

# **The Reality of Management Philosophy and Its Impact on Business Performance: A Comparative Case Analysis**

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## **I. Background of the Topic**

The concept of a joint-venture commercial bank emerged in Korea in 1980, with its principal objectives focused at fostering a more competitive environment in the Korean banking industry through inducement of foreign capital, modern technology and advanced management know-how to enhance productivity. Thus in April 1981, The Korean Government announced a new policy in commercial banking which allowed foreign capital to establish commercial banks in Korea.

As a result of this development, 16 large Korean corporations joined together in a joint venture with the Bank of America. They shared 50 percent of the stock and Bank of America owned the other half. This bank was called KorAm Bank. Since the largest portion of ownership by a Korean company was less than 9 percent, the new bank went under the leadership of Bank of America and its management.

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Almost simultaneously a group of 341 Korean citizens with permanent residence established in Japan also got together to start a new bank in Korea. This bank was named the Shinhan Bank. Its ownership was widely dispersed among the 341 members of the initial group, with no individual owning more than 2 percent. KorAm and Shinhan were the first two banks in Korea to start without any government equity participation. Therefore they could operate on free market principles.

## **II. Objective of the Study**

The Shinhan and KorAm bank's existence began almost at the same time. They competed in the same market place by bringing innovative products, services and management technique to the Korean market-place. However, besides these common denominators there was an interesting difference between the two banks. The difference relates to what we call "management philosophy" under which they were being managed: KorAm was naturally under American (or BOA) style management, while Shinhan was under Korean style management influenced by Japanese philosophy.

In view of this interesting contrast between the two banks, the objective of this article is: (1) to study how the differences in management philosophy at the two banks were translated into differences in management practices, and (2) to compare the results of their performance after seven years of operation, and (3) to draw some conclusions from the comparative analysis.

## **III. The Founding of the Two Banks**

When the Korean Government's new policy to allow foreign capital to establish commercial banks in Korea was announced in 1981, a group of several large Korean companies, under the Korean Chamber of Commerce and Industry, contacted the Bank of America, one of the largest banks in the

world at that time, to persuade them to establish a joint venture. During the intervening time until the Shareholder's Agreement was signed on July 22, 1982, discussions were conducted among Bank of America and Korean companies to obtain consensus on objectives and set the directional framework for the KorAm Bank, the first financial institution of its type in Korea.

The joint venture with BOA actually got underway before the Shinhan Group got started but the negotiation with BOA proved to be so complicated and drawn out that the Shinhan group actually started business 8 months earlier. Shinhan initiated business in July of 1982 and KorAm in March of 1983. It took Shinhan about a year to get organized, while the KorAm venture took more than two years to materialize.

Although 341 initial investors were involved in the creation of Shinhan, the company's founder is considered to be Mr. Lee Hee-Geon. When Mr. Lee learned of the Korean Government's new policy he contacted many of his friends who had succeeded in becoming financially successful in Japan as permanent residents and asked them to join him in creating a new venture.

Mr. Lee was born in the year 1917 in Korea in a small town in Kyung Sang Buk-Do Province. Since his family was very poor and therefore he decided to leave Korea in 1935 at the age of 18. He left Korea and travelled to Osaka, Japan where he found various odd jobs such as working as a store clerk, delivery person, etc., to support himself. He worked hard to get himself through college. After graduation from Meiji University in 1940, Mr. Lee devoted himself to organizing the Korean business society in Osaka and help Koreans found or promote their business. Eventually he earned himself the nickname of Korean Godfather in Osaka. In 1955 he managed to establish a credit union for Koreans in Osaka, and succeeded to foster this credit union as the second largest among 478 of its kind in Japan by early 1970s. It was from this background that he was prepared to consider establishing a banking company in Korea when the market opened.

Mr. Lee and his friends saw that the Korean capital market had the promise

of being a lucrative business, and they were also quite willing to invest their money in Korea out of some patriotic emotion. They said that they would like to use their money earned through hardship in Japan for the economic development of their fatherland, Korea.

In the case of creating the Shinhan Bank a score of major investors formed what they called a non-residence board of trustees to organize and establish the enterprise. Mr. Lee Hee-Geon was designated as the chairman of the board. The board in turn recruited a team of professional managers. Mr. Kim, Se Chang, an expert in money and banking, having experience working for the Bank of Korea at a high level, was chosen to become the first president of the new bank, and Mr. Kim, Se Chang in turn recruited managers having experience in commercial banking to work with him as the top management team.

