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# THE ACQUISITION AND RESTRUCTURING OF KIA MOTORS BY HYUNDAI MOTORS[1]

*Professors Seungwha (Andy) Chung and Sunju Park wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.*



In 1998, the chief executive officer (CEO) of Hyundai Motors (Hyundai), Mong-Gu Chung, envisioned for the future a globally powerful Hyundai that vied as an equal with such giants as Volkswagen and Toyota. Acquiring Kia Motors (Kia) as a key division, Hyundai Motors intended to achieve new economies of scale and scope and broaden its global market access. The acquisition of Kia could alleviate domestic competition and make Hyundai a bigger player in the global market. Hyundai, however, faced considerable challenges such as the creation of synergy effects between two companies and integration of two different organizations and their cultures.

On December 14, 2000, two years after the acquisition of Kia by Hyundai, a meeting was convened at Kia's headquarters in Yeouido, a business district of Seoul, Korea. In attendance were the CEO of Kia and Hyundai, Mong-Gu Chung; the president of Kia, Soo-Joong Kim; the president of Hyundai, Gye-An Lee; and the top management teams and the board of directors of both companies. They had gathered to evaluate the merger's progress and to discuss plans for future business activities. Their assessment of Kia's restructuring was generally favorable and the atmosphere in the room was positive. Strong synergy effects had been achieved and restructuring of Kia was largely accomplished. Yet some issues required attention.

## CONDITIONS IN THE GLOBAL AND KOREAN AUTOMOBILE INDUSTRIES

### The Global Reorganization Trend

Since the mid-1990s, the automobile industry had faced a global oversupply and a production capacity well in excess of demand (see Exhibit 1). In 2001, global automobile production was 56.8 million cars (a 14.5 per cent increase over 1996), far below the supply capacity of 77 million cars (an increase of nine million cars over 1996). Since the mid-1990s, the market had expanded thanks to dramatic advances in

[1] *This case has been written on the basis of published sources only. Consequently, the interpretation and perspectives presented in this case are not necessarily those of Kia Motors or Hyundai Motors or any of their employees.*

information technology as well as market openings in line with the World Trade Organization (WTO) framework. The results were the globalization of supply and, with the diversification of customer preferences, a shortening of production cycles.

Shifting consumer preferences had increased the demand for product safety and for environmentally friendly automobiles, escalating research and development (R&D) costs higher than ever before. Automobile companies around the world responded to these changes in the market environment by increasing their production efficiency and by restructuring and entering strategic alliances to realize economies of scale and scope. Thus, more and bolder mergers and acquisitions (M&As) than ever before were occurring among global competitors. In the past, M&As had mostly targeted small or weak companies, but recent M&As sought to expand the acquiring company's size and reach dramatically. Recent M&As had included BMW's 1994 acquisition of the Rover Group, Ford's 1995 acquisition of Mazda, Daimler-Benz's 1998 merger with the Chrysler Corporation, Volkswagen's 1998 acquisition of Rolls-Royce and Renault's 1998 merger with the bus business division of Iveco (Italy). Such M&As — the merger between Daimler-Benz and Chrysler is a good example — aimed to improve competitiveness on multiple levels.

In pursuit of economies of scope, global automobile companies were reorganizing in a fiercely competitive environment to deal with diversifying consumer preferences and the globalization of supply. Such mergers and acquisitions aimed for synergy effects among companies with complementary sales regions or automobile types. For example, Daimler-Benz was concentrated in Europe and focused on making luxury sedans, while the Chrysler Corporation (Chrysler) was concentrated in North America and focused on multi-purpose small- and medium-sized cars. In merging, each company addressed its own weaknesses and gained a partner with complementary strengths, while avoiding overlap in the types of cars they produced.

## The State of Korea's Automobile Industry

Korea's automobile industry, which had grown remarkably over the past years, had entered a period of transition. In addition to weak domestic demand since the mid-1990s, the industry suffered from continuous oversupply as a result of the introduction of new companies and the facility expansion by existing ones. In 1997, the domestic industry's production capacity was 3.95 million, and the number of cars produced was only 2.85 million — an oversupply of 1.1 million. To put it another way, facilities were working at only 67 per cent capacity (see Exhibit 2).

