

# **A FIELD STUDY OF FINANCIAL PRACTICES OF MEDIUM-SIZE FIRMS IN KOREA**

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## **I Major findings**

### **1. An objective of analysis.**

The main objective of this study is to analyze financial problems of medium-size firms in order to get a general picture of financial conditions and practices of these firms in Korea. By tracing sources and uses of funds, we may obtain a clear picture of financial operations of these firms. The reason for relying on a field study to draw a general picture of financial problems is that shortages of reliable data are very acute in Korea. Under the circumstances, a more meaningful conclusion may be obtained through detailed analysis of individual firms rather than utilizing unreliable industrial data.

In this study, the writer carefully selected 10 manufacturing firm from textile, chemicals, metal products, machinery, printing, and electrical appliance. All of them were recognized as good models for other firms to follow by the Medium

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Industry Bank<sup>(1)</sup> and fall under the category of medium-size firm<sup>(2)</sup>. I personally visited all of ten companies and talked most of their executives.

Among ten firms analyzed, the details of only four cases are presented in this paper due to the limited space. The writer admits that this analysis may be subjective in its judgement and limited in its scope. It may be subjective due to the fact that, since financial data of even carefully selected firms are still very crude, a judgement becomes a qualitative one based upon personal judgement and impression with them. It may be also limited in that characteristics of ten companies can not necessarily be the typical firms among all manufacturing firms. Nevertheless, the writer hopes that this study will contribute to the understanding of medium-size firms in Korea.

## 2. Question on the reliability of existing financial data

Let me indicate, first of all, why the existing data are unreliable by demonstrating the nature of capital structures of major industries as an example.

A major criteria characterizing capital structure of any firm is the balance between all borrowed funds on one hand and ownership funds on the other hand, both of which constitute the financial resources of a business. This balance can best be expressed by what is known as debt ratio (total debts/total capitalization). The following table is a summary of capital structure of major industries (by using 327 samples) for the year of 1964 prepared by Research Department, The Bank of Korea.

	Manufacturing	Mining	Electricity	Construction
Borrowed Funds	50.11%	43.27%	39.78%	29.91%
Ownership Funds	49.89	56.73	60.22	70.09
Debt Ratio	100.43	76.30	66.07	42.69

Source: Business Analysis (1965), The Bank of Korea.

As indicated on the Table, more than half of total capitalization of major industries appear to have been supplied by ownership capital. Literally speaking, it can be said that the capital structure of our industry is not unsound.

However, what can actually be observed is quite opposite. It is not far from the truth by saying that most of medium-size firms are under a great difficulty due to the lack of financial reserves.

- 1) The Medium Industry Bank designated 50 firms from medium-size firms in this country as good models for other to follow in the year of 1966.
- 2) According to the Medium Industry Bank, a company is defined as a mediumsize firm whose employees are less than 200 and its capital is under 20,000,000 won.

The reason is that the balance between equity and debt is jeopardized by utilizing too high proportion of leverage.

Then, how possibly does the content of the statistics indicate quite an apposite result to the actual observation? The obvious answer is that financial statement, balance sheets in this case, used for compiling statistical data are wrong. Most of balance sheets presented by medium size firms are unreliable due to the following reasons.

In the first place, even though many of medium-size firms are formally organized as corporate entities, they are practically similar to a single proprietorship or a family business concern, i.e. the president of a supposedly limited liabilities is an actual owner of the company. Under these circumstances, preparation for financial statements to stockholders is not even required, since all of stockholders are the active members of higher officers. The only reason to prepare any financial statement is for loan application submitted to banks or the use of internal Revenue Service for the tax examination.

Secondly, most of medium-size firms do not understand the principles of modern accounting system. Even though a few of them understand the basic concept proper book-keeping and accounting practise for companies of this size may not be feasible or too much time-consuming. Furthermore, there is no system of approval by Certified Public Accountants on their financial statements.

Thirdly, it is an open secret that most of firms are heavily depending on the private money markets for needed working capital. Even though the real amounts of private liabilities a company holds are secret, it is my impression that almost more than half of their total debts (of medium size firms) is consisted of private liabilities. An interesting thing to note is that a company's balance sheets does not usually include this portion of private liabilities.

Since money-lenders do not like to be known their names, and amounts loaned, by outsiders or Internal Revenue Service, and the company has to pay extra tax on private liabilities if it shows them on its balance sheets, it is quite understandable as to why most of companies are much reluctant to disclose the real figure on their liabilities-side. Thus, the amounts of total liabilities shown on their balance sheets are undoubtedly understated.

And finally, since the lower proportion of liabilities (that is higher current ratio and lower debt ratio) becomes a better qualification in applying bank

loan, other things being equal, companies tend to hide the real amounts of their debts.

