatized firms. The People’s Share Programme, legislated in 1987, provided for the allocation of up to 20 per cent of shares for special incentives for employee ownership, providing either a 30 per cent employee discount or five-year instalment financing at special rates. As a result, ‘the post-privatization employee ownership block was approximately 10%’ (Lee, 1991: 15).

By 1988, it had become clear that, while ESOPs might be helping to broaden wealth somewhat, employees were holding their shares for too short a period of time to achieve such potential benefits as improving firm-level productivity and promoting social stability through broad share ownership. Thus, in June 1988, the rules were modified to require employees to hold ESOP stock in the KSFC trust until they retire or otherwise leave their company; but they were allowed to redeem their ESOP stock three years after purchase in some special circumstances, such as the purchase of housing, medical, funeral, marriage and schooling expenses, and ‘recovery from disasters’. In July 1993, this compulsory holding time was reduced to seven years for all employees but just two years in the special cases. In 1988, the government also promulgated the ‘standard agreement’ for ESOAs, including general purposes, composition of representatives, selection of the ESOP trustees, the structure of voting rights and the allocation schedule of the ESOP shares. Importantly, some of the tax deduction provisions were abolished in 1996.

When the Capital Market Development Law was abolished in April 1997, ESOP benefits were scaled back, and the remaining ESOP provisions were then included as a section of the Stock Exchange Law. This placement has proved somewhat controversial, however. In 1999 the compulsory holding time was reduced from seven years to just one year because of union lobbying, reflecting concerns that forcing employees to hold the purchased Employee Ownership (EO) Stock for seven years infringes on their property rights. The 1999 measure may cause the incidence of EO shares to be reduced further in subsequent years.

ESOAs: current practice

Under the current law, participation in any established ESOP is open to every employee except the board of directors, top executives and part-time and temporary workers who have been working in the firm for less than three months (but less than one year in the construction industry). In addition, individual members of the ESOA must fall under the category of minority stockholders, with slightly different rights depending on whether they hold less than 1 per cent or 3 per cent of total shares under the Business Law as revised in December 1998. ESOP participants enjoy the same rights and responsibilities as other minority shareholders, such as cumulative voting rights on selecting the board of directors and security holders' proposals, and the right to convene a shareholders' general meeting. It should be noted that workers in chaebol subsidiaries are generally eligible to participate only in the plan of their own subsidiary, and not in the plans of the chaebol parent company or its other subsidiaries.

Unlike Japanese companies, Korean companies establishing an ESOP do continue to receive some tax advantages. The Korean government allows companies establishing an ESOP to exclude from corporate income administrative costs and any brokerage fees incurred in employee stock purchases. Moreover, when the company makes either interest-free or reduced-interest loans for employees to purchase stock through the ESOA, the interest on the ESOP loans is also excluded from corporate income to the extent of the subsidy.

Employees have also received three types of tax incentives to purchase ESOP shares; however, the first two were abolished in 1996. First, until 1996, if employees vested their ESOP stock in the KSFC trust for more than two years, only 6.5 per cent of dividend income (up to 18,000,000 won) was taxable. Second, any savings deposited in the KSFC for the purchase of ESOP shares, or for installment payments on ESOP loans, were tax deductible. Further, the full value of any ESOP shares provided by the company in either the form of a wage bonus or as retirement funds were considered non-taxable. Moreover, given the worker's salary level, up to 15 per cent of the combined value of bonus and retirement contributions could be subtracted from the employee's actual net tax liability, as a direct tax credit. The maximum amounts of the tax credit could not exceed 3,600,000 won per year for workers earning less than 7,200,000 won per year, and 30 per cent of annual income for workers paid more than 7,200,000 won. Again, all of these tax advantages have now been abolished, and it is very difficult to find any official explanation for this. Third, donations of ESOP stock, as well as their inheritance due to a participant's death, are treated as non-taxable. The abolition of the first two tax incentives may of course partly explain the reasons for declining ESOP participation since 1996, as reviewed in the next section.

Almost all ESOP shares are voting common stock. ESOP shareholders can individually cast votes, on a one-share/one-vote basis, on all voting corporate issues as defined by Korean business law. Though apparently not stated explicitly in any law or regulation, employee voting rights do not appear to be curtailed in the case of leveraged ESOPs, or in any case in which employees have not repaid loans for acquiring ESOP shares, from whatever source. ESOP shareholders can vest their voting rights, in the form of a written proxy, in other ESOA members.