Although some Korean automobile companies had entered developing countries as the providers of capital and technology, in general, Korean companies remained the recipients. Korean automobile companies had improved proprietary technology, but the industry's dependence on Japanese technology remained unchanged. It was hard to find examples of equal partnerships in pursuit of mutual profits, except for cases in which companies simply bought common parts together, as well as the strategic alliance of Hyundai and Mitsubishi, through which the Grandeur model was developed jointly.

In the U.S. market, Korea's automobile industry was more competitive in its pricing than the Japanese industry. Product quality was not yet satisfactory, but the quality gap between competing Korean and Japanese models had shrunk steadily since 1994. One of the main competitive weaknesses of Korean firms in the United States was marketing and sales, i.e., a dearth of local sales networks and local financial companies.

After the Asian financial crisis of 1997, Korea's automobile industry underwent large structural changes, which, in combination with the oversupply problem, produced a vicious cycle of weak domestic demand, reduced production and excess equipment. One casualty was Kia Motors. At one time the second largest automobile company in Korea and the seventh largest in the world, Kia had grown at a tremendous rate through the 1980s and into the early 1990s. However, in the mid-1990s, the company fell into trouble that only grew worse with time. The failure of the company's investment in small and large utility vehicles, as well as the weak market performance of its Sephia, Credos and Avella models, contributed to Kia's heavy losses. So did ineffective management, such as over-investment in the acquisition of Kia Special Steel and Kia's role as the payment guarantor for Kisan, an affiliated construction company. Kia declared bankruptcy on July 15, 1997.

## THE ACQUISITION OF KIA MOTORS

### Background

According to conventional wisdom in the automobile industry, to be economically viable, a firm needs an annual production of at least 300,000 cars per model and a total annual production of at least one million cars. In the mid to late 1990s, there was widespread discussion of restructuring in the Korean automobile industry, which faced overlapping and excess investment in equipment and a sluggish domestic market. The dominant global automobile companies were moving rapidly to build networks or to undertake M&As, and it was urgent that Korean automakers respond. Specialists argued that to remain competitive, domestic automakers had to reorganize into two or three companies. Such reorganization appeared to start when Kia Motors declared bankruptcy in 1997 and filed for protection.

A power game surrounded the future of Kia Motors (see Exhibit 3). Daewoo Motors acquired Ssangyong Motors at the end of 1997, which threatened Hyundai's leadership in the Korean market. Samsung Motors, in danger of joining the list of companies to be restructured, was actively considering the acquisition of Kia to improve its position. If the acquisition went forward, Samsung would be a formidable competitor for Hyundai, with deep reserves of capital, technology, human resources and sales expertise. If Ford acquired Kia — another possibility — the relatively protected domestic market would become more fiercely competitive, with the aggressive entry of a leading foreign company.

### Effects of the Acquisition

With one foreign company and three domestic companies showing active interest in Kia, Hyundai faced some crucial decisions. How the Kia power game played out could decisively affect Hyundai's competitiveness. The company's top executives discussed whether Hyundai might itself acquire Kia. Diverse opinions were expressed, but in the end the consensus was that acquiring Kia would improve Hyundai's competitiveness. Although Hyundai Motors was acknowledged as the largest producer of cars in Korea, it was still vulnerable to competition from the world's top 10 automakers, which were expanding to strengthen their price competitiveness.

The potential benefits of acquiring Kia fell into three broad categories: economies of scale, economies of scope and construction of a global network.

## Economies of Scale

Competition among domestic automobile companies for economies of scale had driven Kia into bankruptcy. At the time, Hyundai was leading its competitors in quantity of cars produced and it aimed for the production of two million cars per year by 2000. This figure was the threshold to cross if Hyundai were to pursue global operations with a full lineup of its own models, a global network for equipment procurement and localization of product development.[2] Hyundai, the largest automobile producer in Korea, had thus far achieved its growth by developing proprietary models. Acquiring Kia was an opportunity to move to the next tier by expanding its production capacity to 2.6 million cars annually. Hyundai would then displace Honda (at 2.4 million cars per year) as the world's 10th largest automobile producer.[3]

Previously, when a new model was developed, new parts were also designed. Thus, product development placed a considerable burden not only on the parts company, which generally had weak design capabilities, but also on the company in charge of the completed vehicle. The problem seemed solvable to a certain extent through the use of common parts. In other words, a merger with Kia could improve competitiveness by allowing the use of common parts, integrated quality control and shared functional improvements, as well as cost reduction through the purchase of large quantities. Not only would manufacturing costs be lowered, reductions would also be achieved in logistics and after-sales service (A/S) costs through improved parts compatibility and the consumer would be better protected by the standardization of products. In sum, if Kia were acquired, parts companies could be integrated and the cost of parts production could be lowered through larger purchase quantities.