Therefore, to regard financial statements of medium-size firms at least as true figures without qualification would be most likely to lead quite an unsound or dangerous conclusion.

As was indicated before and will be again stated later, unusually higher proportion of debt, particularly heavy reliance on private liabilities, of medium-size firms is one of the main causes of financial troubles and risks. And this is the chief reason of most of companies to get bankrupted.

### 3. Short-term financing of medium-size firm

The most critical problems of companies seem to be the lack of adequate working capital. The shortage of working capital means that funds covering account-receivables, inventories, raw materials are not sufficient.

Before explaining the reason for shortage of working capital, it seems to be useful to discuss briefly the meaning of working capital.

There are two kinds of working capital; one is "gross" and the other "net". Gross working capital includes all items that constitute current assets, while net working capital means the excess of current assets over current liabilities. When we say working capital, it usually means net. The reason behind securing adequate working capital is to protect stockholders from the financial crisis of short-term nature, such as in the case of disruption of current regular operations, due to unexpected or irregular fluctuations.

Some companies cannot possibly secure all needed funds at one time because their operations are highly seasonal. For instance, the nature of needed raw materials is such that they be purchased during one season for a year around production requirements. It is quite natural, in this case, for a company to borrow outside funds in order to compensate lack of working capital. This kind of borrowings should be regarded as a natural or normal way of doing business. However, most of companies are having troubles due to inadequate of working capital for the reason other than the above legitimate one. They are in trouble owing to that there are tendencies of investing too heavily on fixed assets at the time of starting a new business. Businessmen do this sort of awkward investment for various reasons, such as the inflation psychology, the lack of technical know-how on financial operations, or to meet collateral requirements in form of physical assets.

In the inflationary economy of such as ours, people tend to think that the only safe investment would be those on fixed assets. Thus, entrepreneurs put the entire amounts of initial capital to fixed assets only and plan to rely on borrowed funds to meet the future need of working capital. Moreover, most of new venturers do not understand the technical complexity of new business or the importance of having adequate working capital itself. Therefore, they tend to regard that investment of fixed assets, such as building a factory, is sufficient enough in starting a new business. Furthermore, some of them tend to underestimate the real cost of fixed assets so that they are in financial trouble even before starting actual business operations.

Secondly, since competition is too severe among medium-size firms in such that it creates difficulties in collecting account receivables, this certainly requires more operating funds.

Thirdly, companies' miscalculation of future demand and general market conditions tends to contribute toward unsound management of working capital.

And finally, the lack of working capital seems to be related to the general psychology of businessmen. It is a sad story to note that there are too many entrepreneurs who are victims of what professor Galbraith calls "get-rich-quickly-fantasy". Their attitude toward ruining business is so speculative that many of them become bankrupted due to the shortage of operating funds resulted from too reckless investments.

i) **Bank Borrowings:** Since bank borrowings are the cheapest source of available outside funds, every company tries to use them as many as possible. Even though some of companies are better positioned than others, depending upon their credit reliabilities, current financial strength, the type of industry, and so on, it is a general view that bank loans are too hard to get.

The reason of difficulty obtaining bank loans is, first of all, that banks themselves do not have enough money to satisfy private industrial needs for funds. It may be the typical difficulty found in developing countries that (1) capital is scarce and (2) savings are not efficiently channeled to investments. Therefore, banks establish a ceiling for each company, and that ceiling is never high enough to satisfy needed funds of industries.

Secondly, the procedures of applying bank loans are too complicated for medium-size firms to get through. One executive of a knitting firm states that a method of obtaining bank loan is so complicated that all his manpower may

be required in preparing to satisfy banks' demands. A president of metal products firm says that his company has to get in touch with more than ten government agencies in order to get bank's initial approval. Besides such time and energy-consuming procedures with banks, a company is not sure whether its application will be finally approved by bank. Therefore, the company can not possibly forecast its obtainable funds if it relies on bank financing.

Thirdly, many executives complain that banks do not do their job as they should. Since all of our commercial banks are actually owned by the government, the loan-decision is sometimes influenced by political dealings. Moreover, the political pressures force to banks to change their policies too suddenly and sometimes too unreasonably.

After interviewing executives of various companies, it is my impression that most of companies are quite critical to the present bank's policies on granting loan and they do not regard banks as their reliable source for even short-term funds.

**ii) Private Liabilities:** As was indicated before, the use of private liabilities so as to compensate the inadequate working capital is a well known fact among business world, particularly to small and medium-size firms. To many of them, private liabilities are the chief source of working capital. It is, therefore, interesting to investigate why companies use them.

In the first place, companies use private liabilities because available bank-borrowings can not satisfy their needs for short-term funds.