Despite these rights, in practice, the chairman of the ESOA participates in the general shareholder meeting as a representative of the ESOA and casts votes on issues as defined in the Business Law. But direct employee participation may be valued by many societies for its inherent value as well as for its widely reported efficiency effects, and for the benefits of providing ordinary workers with an expanded practice in up-close democracy or experience in the workings of a modern economy. Determining why employees have not exercised their voting rights in Korea, and whether this ought to be encouraged, would be an important subject for further study.

No government agency is charged with compiling information about ESOPs on a regular basis. As a result, detailed information on Korean ESOPs is not readily available. The descriptive information presented here is primarily drawn from KSFC reports, company annual reports and questionnaires conducted by the Korea Listed Company Association in 1989 and 1998.

Incidence of ESOAs

Available evidence suggests that the incidence of ESOP shares among listed companies in Korea increased in the period after incentives were introduced in the mid-1970s, rose dramatically in the stock boom of the late 1980s and reached a peak in the mid-1990s before significantly falling during the financial crisis. Korean ESOPs had become a pervasive and significant phenomenon by the 1990s. In Table 7, we present summary statistics on the incidence of Korean ESOPs, showing the number of listed companies (column 1), number of listed companies forming an ESOA (column 2), the percentage of listed firms with an ESOA (column 3) and the percentage of eligible employees participating in the ESOP programme (column 4). Before active incentives began in 1974 only eight firms had established an ESOA, but by 1980 346 companies had done so. By 1997, more than 99 per cent of listed firms had formed an ESOA. As seen in column 4, employee participation rates also increased sharply, from 38.2 per cent in 1974 to 76 per cent in 1997, when nearly one million employees participated in ESOP programmes in publicly traded companies.

Despite these long-term trends, Korean ESOPs have recently been in at least short-term decline. In Table 8, we report the distribution of Korean ESOPs by the share of stock held by employees. The table indicates that, overall, the fraction of ESOP shares in listed companies has decreased by one-quarter, from 2.4 per cent in 1996 to 1.8 percent in 1998. Most strikingly, the table makes it clear that this decline is explained by the decreasing incidence of ESOP companies with more than 5 per cent employee ownership. For example, while ESOPs with at least 10 per cent employee ownership (EO) accounted for 9 per cent of all ESOPs in 1996, by 1998 this share had fallen to just 6.7 per cent. Similarly, the share of ESOPs holding between 5 per cent and 10 per cent ownership fell in this short period from 18.2 per cent to 15.4 per cent.

There are two apparent explanations for the decline in ESOPs in Korea in the last few years. Again, almost certainly a key factor is Korea's 1997 financial crisis. In particular, laid-off workers may understandably have sought to redeem their ESOP shares, while others may have sold to increase precautionary liquidity (or, more emotionally, out of fear). Second, the abolition of tax incentives in 1996 has almost certainly had some effect. A 1998 KSFC questionnaire revealed that 82 per cent of respondents now believe purchasing stock through the ESOA does not have any advantages.

Korean companies have not taken up the slack: ESOPs have rarely been used as stock bonus or profit-sharing plans. A company may make contributions to employees in cash or stock; and financial institutions may make loans to employees by using the ESOP stock as collateral. However, in practice, companies have made few contributions other than to offer the primary purchase option at a discounted price (this is not special to employee owners but is a usual practice for all existing owners when a company increases capital by issuing new stock), to make loans with or without interest and to pay brokerage fees. Consequently, employees repay principal, or in some cases both principal and interest, on ESOP loans. Normally, repayment must be completed within five years.

Table 7 *Summary statistics on the incidence of Korean ESOPs*

Year	*(1)*	*(2)*	*(3)*	*(4)*	*(5)*
1974	128	8	8	6.3	n.a.
1975	189	158	159	84.1	n.a.
1976	274	281	253	92.3	n.a.
1977	323	337	307	95.1	38.2
1978	356	380	345	96.9	47.5
1979	355	383	346	97.5	47.6
1980	352	385	346	98.3	34.1
1981	343	386	340	99.1	35.3
1982	334	384	334	100	36.2
1983	327	386	323	98.5	46.3
1984	335	403	335	99.7	51.4
1985	342	409	339	99.1	49.4
1986	355	426	351	98.9	53.5
1987	389	484	385	99.0	60.8
1988	502	601	498	99.2	72.0
1989	626	751	622	99.4	74.7
1990	669	784	666	99.6	74.4
1991	686	813	682	99.4	73.7
1992	690	833	688	99.7	72.8
1993	693	854	689	99.4	74.3
1994	697	899	695	99.7	75.4
1995	721	960	719	99.7	77.1
1996	760	962	757	99.6	76.8
1997	776	1009	773	99.6	77.0

Source: KSFC Security Finance (Quarterly).