## Economies of Scope

In 1998, Hyundai led domestic sales in all categories of cars, buses and trucks. Kia, however, had shown considerable strength in the markets for commercial vehicles and minivans. An integrated Hyundai/Kia could meet consumer demands across a diverse product range — commercial vehicles, small cars, buses, trucks and minivans — and enjoy an economy of scope in an era of diverse consumer preferences.

In addition, if Hyundai absorbed Kia's R&D capabilities, business divisions and human resources, integrated or restructured overlapping parts, and reorganized or reduced the workforce, it could expect both to reduce costs and to create new value. Also, despite Kia's dearth of capital, it had completed most of the proprietary technology development and product development for several new models: Carnival, Carens and Rio. Pressure for capital to develop new models would thus be limited, at least in the short term, because only standard operational management would be needed.

## Construction of a Global Network

Korea's automobile industry had struggled with weak domestic demand, poor exports, labor disputes and bankruptcies by parts companies. To thrive under these circumstances, Hyundai needed to solve the problem of domestic overproduction by exporting to the global market. However, Hyundai had been quite conservative about overseas investment, especially considering its position as the largest automobile

*[2] In 1997, General Motors, the world's largest automaker, produced 8.5 million cars; Hyundai produced only one-seventh that number. Hyundai lagged by more than one million cars behind the world's 10th ranked automaker, Honda, which was producing 2.4 million a year. To enter the world's top 10 automakers, then, a company had to produce at least 2.5 million cars annually.*

*[3] At the end of 1997, Hyundai had a production capacity of 1.8 million, and Kia had a capacity of 0.83 million.*

company in Korea. In 1997, Hyundai had factories in Botswana (20,000 cars produced annually), Thailand (10,000 cars), Malaysia (10,000 cars) and Egypt (20,000 cars). It also had very small-scale productions in Indonesia, the Philippines, Vietnam, the Netherlands, Venezuela, Turkey and Zimbabwe.

In comparison, Kia had concentrated, from its inception, on strengthening its domestic market basis and international competitiveness through the management of quality, product, cost, price and marketing. Early on, it had built a global network through the localization of production, sales and development. Subsequently, it set about integrating a global system for each country and region. Thus, Kia offered Hyundai both the requisite expertise for building a global network and the necessary infrastructure. Prior to declaring bankruptcy, it had established small to medium production capacities in Taiwan (30,000 cars produced annually), Iran (30,000 cars), Pakistan (15,000 cars), Germany (30,000 cars), Indonesia (10,000 cars), India (30,000 cars) and Brazil (30,000 cars). It also owned factories with production capacities of fewer than 10,000 cars in the Philippines, Venezuela, Vietnam and Namibia. The potential value of these operations to Hyundai's global strategy was obvious. Hyundai also anticipated access to information about markets it had not yet entered, for example, through Kia's technology training institute in China.

## The Decision to Acquire Kia Motors

After extensive discussions, CEO Chung and his top executives agreed that merging with Kia could produce many synergy effects. They agreed to pursue acquisition much more aggressively than they had in their first and second bids. Hyundai's acquisition of Kia was confirmed on October 19, 1998.

For Hyundai Motors, the acquisition of Kia was, among other things, a way to make inroads into the domestic automobile market and it planned to maximize synergy effects by maintaining the original Kia brand and carefully managing the export and sales structures of both companies. However, many in academic circles and the media looked unfavorably on the acquisition because there were many problems with no obvious solutions, among them the regulation and integration of capital and human resources. Among responses in favor of the acquisition were these:

> Among domestic automobile companies, only Hyundai Motors is able to acquire and normalize Kia Motors. If the production capacities of Hyundai and Kia are combined, they will exceed 2 million cars per year, lifting Hyundai into the top ten [automobile] companies in the world. Through economy of scale, product development costs would be reduced, improving international competitiveness.[4]
>
> It will be an opportunity for the chaebol[5] to rearrange overlapping investments themselves and to demonstrate a paragon of business management without excessive competition. It will become easier to invest in joint ventures with foreign companies, and the company's value will also increase greatly.[6]