Secondly, the process of getting private liabilities is very simple (usually one telephone call is good enough), compared to the complicated procedures of bank borrowings. Moreover, private money lenders do not ask collaterals, while banks require reasonable amounts of fixed assets as collaterals.

Thirdly, if a company maintains a good relationship with private money lenders, the company can obtain funds in any time so that it uses private liabilities as its financial reserve in the case of emergency.

The chief supplier of private liabilities are extortionate creditors who usually charge at least 5% per month as an interest. The interest charges sometimes go up depending upon their customers financial strength. It is interesting to note that partners or stockholders sometimes act as an extortionate creditors to their companies.

It is not far from the truth to say that the chief source of funds, particularly short-term funds, for most of medium size firms is from the private money markets. This tendency of depending on too expensive funds creates a chaos in our business community and hinders a sound growth of our private enterprise system.

#### **4. Long-term financing**

Since competition of firms within the industry is quite severe particularly to small-and medium-firms, the development of new products as well as improving quality of existing one by investing in equipment and research is almost necessary factor for survival. The rapidly increased exports and industrial production in recent years enlarge their demand and markets. All these require more funds for investments. Most of plants and equipment of medium size firms are too old or out of date. It is very urgent to replace as quickly as possible.

Unlike in the case of short-term finance, banks borrowings and private liabilities can not be regarded as sources of long term finance. Banks are not traditionally engaged in long-term financing, and the interests charged by private money lenders are too costly to be used in the long-term financing.

In the developed countries such as the United States, the main source for long term funds is usually obtainable by selling stocks or bonds. Since Korean capital market is yet to be developed, financial instruments such as stocks or bonds are not marketable.

Funds for expansion or other investments have been particularly supplied by net operating profits or reinvestments by existing stockholders. However, these sources are limited and can not be regarded as reliable factors in the future.

Some companies use short-term borrowings (current liabilities) so as to finance planned investments. Even not mentioning higher cost of using them, to substitute short-term borrowing for long-term investments is what is known as an unbalanced growth which may eventually lead to a great financial crises.

Every observation from problems in long term financing for medium-size firms adds up to one conclusion that there is particularly no outside source to finance the needed investments. This is the real dilemma for a sound development of medium size firms.

## II Case studies of selected firms

### 1. T KNIT GOODS CO., LTD.

<b>Location :</b>	Office.....	Da Dong, Seoul
	Factory...	Shin-dang Dong, Seoul
<b>Brief history</b>	On April 15, 1951, the company was established in Pusan as an unlimited company. in 1953, moved to Seoul. in 1965, started to produce sweaters and directly engaged in exports. in 1966, became a limited company.	
<b>Products :</b>	knit goods and sweaters.	
<b>Capital :</b>	25,000,000 won.	
<b>Number of employees :</b>	198	
<b>Management :</b>	Chairman, 60 years old, college graduate. President, 44 years old, college graduate. Executive Director, 40years old, college graduate	

#### Knit Goods Industry and the Firm's Position in the Industry

Since the means of producing knit goods does not require a large scale of operations or huge amounts of capital, most of firms in the industry belong to small or medium-sized firms. The industry has been particularly benefited by the government and banks owing to the fact that its products are happened to be one of the most promising export items. The government's financial assistance to the expansion of modern plants have created a sort of production boom in this industry and resulted in over capacity of production. Thus, the severe competition among firms has become the characteristics of the industry. The problem of over-production has been recently reduced by the industry's aggressive drive to find foreign markets.

There are 98 knit goods producing companies in Seoul, but 18 of them are engaged in directly to export. T Knit-Goods Company has pioneered in setting up an export department and since then has exported its entire products of sweaters. In 1965, the annual export of the company was \$ 112,444 while those of the whole industry was amounted to \$ 4,856,300. The company's target for this year sets to \$ 1,500,000.

While T company plans to export to the U.S., its chief markets has been European countries, particularly to West Germany and Italy. The company has fairly well forecasted its demand despite that the nature of its products is greatly affected by the ever changing models or taste. The comparative costs of sweaters production in Korea is cheaper than other foreign competitors such



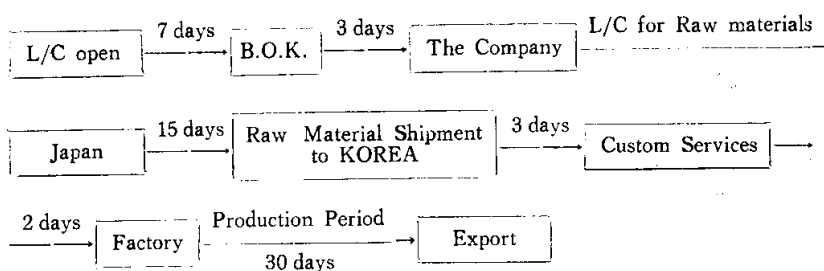
as Japan, Taiwan, and Hong Kong, due to lower cost of labors. Thus, the company has an optimistic view toward future exporting markets.