In the case of KorAm Bank, Mr. Kim Mahn-Je, an economist with a doctoral degree from an American university, and having served as the head of the Korean Development Institute became the first President and Chairman of the Board. Executive Vice President and Vice Chairman of the Board was nominated by the Bank of America. Another American was appointed by the Bank of America to form the four-member Executive Committee which would render any final decisions on major corporate actions and guide the new bank's strategy.

#### **IV. Management Philosophy**

The concept of management philosophy is very broad and pervasive and gives little guidance to researchers wishing to study or compare management philosophies. Therefore, some classification of the elements of management philosophy is required to form the basic framework needed for grasping the differences in the patterns of management philosophies and relating these patterns to differences in management practices. This study assumes that the management philosophy consists of three hierarchic layers: assumptions, values,

and perspectives.

At the innermost core of a group's management philosophy are the basic assumptions. These basic assumptions or tacit beliefs underpin overt values and perspectives of the group. By perspectives we mean a coordinated set of ideas and actions a person uses in dealing with a specific situation. Whereas perspectives define specific courses of action in particular situations, values are trans-situational, broader principles that serve as guides for overall behavior. Thus, while values reflect general goals, ideals, and standards in managing the organization as a whole, perspectives reflect some specific approaches in particular situations.

## **V. Differences in Assumptions**

Not surprisingly, Our two competitors began their lives with philosophies based upon entirely different assumptions, values and perspectives. In the case of KorAm, following BOA's leadership, it was assumed that a successful bank could be established by planning and developing a careful and rationally structured organization, staffed by the best people who would be motivated to do their best by a lucrative incentive pay system.

In contrast, Shinhan management's founding assumption was that a profitable and growing bank could be developed by focusing efforts on recruiting and training new managers and staff who had a great desire or will to make the company successful and who possessed a very positive and cooperative attitude in their relations with others.

In the KorAm Bank case top management set out to find the most technically competent and qualified people to lead at the middle management level. Only individuals with considerable banking experience, who were also graduates of Korea's top universities were recruited. KorAm management believed that the best people, in terms of technical expertise and work experience, would result in creating a very profitable and dynamic company. Similarly, they held that

all new recruits from the field of graduating college seniors should also come from top universities with the highest grades and test scores. It was believed that a great deal of money could be saved in the long run by recruiting such people, because they would require no further training. Furthermore, it was also felt that these highly motivated individuals, who had already proven themselves by making significant individual achievements, could be channeled and motivated into doing their best for KorAm by providing a considerable economic incentives. As a matter of fact, KorAm Bank has no basic education programs to this day and they have no training programs to socialize employees in the way in which Shinhan Bank's training program does (as will be described later).

In contrast to KorAm, Shinhan management first sought to recruit individuals who they felt through their interviews displayed a positive human spirit, a desire to help make Shinhan succeed, and who had worked through very difficult circumstances to reach their present station. And it was felt that such people could best be found among those who had succeeded in completing their college education under great difficulty. Candidates who had taken jobs immediately out of high school because of limited financial resources but who had gone on to complete bachelors degrees by going to evening school while working were targeted as potentially a very excellent group for their middle management. Furthermore, it was felt that people in this position were very often in situation where they were not fully appreciated by the companies for which they were working because they had started in their jobs at a very low status. Thus, the opportunity to move into a new company where they would be appreciated and have the chance for promotions at the normal rate for college graduates could prove to be very attractive to such people. So individuals with this type of background and evidence of a positive spirit of harmony and cooperation were hired in considerable numbers by Shinhan. Similarly, a cooperative, willing and loyal attitude was established as a central criterion for all new recruits from the field of graduating college seniors.

To ensure that these new recruits would fit well into the corporation and work harmoniously towards its goals and objectives, an intensive and comprehensive eight week training program was developed for all employees and all new recruits in future years. The emphasis of this training, which was called "Sensitivity Training," was upon building feelings of warmth and closeness between employees as well as spirit of loyalty toward the bank and a desire to see it succeed.