Notes

(1) Number of firms listed on the Korean Stock Exchange.

(2) Number of listed and unlisted firms establishing an ESOA.

(3) Number of listed firms establishing an ESOA.

(4) Ratio of listed firms with an ESOA to all listed firms = (3)/(1) × 100.

(5) Participation rate (%) = number of ESOA members/total labour force of listed firms × 100.

Table 8 *Distribution of Korean ESOPs by share of stock owned by employees*

Year	*(1)*	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*
1996	286(36.1%)*	175(22.1%)	117(14.8%)	144(18.2%)	71(9.0%)	793(100%)	2.4%	6.1%
1997	283(36.1%)	176(22.4%)	126(16.1%)	143(18.2%)	56(7.1%)	784(100%)	2.1%	5.4%
1998	291(38.2%)	192(25.2%)	110(14.5%)	117(15.4%)	51(6.7%)	761(100%)	1.8%	5.1%

Source: KSFC Security Finance (Quarterly), various issues.
Notes
(1) Number of companies with less than 1 per cent of their shares in the ESOP.
(2) Number of companies with 1–3 per cent of their shares in the ESOP.
(3) Number of companies with 3–5 per cent of their shares in the ESOP.
(4) Number of companies with 5–10 per cent of their shares in the ESOP.
(5) Number of companies with more than 10 per cent of their shares in the ESOP.
(6) Total numbers of companies establishing an ESOA.
(7) ESOP shares of outstanding stocks of listed companies.
(8) ESOP shares of outstanding stocks of unlisted companies.
*Values in the parentheses are percentages of total number of firms.

Table 9 *Distribution of holding periods of ESOP shares in South Korea*

Time in years	*Percentage of shares deposited*		
	Total	*Listed firms*	*Unlisted firms*
Less than 1	16.9	14.9	20.8
1 to less than 2	23.5	21.6	27.1
2 to less than 3	18.3	21.7	11.7
3 to less than 4	20.7	23.5	15.1
4 to less than 5	8.4	7.7	9.8
5 to less than 6	2.6	2.0	3.7
6 to less than 7	4.3	4.4	3.9
7 or more	5.3	4.2	7.5
Total	100	100	100

Source: KSFC.

A major goal of the 1988 reforms was to encourage employees to hold their ESOP shares for longer periods of time (though these requirements were relaxed in 1993). The evidence suggests that this has been ineffective in practice. As indicated in Table 9, column one, about 58 per cent of all ESOP shares had been held for less than three years, while over three-quarters had been held for less than four years. As seen in the table, the trends between listed and unlisted ESOPs are not qualitatively different. Recalling that the data in Table 7, as well as other evidence, suggests that the incidence of ESOPs and participation within them has remained rather flat in recent years, and noting that employment in Korea tends to be quite stable, the explanation for these low holding periods seems unavoidable: employees are finding the ‘special circumstances‘ for early withdrawal (reported in the previous section) to be a rather large loophole, and one that they have perceived it to be in their interest to use.

There are three major sources of funds for purchasing ESOP shares: the employee’s own savings or debts (including loans from relatives or banks using other assets as collateral), loans from the company (with or without interest) and special loans made by the KSFC and the Kookmin Bank, using purchased ESOP stocks as collateral. Korean ESOPs differ from US ESOPs (Blasi and Kruse, 1991) in that the loans are eventually repaid directly from the employees’ own funds. Although fringe benefits are obviously fungible, this feature is at least a psychological barrier to participation, and may also reduce participation when employees face more stringent credit constraints than the firm. Thus stock purchase financing is an obvious candidate for ESOP law reform.