The raw materials — synthetic fiber — for producing sweaters have entirely imported from Japan. The availability of synthetic fibers is, therefore, depending upon Japanese business conditions in sweater market. If sweater-production is in the state of boom in Japan, her capacity to export raw materials is adversely affected.

Even though the markets for both export and import have been quite stable up to now, the future state of T company will be greatly influenced by market conditions of Japan and Europe.

**Short-Term Financing** An analysis of funds-flows is practically a study of revolving process of current assets. The circular flows of current assets mean actual business operations in the short run. Let us look at, first of all, how T company does its operations.

Business starts when the company opens the Letter of Credit (L/C) from buying countries (European countries). As soon as the company receives L/C through the Bank fo Korea, which usually takes 10 days, it can order for raw materials (L/C for raw materials) to Japan. The following diagram is a detailed process for the opening L/C from buyers to the actual shipment, which usually takes two months.

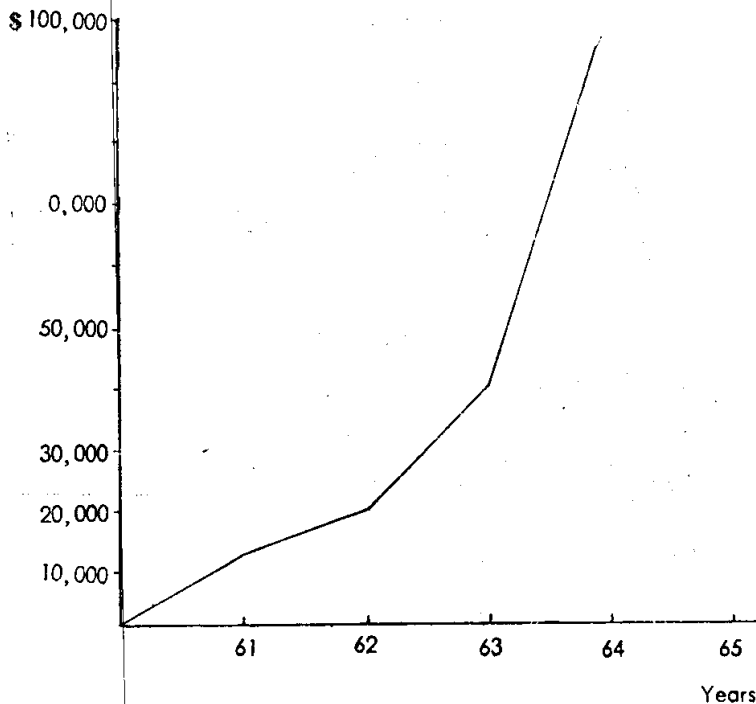


The company usually receives the government's guarantee for the payment of total raw materials costs, so that the actual funds to be secured by the company is only 20% of needed funds. The company does use bank borrowings during the time of purchasing raw materials and has been no difficulty

so far in obtaining them. The company currently holds 8,900,000 won of loan from the Medium Industry Bank. Thus, as far as working capital is concerned, the company has been doing fairly well.

It's difficulty comes due to the government's regulation on the opening of L/C from Japan. It is the government policy that any order for purchasing raw materials can be done only after receiving L/C from the buying country and that the amounts of them should be equal to those indicated on buying Country's L/C. The company, therefore, is not able to stock any amount of raw materials, and thus there is practically no inventories for raw materials.

Therefore, however good the company's demand forecasting is, an actual preparedness to meet the future demand is not possible. Since sweaters have to be produced only after the time of being received L/C from buying coun-



tries, the company's production period bounds to be sporadic. It is quite often the situation that the amounts to be produced for a given period of time are too heavy for the company. This helps increase the production cost and reduce the quality of products. It also create a situation that in many times the

company can not meet its production schedule so that the shipment to buying countries has to be delayed. People in the company are bitterly complaining about the existing quota-system of purchasing raw materials and told me that this policy is contradict to the government's gallant slogan of more 'export'.

**Long-Term Financing:** As can be seen from the above graph, the amounts of sweater export made by the company has been greatly increased in the recent years. For instance, the amounts of exports in 1965 are more than ten times those that of 1962.

Thus, the scale of production should correspond with such an increasing demand which in turn would require a great deal of investment on equipment and manpower. The company has financed such needed funds through extra-contributions made by the existing stockholders. However, the amounts obtainable from stockholders were never enough, and therefore conditions of its factory became in a terrible shape — most of machines are too old; the space of the factory is too small.