## **VI. Differences in Values**

The difference in value assignment when making decisions is also evident between the two banks. KorAm has followed the standard of "Return on Investment" as its criteria for deciding where to place its funds and which businesses to pursue. Shinhan, on the other hand, has been firstly concerned with the growth of the bank and its market share in the long run. This adds up to saying that KorAm values more than anything else the returns from their investment that can accrue in the short term, whereas Shinhan seeks the optimization of their business in the long run.

The contrast between these two different philosophies in value assignment is well reflected in their attitudes toward the expansion of their branch networks. Shinhan is very aggressive in increasing their number of branches. They view the expansion of their branch networks as the most important vehicle for growth of the bank in the long run. On the other hand, KorAm is not so aggressive in enlarging their number of branches since they understand that opening a new branch requires substantial new investment which does not bring short term profits. In other words, opening a new branch is not conducive to raising the return on investment in the short run.

Another area where this kind of value difference is strongly contrasted is found in loan policies. The KorAm credit committee looks closely at past performance and credit history to decide on the size of the loan. The concern in

this case, like most Western banking institutions, is on whether or not the loan is properly secured and on whether the individual or company has adequate cash flow to serve the loan on a timely basis. At Shinhan bank, on the other hand, the guiding philosophy is to loan on the basis of the economic potential of the enterprise to which the loan is being given. Careful and detailed research is used to evaluate future potential. A venture which is determined to have a high potential and competent management will receive a loan. Furthermore, Shinhan also provides substantial management services to the firms to which it lends. Special management courses and seminars are held for the firms to which funds have been loaned, and Shinhan even takes managers from its client firms to Japan to help them learn about how similar enterprises are managed there and to have them see the newest process and product innovations.

Differences in philosophy in terms of preference between long term and short term oriented values are also noticeable in their attitude toward their own real estate. Shinhan prefers purchasing the real estate to be used for their business purpose to renting it. This preference of Shinhan is quite natural since they value the long term optimization of the returns from their investment, and in Korea with its limited supply of usable land, investment in real estate is a sure and lucrative business in the long run. But at KorAm, they prefer renting the real estate to purchasing it, because they understand that investment in the real estate does not produce profit in the current or short term, thus lowering the return on investment in the short term.

## **VII. Differences in Perspectives**

Both of the new banks adopted rich compensation strategies for their managers and employees. However, their compensation systems diverged dramatically. At Shinhan the compensation system was organized along traditional Korean pay system lines. That is, the pay raises and bonuses were established in terms of seniority progression with more senior employees



receiving larger amounts than their juniors. Special rewards for high-achievement employees were also established, but these rewards did not involve pay-raise compensation. These will be discussed later.

The KorAm compensation, on the other hand, was formulated along performance oriented lines based upon what might be considered very rational and perhaps even innovative formulas. At KorAm it was decided that 75 percent of annual pay increases would be based upon years of service with the firms. The additional 25 percent would be calculated based upon an evaluation of both group and individual performance. It was believed that this incentive system would inspire the most competent employees to their very best effort for the firm, and that employees receiving low evaluations would either be motivated to work harder or they would leave the bank making an opening for new qualified recruits. Essentially, the system works like this:

1. First, of the total amount of moneys made available for pay increases in any given year 25 percent is set aside to be allocated on the basis of performance. (Let us call this amount bonus in this article.)
2. Second, all departments and branches of KorAm are then evaluated on the basis of an A, B, C system. In other words, some subunits are graded by top management as having distinguished themselves with an excellent performance record, some with an average record and some with a poor record. Approximately, one third of all subunits in a particular classification fall into each group. The highest performing departments are eligible to receive an average bonus 20 percent higher than the average bonus for the bank as a whole. The middle ranking groups are allowed to receive an average bonus that is equal to the company-wide average. The low performing groups are supposed to receive an average bonus which is 20 percent lower than the company-wide average.
3. Third, the head of each department or branch in turn rates their individual employees using the same A, B, C rating system. On the basis of this rating, the total bonuses allotted to that department is then distributed to

each individual.

4. Thus the result of the combined group and individual ratings ranges from  $1.2 \times 1.2 = 1.44$  or 144% for an excellent performer in high performing departments to as low as  $0.8 \times 0.8 = 0.64$  or 64% for a poor performer in low-performing departments.

