

## RobecoSAM takes a closer look at governance in South Korea

At the KB Financial Group Inc. Annual General Meeting (AGM) on July 12, 2013, a new CEO/Chairman was appointed. In order to evaluate the qualifications of the candidate that had been selected by KB Financial's Evaluation Committee, RobecoSAM discussed the proposal with the company in preparation for the AGM vote. Robeco Emerging Markets Equity Analyst Koos Burema and Engagement Analyst Peter van der Werf explain why they supported the election of the new CEO and Chairman.

### Thorough election procedure

KB Financial described the nomination process for selecting a candidate through its internal succession program. The Evaluation and Compensation Committee consisted of five non-executive directors. Out of 100 nominees, the Committee established a long list of 40 candidates. Based on four criteria, these candidates were assessed, a shortlist of four candidates was finalized, and the Committee unanimously voted for the final candidate.

"We paid special attention to the third criterion – the proposed candidate's experience in the financial industry. The candidate's biography shows that he primarily has government experience as vice-minister at the Ministry of Finance. Our concerns were based on the strong ties between the government and the private sector in South Korea, which are often not in the best interest of shareholders," explains van der Werf.

"The company told us that the candidate himself had acknowledged that his limited experience in the private sector was his main weakness, but we value his extensive knowledge of the macro-economic environment and believe he can add value in strategic projects to be finalized in the coming years," Burema adds.

### Powerful labor unions in South Korea

Labor unions in South Korea wield considerable power, particularly in the financial industry. This was confirmed by RobecoSAM's Company Sustainability Assessment results, which revealed the increasing influence of local stakeholders on South Korean companies. Labor unions have been known to throw all their weight into negotiations

involving the election of a new CEO. The proposed CEO candidate for KB Financial Group Inc. was not allowed to enter the main office building between June 7 and June 19, 2013. For those unfamiliar with the South Korean market, this may seem harsh, but Burema puts this into perspective. "Korean labor unions have a reputation for being tough negotiators with companies, often leading factories or offices to close down for weeks or CEOs being barred from entering the building for an extended period of time," observes Burema.

"For this reason, we strongly urge companies to maintain a good relationship with labor unions and are pleased to see that KB Financial has proven to do so in the weeks leading up to the AGM," states van der Werf. "The company indicated that communication with the unions improved significantly compared to previous CEO elections."

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### Strong communication skills and decisiveness are key

With such influential labor unions as important stakeholders and looming consolidation in the Korean financial sector, solid communication and decision-making skills are essential qualities for the new CEO. This is particularly true as KB Financial Group is said to be a primary merger candidate in the planned privatization of government-controlled Woori Financial Group.

"A successful merger requires the two parties to leverage synergies, which may often involve a company restructuring and lay-offs. We questioned the company on its flexibility in this area and its relationship with the unions, as this is a crucial factor for creating long-term shareholder value following a merger," states Burema. The company answered that it is the only player in the Korean financial sector that has been able to negotiate larger restructuring programs with the union in 2005 and 2009.

### "Stakeholder management is a good indicator of the Board's quality of management."

"Such stakeholder management is a good indicator of the Board's quality of management, even though the restructuring programs came at a price. The unions negotiated huge pay-offs for the people made redundant, thereby severely impacting the financial reserves of KB Financial," concludes Burema.

### Board independence is paramount

Proper Board oversight over management's plans is crucial. "We asked KB Financial how it can ensure independent Board oversight when its executive chairman fulfills both the role of the CEO and Chairman of the Board," says van der Werf. The company provided a convincing example of how its Board acted independently from company management in 2012.

"In July 2012, a deal to purchase ING Life Insurance had been initially proposed and ratified by the Board. But following interest rate cuts, the market environment declined severely during the second half of the year, making the deal less attractive. Subsequent negotiations with the counterparty did not result in a significantly lower offer. As a result, the Board vetoed the deal in November 2012. Such a commitment to protecting shareholder value by the Board, which consists of nine independent Board members and one executive chairman, eases our concerns regarding the combined CEO and Chairman role. However, we did ask the company to split the role of the CEO and Chairman in future elections," concludes van der Werf.

In light of the discussions with KB Financial Group, RobecoSAM voted in favor of the election of the company's new CEO and Chairman.



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