The company applied \$ 300,000 of Japanese Reparation Funds in order to purchase new machines from Japan. The Medium Industry Bank examined the application and reduce amounts to \$ 80,000. Under this situation, the company changed the original plan of buying new machines and tried to use \$ 80,000 to enlarge the existing factory. The company thought that this plan was the last hope to solve the horrible shape of the factory. Unfortunately, the Bank turned down \$ 80,000 in the second examination without giving any reasonable why. Therefore, the modernization plan which was so urgent to the company has become only a dream.

Thus, the last hope for financing urgently needed equipment has disappeared. There seems to be no other way to finance, since the financial reserve of existing stockholders was exhausted in the long time ago. The company considered using private liabilities from money lenders with the interest of 5% per month and gave up the idea because of too higher cost of interest.

**Other Financial Aspects:** The company seems to be very weak in the area of finance. There is no executives who have any background of finance or accounting, while all of executives have engineering backgrounds and very strong on production. Every accounting work has been done by one man, an accounting clerk.

The company has no experience to make balance sheet, nor required to do

so until it became a corporation on July 1, 1966. However, I obtained a copy of 1965 balance sheet, income sheet, income statement as well as analyzed ratios made by banks and showed to accounting clerk. The following is a summary of them.

(For December, 1965).

**A Summary of Financial Conditions of T Knit Goods Co.**

Current Assets	6,923,000 won
Current Liabilities	8,988,000
Fixed Assets	23,120,000
Fixed Liabilities	9,705,000
Net Worth	11,350,000
Net Sales (for 6 months)	29,256,000
Net Profit	1,350,000
Current ratio	77%
Fixed ratio	203.7%
Debt ratio	164.7%

The accounting clerk frankly admits that 1965 balance sheet is not accurate and that some of figures may have come out of the blue. He gave me the following balance sheet of 1966 which seems to be somewhat more reliable than that of 1965. Since there is no individual account on each item of balance sheet, I myself do not know how accurate this is.

**Balance Sheet of T Knit Goods Co.**

On July, 1966.

Current Assets :		Current Liabilities :	
Cash	5,220,000 won	Bank Borrowings	8,900,000 won
Dollar Reserve	1,400,000	Bank Guarantee on L/C	14,600,000
Raw Materials	4,120,000		
Accrued	17,569,000	Total Current	
		Liabilities	23,500,000 won
Total Current			
Assets	26,300,000 won		
		Fixed Liabilities :	
Fixed Assets :		Loan from Stockholders	6,100,000 won
Land	10,850,000 won	Capital	25,000,000
Building	2,400,000		
Madhines	8,300,000	Total Net Worth	31,100,000
Trucks	950,000		
Equipments	1,300,000		
Others	2,500,000		
Total Fixed Assets	36,300,000 won		
		Total Liabilities and Net Worth	54,600,000
Total Assets	54,600,000 won		

**2. D BATTERY CO. LTD.,**

**Location :** Office and factory.....Chong-Ro, Seoul.  
**Brief history :** On Feb., 1946, established as an unlimited company.  
 On Jan., 1957, became a corporation.  
**Products :** Battery and Glass Fiber.  
**Capital :** Capital.....500,000 won  
 Price per share.....1,000 won  
 Outstanding shares..... 125  
 Number of stockholders..... 8

**Number of employees :** 41.

**President of the Company :** 60 years old, a high school graduate, owned 80% of stocks.

**Battery Industry and the Company's Position in It.:** Battery industry is quite new in that the mass production for commercial purpose was inaugurated since 1952 by the emergence of semi tudor as an industrial use. In 1957, the industry earned \$ 300,000 by supplying exclusively to U.S. 8th Army. Ultra-type of battery was successfully produced in 1963, and since then all types of batteries that are needed for domestic uses have been supplied by the industry without relying on imports.

The domestically self-supplied batteries have greatly contributed in improving the balance of payments position of Korea. Furthermore, battery-products are used almost in every field of industries including fishing, mining, railroad, transportation, and public utilities.

Like in the case of knit goods industry, small and medium-sized firms are most feasible in producing batteries, due to the fact that (1) its markets are relatively narrow; (2) mass production is not feasible, since there are too many different types of model; (3) since 90% of products is produced on an order base, aggressive means for distribution are not possible. There are 26 firms in the industry, and none of them can be regarded as a big company.

A crude estimate for financial conditions of the industry was attempted by The Medium Industry Bank, and the following is the industry's balance sheets by percentage prepared by the Bank(MIB).

**Balance Sheet of the Industry by Percentage**

Current Assets .....	51.1%	Current Liabilities .....	47.1%
Cash and Account Receivables .....	20.4%	Fixed Liabilities .....	1.9%
Inventories .....	23.6%	Capital .....	51.0%
Others.....	7.1%		
Fixed Assets .....	48.9%		

Land .....	9.3%		
Building .....	13.1%		
Equipments .....	15.6%		
Others .....	10.9%		
Total .....	100%	Total .....	100%

The balance between ownership capital and borrowed funds is relatively reasonable in that more than 50% of total capitalization is supplied by equity-funds. However, as was indicated in introduction of this paper, it is very probable that the contents of liabilities are most likely understated.