At Shinhan the contribution made by individual employees is also evaluated but the rewards given to those with an excellent performance are not part of the annual increases in compensation. To determine who has made an exceptional contribution during the year, supervisors are asked to recommend their employees to the President's office for recognition. Some objective performance data as well as the supervisor's rating of employee's attitude, relations with other employees, loyalty and hardworking spirit constitute evaluation criteria. Employee's who have been recommended by their supervisor receive a personal letter thanking them for their hardwork, sacrifice and achievement from the company president. These employees also receive some cash in an envelope for them to use to take members of their work team out for celebration.

KorAm and Shinhan bank differ markedly in their perspectives on the distribution of power, authority, and even on their control of expenses. KorAm is a highly centralized structure which is dominated by the wholesale banking business whereas Shinhan is primarily a retail banking firm with a highly decentralized structure.

At KorAm wholesale banking is done only at the headquarters. Branch offices are only allowed to become directly involved in retail banking. At Shinhan the branch offices can perform both activities. At KorAm all loans must be passed upstairs from the Branch Office to headquarters where it passes through several levels of decision analysts, and finally it must be reviewed by a credit committee of officers.

At Shinhan the bank's branch officers are allowed to approve substantial loans including export and import financing on their own. In fact the major

role of the headquarters in this process is to perform a support and service function. The attitude is that "we" the headquarters are here to help and not control. It is up to the branch to do the job correctly and make a good decision.

As for the control on expenses, business development expenses are under the branch manager's responsibility at both banks. However, as for all other expenses they must be approved by the headquarters at KorAm, while, at Shinhan they are allocated by the budget to each branch and within the budget allocated, the branch manager has the ultimate power in executing them.

At KorAm, even stationery and miscellaneous supplies are distributed by the headquarters. This practice has adversely affected KorAm's potential in soliciting deposits from their neighboring stores by procuring services and miscellaneous items from them as is the practice at Shinhan.

### **VIII. Analysis and Conclusions**

Both KorAm and Shinhan have navigated through a remarkable course of growth in terms of paid-in capital, total deposits attained, profit, the number of employees, and the number of branches. These growth indicators are shown in Table 1.

By comparing data on Table 1 year by year, however, one can easily notice a growing gap between the two banks. As a whole, one can say that Shinhan has performed better than KorAm in most respects.

We recall that KorAm's primal value in making investment decisions was placed on the "return on investment," while at Shinhan it was on the long term growth of the bank. But if we consider the return on investment in terms of "return on equity" and "return on assets," KorAm lags behind Shinhan in this dimension as shown in Table 2 which is obtained from Table 1 by dividing the term profit by paid-in capital and total assets, respectively.

**Table 1. Yearly Growth of Shinhan(SH) and KorAm(KA)**

| At the<br>End of | Paid-in<br>Capital | Total<br>Assets | Total<br>Deposits | Term<br>Profit | Number of<br>Employees | Number of<br>Branches |
|------------------|--------------------|-----------------|-------------------|----------------|------------------------|-----------------------|
| (SH) 1982        | 250                | 2,299           | 1,080             | -10            | 386                    | 8                     |
| (KA) 1983        | 300                | 2,428           | 770               | -6             | 246                    | 4                     |
| (SH) 1983        | 380                | 7,043           | 3,407             | 29             | 655                    | 18                    |
| (KA) 1984        | 300                | 4,426           | 1,405             | 38             | 380                    | 7                     |
| (SH) 1984        | 500                | 11,698          | 5,155             | 105            | 930                    | 26                    |
| (KA) 1985        | 300                | 7,255           | 2,733             | 56             | 579                    | 16                    |
| (SH) 1985        | 500                | 17,735          | 7,017             | 167            | 1,228                  | 34                    |
| (KA) 1986        | 300                | 9,825           | 3,384             | 76             | 719                    | 23                    |
| (SH) 1986        | 1,000              | 26,357          | 9,788             | 267            | 1,515                  | 45                    |
| (KA) 1987        | 300                | 12,630          | 5,203             | 105            | 825                    | 26                    |
| (SH) 1987        | 1,000              | 34,181          | 15,097            | 431            | 1,804                  | 55                    |
| (KA) 1988        | 600                | 14,673          | 7,945             | 158            | 958                    | 30                    |
| (SH) 1988        | 2,000              | 43,592          | 22,647            | 597            | 2,233                  | 65                    |
| (KA) 1989        | 1,200              | 17,373          | 10,764            | 205            | 1,130                  | 39                    |
| (SH) 1989        | 4,300              | 61,908          | 33,719            | 1,029          | 2,713                  | 78                    |