Table 10 shows the sources of funds for ESOP stock purchases. In the table, column 1 indicates the annual amounts of ESOP stock purchases. Column 2 represents the share purchased out of employees’ individual funds. The sum of columns 3 and 6 amounts to 100 per cent of total loans. These total loans are composed of company loans to employees without interest (column 4), company loans to employees with interest (column 5) and direct, interestbearing loans from either the KSFC or the Kookmin Bank (column 6). For example, in 1998, some 36 per cent of ESOP stocks acquired were purchased out of employees’ funds (either debts or savings), while 64 per cent of total purchases were financed by total loans, of which 55 per cent represented company loans with interest, 8 per cent company loans without interest and 1 per cent bank loans with interest.

Notably, the purchased amounts of ESOP stocks appear to be related to the types of financing available to employees. Table 11 indicates the percentage of stocks available for employee ESOP purchases that were forgone by employees, or forfeit rate, as reported by the KSFC. In 1997, workers failed to purchase, on average, 35.9 per cent of the total ESOP stocks available to them. One major determinant of this rate was clearly the availability of financing: when the company financed employee purchases, either with or without requiring interest payments, employees failed to buy 33.8 per cent of the ESOP stocks available; when the company did not provide finance, the forfeit rate increased to 40 per cent. There has been a decline in company financing of ESOPs. This has combined with reduced tax incentives to employees in causing the decline in the ESOP purchase rate.

While ESOPs have been in short-term decline in Korea, there are reasons to believe that their incidence and general profile may be about to enjoy a period of resurgent growth. As the financial crisis has gone into remission, the fear of stock ownership by ordinary workers has also apparently reduced. In addition, there have been numerous proposals for the expansion of ESOPs in Korea since the financial crisis (e.g. Lim, 1999; Cin and Smith, 1999), and some of these are under serious consideration. Regulations and incentives for a broad-based stock option system are also currently under development. While it is too early to predict that performance-based pay systems will enjoy a substantial renaissance and expansion in Korea, it is fair to say that reports of their death during the financial crisis have been greatly exaggerated.

Comparisons between the cases and concluding remarks

This paper has documented the significant if still modest use of systems of employee financial participation in Taiwan and South Korea. Although year-end bonuses are pervasive in these economies, bonuses are usually set in advance as a predictable fraction of salary, such as two months' wages, with bonuses generally omitted only in the case of financial emergencies, and augmented only when the firm has earned exceptionally high and perhaps publicly visible profits. Thus, the impact of bonuses on loyalty and productivity is unclear at best.

However, other forms of employee financial participation more closely parallel current systems in Europe and North America. In particular, employee ownership plans, separately and in combination with profit-sharing schemes, have long roots in each of these economies, predating or at least parallel to the chronology of the rise of ESOPs in the US. Although Korea has debated legal reforms that would encourage other mechanisms of employee financial participation, it has been slow to implement these.

This stands in contrast to the case of Taiwan, in which a much more diverse set of mechanisms is in place and innovations continue.

Thus, while strong parallels in employee financial participation practices were found between the two Asian tigers, some significant differences were found as well. Many of the differences may be attributed to contrasts in the corporate cultures of the two economies. In particular, the highly entrepreneurial culture in Taiwan has led to a more rapid embrace and expansion of broad-based stock option plans and combination plans featuring both profit sharing and employee ownership, while the Korean case features more traditional forms of financial participation, such as ESOPs. Taiwan's flexible and diverse modes of employee financial participation appear to have been a good fit with its economy and business culture of smaller, more entrepreneurial firms. In contrast, Korea's more uniform employee ownership associations may have been a natural fit with Korean industrial relations and industrial organization, featuring large conglomerates with close ties to government and more paternal industrial relations. As the Korean economy continues to reform, encouragement of new forms of financial participation seems likely. A government-sponsored task force has been active in Korea throughout 2000 and 2001, exploring alternatives for reform. A significant fact-finding tour of the US, comprised of Korean government, union and corporate representatives, is slated to study US systems of employee financial participation, especially alternative forms of ESOPs, in August 2001. In addition to reform of ESOAs, a new government initiative to encourage broad-based stock options is expected, perhaps by the end of 2001, and other forms of financial participation may also be in the offing. As with the encouragement of employee ownership as part of the privatization process, similar incentives may be expected with the long-delayed, but inevitable, substantial reforms to the Korean economy, leading to a less cosy state–chaebol relationship (Burton, 1998). The development of a greater diversity of forms of employee financial participation in Korea should lead the menu of participation options in Korea to more resemble that of Taiwan.