The proportion of fixed liabilities occupies only 1.9% of total liabilities and net worth. This surprisingly small proportion indicates that there is almost no financial source in providing the industry's needs for long-term funds, except the stockholder's plow-back of profits. Another impression from the industry's balance sheet is that almost all ownership capital seem to be used in fixed assets, and working capital seems to be entirely depending upon the current debts.

The size of D Battery Company is about the middle of the industry.

**Demand Aspects and Short-Term Financing.** The government and its agencies — Ministry of Communication and other government-owned public utilities — are major customers of D Company. In purchasing batteries, the government takes the best offer with respect to price from various bidding companies. A decision-making process of the government is much more complicated than that of private institutions, and the amounts and timing of buying batteries are entirely depending upon the national budget. As too many unforeseeable factors are involved in the process of government budgeting, it has been extremely difficult to be forecasted by the company.

One of characteristics of batteries is their fantastic varieties of models and sizes. Since the model has been changed in every year, and the company is not possible to forecast as what types of products the government will want, a demand-forecasting has been an extremely difficult task for any firm in the industry. For this reason, the company has not been able to prepare inventories for finished products which are undoubtedly a necessary factor for an efficient operations. The situation becomes more aggravated by the fact that competition among firms is very severe.

What all these add up to is that the demand is neither stable nor foreseeable.

The situation forces the company to produce batteries only when its bidding has been accepted by the government. During other times, whole process of production has to be stopped. This has been the chief cause of having difficulties with respect to working capital.

The problem in inadequate working capital has been worsen when the company obtains unexpectedly large offers from the government.

The company has been relied on the buttry-producing cooperative to get helped for needed funds (short-term). This amount has never been enough, and the company had to borrow from the private money market with 5 per cent of interest per month. The amounts of private liabilities the company holds can not be accurately stated, but they seem to be more than five times than the short-term borrowings (1,090,000 won) indicated on the balance sheet. The fact that the high-interest private liabilities are the chief source for the working capital puts the company to a financially vulnerable position. Thus, almost all of the company's problems seem to be related as to where and how to get money to pay interest on private debts. When I was there in talking to the company's president, all telephone calls he received were from private money lenders.

The company does fully realize how dangerous to rely on private money markets. The company has tried to get bank borrowings in many times. The president frankly states that, since the procedure in preparing application is fantastically complicated, to be eligible for bank's requirements would require all his employees just to preparing the application. So, "why should we bother even to try?" This was the company's opinion on banks.

**The Supplies:** Chief materials in producing batteries are zink, rubber, and glass fiber which 44 per cent of them are imported. In purchasing raw materials, the company has to pay 70 per cent of them for cash. The company has been engaged in producing glass fiber since the last year.

The turnover of working capital takes usually a month, and the needed amounts for a single turnover are 2,500,000 won. Its components are as follows :

Raw Materials .....	1,000,000 won
Power .....	75,000
Labor .....	500,000
Others .....	500,000
Sales and administration .....	425,000
Total .....	2,500,000 won

**The Future Prospect:** Because of the sporadic demand and severe competition, profits from producing battery has not been satisfactory (20 per cent of profit margin). The company seems to regard that the future prospect of battery production would not be very bright.

For a long-run objective, the company plans a mass production of glass fiber and spent 20,000,000 won in order to invent a new machine for it. The chief raw material for glass fiber is sand whose supplies are almost limitless. Due to a determined effort made by the company's president, the company has obtained all needed techniques for the production.

The demand aspect for glass fiber is fantastic in that, beside using battery production, its possible uses as a conductor for heat and electricity are almost limitless. The company's president believes that domestic self-supplying of glass fiber would give a revolutionary benefit to every aspect of our industry and would greatly contribute to the balance of payments position.

The problem is where to get such needed funds (3,000,000 won per machine). The company applied a long-term loan to the Medium Industry Bank, but the application was turned down. Since the interest on private liabilities is too expensive, and the company has already been too highly relied on them, the private money market is impossible to be used for this purpose. It is really unfortunate that such a bright idea can not be materialized due to the lack of funds. It's also regrettable to note that we do not have any financial institution to help such a necessary project.

### 3. K CHEMICAL CO., LTD.

<b>Location :</b>	Office, Choong-mu-Ro, Seoul. Factory, Yung-Dung-Po, Seoul.
<b>Brief history :</b>	In 1963, established as an unlimited company. In 1965, became a corporation.
<b>Products :</b>	Chemicals for paper products.
<b>Capital :</b>	5,000,000 won.
<b>Numer of employees :</b>	40.
<b>President of the company :</b>	36 years old, college graduate, owned 80% of the total shares.