(unit: 100 million Korean won)

**Table 2. Return on Equity and Return on Assets**

| For the Year of | Shinhan |       | KorAm              |       |
|-----------------|---------|-------|--------------------|-------|
|                 | ROE     | ROA   | ROE                | ROA   |
| 1982            | -4.0    | -0.43 | (not in operation) |       |
| 1983            | 7.6     | 0.41  | -2.0               | -0.25 |
| 1984            | 21.0    | 0.90  | 12.7               | 0.86  |
| 1985            | 33.4    | 0.94  | 18.7               | 0.77  |
| 1986            | 26.7    | 1.01  | 25.3               | 0.77  |
| 1987            | 43.1    | 1.26  | 35.0               | 0.83  |
| 1988            | 29.9    | 1.37  | 26.3               | 1.08  |
| 1989            | 23.9    | 1.67  | 17.1               | 1.18  |
| Average         | 31.41   | 0.89  | 24.6               | 0.75  |

(unit: percent)

We understand that the return on investment can be dependent upon the productivity of employees. Let's recall here that KorAm assumed that people having graduated from top-ranking universities and possessing excellent work experience and technical expertise would be more productive, and Shinhan

believed in people having a strong will and desire with positive attitudes to work hard for the growth of the bank. Table 3 shows the productivity per employee, obtained from Table 1 by dividing the term profit by the total number of employees. We notice that even in this department Shinhan has performed better than KorAm.

Now let's turn our attention to the amount of deposits per employee. In Korea deposits are the largest single funding source for the bank and the competition among banks to draw deposits from potential depositors are very keen. As a matter of fact, banks in Korea often hold company-wide campaigns to raise their deposits, trying to utilize all kinds of efforts of their employees. Hence, the data of deposits per employee can serve as a good measure to show how hard employees have worked to make their bank grow, and at the same

**Table 3. Profit per Employee**

| For the Year of | Shinhan | KorAm              |
|-----------------|---------|--------------------|
| 1982            | -0.26   | (not in operation) |
| 1983            | 0.44    | -0.24              |
| 1984            | 1.13    | 1.00               |
| 1985            | 1.36    | 0.97               |
| 1986            | 1.76    | 1.06               |
| 1987            | 2.39    | 1.27               |
| 1988            | 2.67    | 1.65               |
| 1989            | 3.80    | 1.81               |

(unit: 10 million Korean won)

**Table 4. Deposits per Employee**

| For the Year of | Shinhan | KorAm              |
|-----------------|---------|--------------------|
| 1982            | 2.80    | (not in operation) |
| 1983            | 5.20    | 3.13               |
| 1984            | 5.54    | 3.70               |
| 1985            | 5.71    | 4.72               |
| 1986            | 6.46    | 4.71               |
| 1987            | 8.37    | 6.31               |
| 1988            | 10.14   | 8.29               |
| 1989            | 12.42   | 9.53               |

(unit: 100 million Korean won)

time, how effectively they were motivated to do so. We also saw that the two banks differed significantly in their perspectives in motivating their employees through pay system, delegation of authority, and control measures. We also notice here that even in this dimension KorAm lags behind Shinhan significantly as shown in Table 4.

So far we have seen that KorAm Bank under American management philosophy has enjoyed a considerable business growth with profitable operations. But when compared with Shinhan Bank, KorAm's performance is considered inferior to that of Shinhan. Since most other conditions being equal, the performance gap between the two banks can be attributed to the differences of management philosophies of the two banks.

We have seen many successful joint-venture cases in the area of manufacturing in Korea since 1960's. But in service sectors Korea only began to allow foreign capital as late as in early 1980's. In a service industry such as banking, the business contact with the customer is direct and immediate, not mediated by any material products as in a manufacturing industry. Hence, the direct effect of management philosophy upon employer-employee relations as well as upon company-customer relations could be more profound in service sectors than in manufacturing industries. Thus, this comparative case analysis would provide us with a conviction that the compatibility of a management philosophy with its environment is more important in service industries than in manufacturing.

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