Table 10 *Sources of ESOP finance in South Korea*

Year	*(1)*	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*
1978	58.6	35.7	13.5	11.5	2	9.4
		61%	23%	20%	3%	16%
1979	73.3	48.3	14.8	12.8	2	10.2
		66%	20%	17%	3%	14%
1980	81.3	54.5	16	13.4	2.6	10.8
		67%	20%	16%	3%	13%
1981	94.6	65.1	17.6	13.6	4	11.9
		69%	19%	14%	4%	13%
1982	106.5	74.7	19	13.6	5.4	12.8
		70%	18%	13%	5%	12%
1983	123.6	85.2	23.9	16.1	7.8	14.5
		69%	19%	13%	6%	12%
1984	167.6	113	39	27.3	11.7	15.6
		67%	23%	16%	7%	9%
1985	23.5	16.6	5.6	2.7	2.9	1.3
		71%	24%	11%	12%	6%
1986	63.2	41.3	19.1	15.4	3.7	2.8
		65%	30%	24%	6%	4%
1987	198.9	171.1	21.5	16.4	5.1	6.3
		86%	11%	8%	3%	3%
1988	1109.2	583.7	456.5	215.5	241	69
		53%	41%	19%	22%	6%
1989	1114.6	503.9	581.1	346.5	234.6	29.6
		45%	52%	31%	21%	3%
1990	364.1	131.1	215.2	179.3	35.9	17.8
		36%	59%	49%	10%	5%
1991	261.3	130.2	118.2	96.2	22	12.9
		50%	45%	37%	8%	5%
1992	381	257.9	106	95.1	10.9	17.1
		68%	28%	25%	3%	4%
1993	489.6	227.3	249.7	175.6	74.1	12.6
		46%	51%	36%	15%	3%
1994	1107	530.6	535.9	305.2	230.7	40.5
		48%	48%	28%	21%	4%
1995	974	498.7	429.3	346.8	82.5	46
		51%	44%	36%	8%	5%
1996	1095.6	457.9	586.3	361	225.3	51.4
		42%	54%	33%	21%	5%
1997	534.1	211.7	248.7	167.4	81.3	73.8
		40%	47%	31%	15%	14%
1998	824.8	286.6	526	457.6	68.4	12.2
		36%	64%	55%	8%	1%

Source: KSFC Security Finance (Quarterly), various issues.

Notes

Units are in billion won. Column headings are:

(1) Annual amounts of ESOP stock purchases.

(2) The share purchased out of employees' individual funds.

(3) Total company loans.

(4) Company interest-free loans to employees.

(5) Company interest-bearing loans to employees.

(6) Direct, interestbearing loans from either the KSFC or the Kookmin Bank.

The sum of columns (3) and (6) amounts to 100 per cent of total loans.

Sums may not add precisely due to round-off error.

Table 11 *Forfeit rates on the employee purchase option in South Korea*

Year	*(1)*	*(2)*	*(3)*
1989	68.5	29.7	85.3
1990	46.0	27.9	72.8
1991	46.2	38.1	72.4
1992	59.3	50.7	69.9
1993	44.5	30.5	66.7
1994	25.4	31.0	29.0
1995	34.8	11.2	49.8
1996	22.3	12.0	39.9
1997	35.9	33.8	40.0

Source: KSFC Security Finance (Quarterly), various issues.
Notes
(1) Average rates at which employees fail to exercise the purchase option.
(2) Forfeit rates when the company finances the purchase.
(3) Forfeit rates when the company does not finance the purchase.

However, the incidence of employee ownership plans and profit sharing has been fairly stable, failing to grow much, especially in Korea but to some extent in Taiwan as well. This relative stasis has occurred despite the enormous international publicity given to these forms of employee financial participation as a human resources strategy over the last two decades, and it stands in contrast with their substantial growth in the US and the EU. Indeed, coincident with the financial crisis, there has actually been a decline in the proportion of firms‘shares of employee ownership in South Korea. This decline has probably been due both to the crisis and to some unfavourable changes in tax policy towards employee ownership plans. Regionally, this decline has been offset to some extent by modest increases in Taiwan in the incidence of employee ownership and ‘combination plans‘that also involve a degree of profit sharing. However, it is fair to say that the incidence of employee ownership plans in these NICs, while substantial by European standards, remains modest by recent US standards.