**Short Term Financing:** Since the company's chief customer has been the paper industry, its sales are entirely depending upon how the paper industry is doing. The demand for paper is affected by the level of per capital income and the scope of industrial development of the nation. The company estimates that its demand would be doubled by the year of 1967.



There are only four companies in the industry, and K Chemical Company is the largest one with respect to the volume of sales. The annual production for the year of 1965 was 41,255,000 won,

The company has been successful in forecasting future demand- the future prospect of paper industry. Its demand has been stable and continuously growing. Sales are made on order-basis, and the turnover of the account receivables has been less than two months.

Major raw materials to be used by the company are pine resin and maleic anhydride. Pine resin comes from pine trees, which are entirely supplied by the domestic forests. The production period for pine resin is limited from April to October, and therefore the company has to purchase the yearly needed pine resin during these seven months. This creates a problem of working capital. The amounts needed financing raw materials have been partially supplied by the Medium Industry Bank and the private money market. However, the amounts of borrowings were never enough so as to stock needed pine resin. Therefore, the company had to purchase the amounts of shortage from individual pine resin dealers with higher price. (during the off seasons)

The proportion of private liabilities (paying 4% of interest per month) to the total borrowed funds is about 40%, and the company regards this proportion as maximum level it can go. One of the company's directors states that to have a given portion of private liabilities is essential as a financial reserve for emergency due to their convenience and flexibility to get.

Since the pine resin production is harmful to pine trees, it is directly contradictory to the government's conservation policy. Under this circumstances, the area of producing pine resin is limited to mountains which have received felling permission from the government. The government regulation has not impaired procurement of pine resin so far, however it may do so in future.

Maleic anhydride — other needed materials — has been imported from Japan.

**Long Term Financing:** The characteristic of producing chemicals for paper products is such that it is relatively easy for the new comers entering to the industry. This is due to the fact that (k) producing chemicals is simple and that (2) needed machines are not expensive. Therefore, constantly developing new products is an essential element in surviving from competition.

The company has spent a great deal of money in research for new products development. As a matter of fact, its research department is best equipped in

the whole company. There are more than five of well-trained engineers.

The company has successfully financed the ever increasing research expenses through exceptionally higher profit during initial operations of 1963. However, profits during the recent years have not been adequate, and therefore the company should find another resource to continue its planned expansion on research activities. One of new activities is to produce chemicals for surgery whose production method is quite similar to that of regular chemicals. Like the case of other medium size firms, the company does not seem to have any reliable source to obtain needed funds for long-term investment.

**Other Financial Aspects :** 1966 balance sheets of the company is presented on the following page. The company directors insist that the balance sheet should be reasonably accurate. Since the company would not show me separate accounts on each item of balance sheets, I do not know how "reasonable" this would be. However, the director in charge of Accounting and Finance seems to be well trained and to be competent in his job.

**K CHEMICAL COMPANY, LTD.**

**Balance Sheets**

**May 31, 1966**

Cash .....	95,544 won
Note Receivables .....	2,046,000
Account Receivables .....	1,862,000
Finished Goods .....	1,610,776
Raw Materials .....	4,507,545
Other .....	250,000
<b>Total Current Assets</b>	<b>10,371,865 won</b>
Buildings .....	1,652,000
Plant and Equipment.....	2,258,000
Trucks .....	500,000
Land .....	2,167,800
Others .....	421,800
<b>Total Fixed Assets</b>	<b>6,999,600 won</b>
Prepaid items .....	40,000
<b>Total Assets</b>	<b>17,411,465 won</b>
Note Payables.....	1,829,800 won
Account Payables .....	1,494,402
Accrued items .....	57,139
Borrowings from Stockholders .....	4,000,000
Other short-term Borrowings.....	2,700,000
<b>Total Current Liabilities</b>	<b>10,081,345</b>
Capital .....	5,000,000



cost of production, and foreign market conditions. The idea behind the Cooperative's co-ordination is to prevent unnecessary competitions among domestic firms and to protect from possible changes in foreign market price. This Cooperative's price is known as "checking price", and exporting companies are free to adjust with in the margin of 10 per cent plus and minus.

**Short-Term Financing:** Grass roots are, of course, the chief raw materials for the wallpaper. However, grass-roots are products of yellow roots which are in turn made by arrow roots. Thus, it takes three stages of production process to come out as grass roots. The Exporting Cooperative assigns amounts and areas to be produced, and the company buys directly from the Cooperative.

All needed arrow roots are supplied domestically, and they can be obtainable only during June, July and August—June products are the best. Under these circumstances, the company has to acquire the whole yearly needed amounts during these three months. This requires a large sum of money during summer time. The company has been relied on banks and private money markets to obtain extra-needed funds. For the last year, the company could acquire 22,000,000 won from short-term borrowings—80 percent of them from banks and the remainder from private money market with interest of percent 5 per month. The amount, however, has never been enough so that the company could stock only half of all needed raw materials. Therefore, the company had to buy more arrow roots by individual producers (of yellow roots) paying extra-higher price during the off-seasons.

The company seems to have a good relationship with The Medium Industry Bank and can usually get the maximum amounts of loan that the Bank assigns for each company. However, the ceiling set by the Bank was not adequate to fill the need of working capital of the company. The chief limitation on bank borrowings is the lack of collaterals the company can offer. The amount of borrowings from the private money markets (20 percent of total borrowings) at the present time is the maximum the company can rely on. Thus, the company's problem on getting adequate working capital would not seem to be quickly solved.

In buying raw materials or selling grassroots wallpaper, the company does business with 100 percent of cash base. A turnover of working capital takes

For Raw Materials .....5,000,000 won

Power.....	20,000
Labor.....	1,000,000
Sales and Administration .....	1,500,000
Others .....	1,500,000
Total .....	9,020,000 won

about a month, and the required amount is approximately 9,020,000 won. A detailed cost schedule is as above.

As can be seen from cost-table, labor cost is less than 1/9 of total costs. This is due to the fact that there is plenty of cheap labor in country side. Another factor that gives comparative advantage to Korea's grass roots is its excellent quality. Since most of our mountains are in a shortage of trees, the lack of trees helps arrow roots grow straight and gets more sunlight than those in thick forests.

**Long-Term Financing:** The company has financed its severe-increasing export through profits from operations. This has been possible owing to the fact that costs of equipment and labor in producing grass-roots wallpaper take relatively moderate amount of funds.

Since 1965, the company has planned to go into another line of business—chemicals, and invested substantial amounts of money to build a new factory. Most of needed funds for this new project came from short-term borrowings. As can be seen from the balance sheet (presented on the next page), fixed assets at March, 1966 was amounted to 24,920,348 won compared to 1,095,009 won of March, 1965. Most of increased amount was used for buildings and land. This was financed by bank borrowings of 29,150,731 won, long-term borrowings of 5,000,000 won and private liabilities which was not indicated on the company balance sheet.

**D MANUFACTURING COMPANY, LTD.**

**Balance Sheet**

**March 31, 1956 and 1966**

	1965	(won) 1966
<b>Assets</b>		
Cash.....	664,428	329,611
Account Receivables.....	776,348	47,452
Finished Goods .....	1,785,313	1,327,277
Semi-Finished Goods .....	2,652,323	3,182,657
Raw Materials .....	3,160,636	5,814,866

Imported Raw Materials.....	290,394	4,571,426
Goods in Process .....	323,779	1,638,395
Loans on Offices and Employees.....	90,850	937,479
Prepaid Expenses .....	68,503	137,303
Security Funds .....	1,112,922	635,192
Employees' Draws in Advance .....	1,170,141	5,049,756
<b>Total Current Assets .....</b>	<b>12,295,938</b>	<b>23,691,420</b>
Buildings.....	8,000	14,296,436
Plant and Equipment .....	748,017	3,243,562
Land .....		6,114,591
Others .....	338,992	1,265,759
Miscellaneous Investment.....		20,000
Accrued Items .....	50,843	
<b>Total Assets .....</b>	<b>13,441,790</b>	<b>48,611,768</b>
<b>Liabilities</b>		
Bank Borrowings .....	5,975,394	29,150,731
Accrued wages .....	493,228	2,907,749
Borrowings from		
Stockholders .....	1,075,618	1,754,666
<b>Total Current Liabilities .....</b>	<b>7,544,245</b>	<b>33,813,146</b>
Long-term Borrowings.....		5,000,000
Capital.....	5,000,000	5,000,000
Retained Earnings.....	897,550	4,800,621
<b>Total Liabilities and Net worth.....</b>	<b>13,441,790</b>	<b>48,611,768</b>

Directors of the company admit their awkward financing method, that is, to finance fixed investment through short-term borrowing. Even though the company received a long-term loan from the bank, 5,000,000 won was not simply adequate for new project. One of directors states that there is no way to finance new venture without going to short term borrowings, since there is no financial institutions being oriented to deal with long-term needs of funds for private enterprises.

**Other Financial Aspects :** D Manufacturing Company, like of others, does not keep separate accounts for each item on balance sheet, particularly those on fixed assets. Only some portion of private liabilities is included on the account of current liabilities, so that the real current ratio would be much worse than the present ratio of 0.71 : 1. There seems to be no systematic procedure for capital budgeting.