On the other hand, as the tiger economies shift from an imitation-oriented, investment-led development strategy, to an innovation-led stage, the value of new forms of employee financial participation for the success of the firm are likely to increase. At the same time, the need to prevent widespread dissatisfaction on the part of employees during substantial restructuring will grow. Thus, a growing role for employee financial participation can be predicted for both economies in the years ahead.

References

Amsden, A. (1989) Asia’s Next Giant: South Korea and Late Industrialization. Oxford: Oxford University Press.
Aoki, M. and Dore, R. (eds) (1994) The Japanese Firm: The Sources of Competitive Strength. New York: Oxford University Press.
Business Week (2000) ‘Asia’s Future: It’s Set for a New Technology-Driven Leap Forward, but Huge Problems Remain’, 27 November.
Cheng, B.-W. (1990) ‘A Study of Profit Sharing and Employee Stock Ownership in Taiwan’, Taiwan’s Banking Quarterly, 41(1): 395–428 (in Chinese).
Cin, B.-C. and Smith, S.C. (1999) ‘The Potential Role of Employee Stock Ownership Plans in Korean Restructuring: Lessons from Korean ESOAs, US ESOPs and other Experience’. International Symposium on Employee Stock Ownership Plans (KLI-World Bank-FIET). Seoul: Korea: KLI, pp. 75–97.
Council of Labor Affairs (ed.) (1993) Understanding Profit Sharing and Employee Stock Ownership. Taipei: Council of Labor Affairs (in Chinese).
Fong, D.-L. (1998) ‘Profit Sharing in Taiwan’s Electronic Companies’, Fortune Information, May: 242–9 (in Chinese).
Freeman, R.B. and Weitzman, M.L. (1987) ‘Bonuses and Employment in Japan’, Journal of the Japanese and International Economy, 1(2): 168–94.
Jones, D.C. and Kato, T. (1993) ‘The Scope, Nature, and Effects of Employee Stock-Ownership Plans in Japan’, Industrial and Labor Relations Review, 46(2): 352–67.
Jones, D.C. and Kato, T. (1995) ‘The Productivity Effects of Employee Stock-Ownership Plans and Bonuses: Evidence from Japanese Panel Data’, American Economic Review, 85: 391–414.
Lee, B. (1991) Should Employee Participation Be Part of Privatization? WPS 664. Washington,

DC: World Bank.
Levine, D.I. and Tyson, L.D'A. (1990) 'Participation, Productivity and the Firm's Environment'. In Blinder, A.S. (ed.) Paying for Productivity: A Look at the Evidence. Washington, DC: Brookings Institution.
Lim, U. (1999) 'Korean ESOPs', International Symposium on Employee Stock Ownership Plans (KLI-World Bank-FIET). Seoul: Korea KLI, pp. 25–49.
Morton, P.J. (1998) 'Annual Bonuses, Employment and Productivity Change in Taiwan's Manufacturing Sector', Journal of Economic Behavior and Organization, 37(4): 481–507.
Ouchi, W.G. (1982) Theory Z: How American Business Can Meet the Japanese Challenge. New York: Avon.
Porter, M. (1990) The Competitive Advantage of Nations. New York: The Free Press.
Smith, S.C. (1988) 'On the Incidence of Profit and Equity Sharing: Theory and an Application to the High Tech Sector', Journal of Economic Behavior and Organization, 9: 45–58.
Smith, S.C. (1994) 'On the Law and Economics of Employee Ownership in Privatization in Developing and Transition Economies', Annals of Public and Cooperative Economics, 65(3): 437–68.
Tien-Hsia Magazine (1997). 'New Strategy for Corporations to Hunt for People: The Talented Fly with Stock', October: 122–33.
Today Weekly (1998). 'A Survey of Employee Stock Ownership in Taiwan's Electronic Companies', 5 May: 20–37 (in Chinese).
Tsao, H.-C. (1999) On the Competitiveness of Taiwan's IC Industries. Taipei, Taiwan: UMC Group.
Wade, R. (1990) Governing the Market. Princeton, NJ: Princeton University Press.
Wang, J.-A. (1998) 'Impact and Design of Profit Sharing and Employee Stock Ownership Plans in Taiwan's High-Tech Industries', Industrial Banking Quarterly 100 (in Chinese).
World Bank (1987) World Development Report. New York: Oxford University Press.
World Bank (1993) The East Asian Miracle: Economic Growth and Public Policy. New York: Oxford University Press.