Those opposed to the acquisition argued that it would create a monopoly rather than economy of scale, that Hyundai did not have sufficient capital to complete the merger or simply that the acquisition of Kia was "wrong":

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[4] *Young-Kwon Kim, "Hyundai Motors' Report on the Trend of Korean Automobile Industry," Segyeilbo (newspaper), March 23, 1998.*
[5] *A chaebol is a Korean business conglomerate. The word means "business group" or "trust."*
[6] *Woo-Choong Kim, Chairman of the Federation of Korean Industries, quoted in "Chaebol in Tune to Expedite Retooling," Korea Times, October 21, 1998.*

> In the case of Hyundai, almost all of its models overlap with Kia models, so it would be a poor [acquisition], with no real synergy effect. If Hyundai were to acquire Kia, an effective competitor would disappear, limiting consumers' choices. Also, quick integration would make large-scale reshuffling of manpower, mostly at Kia Motors, inevitable, in which case production can be expected to suffer as well, thanks to labor conflicts.[7]
>
> If Hyundai, which has been unable to form any major market in Asia or Eastern Europe, acquires Kia, it will have a domestic production capacity of more than 3 million cars. Then not only will GM and Ford turn around and take notice, [the excess production capacity] will also be a stumbling block for Hyundai.[8]

Overcoming these negative opinions with a successful acquisition of Kia meant accomplishing a number of important tasks. Developing a master plan for acquisition and post-acquisition management was the most urgent task. Only with clearly articulated goals and guidelines on such issues as production, sales, R&D, parts procurement, workforce management and capital procurement could Hyundai deal with unforeseen problems during and after the acquisition.

Hyundai's plan was to minimize the time taken to acquire Kia as best as possible. The more time spent acquiring Kia, the more Kia's customers and sales networks would suffer in the transition and the greater the risk would be that the company could not be recovered. Hyundai needed to minimize the management vacuum at Kia during the acquisition process in order to preserve Kia's business resources.

## THE RESTRUCTURING OF KIA MOTORS

Hyundai's basic goal in restructuring was to maximize the synergy effects of the acquisition by integrating Kia's automobile division, thereby strengthening the international competitive power of the integrated firm's automobile business. Hyundai decided to maintain the existing brands, Hyundai and Kia, in order to maximize the sales effect. The two companies would be reorganized as two separate automobile companies, Hyundai Motors and Kia Motors, and separated from the existing Hyundai Group. From the status of affiliated companies of Hyundai Group, Hyundai-Kia Automobile Group would become a new chaebol group specializing in automobile manufacturing.

### Corporate Restructuring Plan

Hyundai Motors, itself carrying KRW5 trillion in debt, requested that KRW7 trillion of Kia Group's KRW13 trillion debt be written off.[9] However, in order to acquire a 51 per cent share of Kia Motors and its affiliated companies, Hyundai had to repay KRW1.2 trillion in debt by the end of March 1999. In its management plan for the automobile division, Hyundai decided on the early normalization of Kia Motors. After restructuring, Hyundai-Kia Automobile Group would then become an independent chaebol, separated from the existing Hyundai Group. Hyundai and Kia also decided to reduce their debt rate by 200 per cent by inducing foreign capital. Exhibit 4 tracks Kia's financial structure before, during and after restructuring.

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[7] *Kia Economic Research Institute, Internal Report, 1998.*
[8] *Kia Economic Research Institute, Internal Report, 1998.*
[9] *The exchange rate at the time was US$1=KRW1318.20. Thus, Hyundai's debt was equivalent to US$5.3 billion and Kia's to US$9.86 billion.*

### Reorganization of the Automobile Division

#### Integration of Management

Hyundai planned to integrate the management of the two companies. Hyundai's chairman of the board, the CEO and the chief operating officer (COO) would hold concurrent positions on Kia's board of directors. Also on that board would be the CEOs and a small number of senior executives of Kia's affiliated companies and outside directors, in accordance with relevant laws. They would be joined on the board by Kia's president and vice-president.

In the first round of management appointments, Se-Young Chung, an honorary chairman of Hyundai Motors, assumed the chairmanship of the boards of both Hyundai Motors and Kia Motors, while CEO of Hyundai Motors, Mong-Gu Chung, assumed the CEO of both companies and Mong-Gyu Chung, COO of Hyundai Motors, became COO of both companies. The president and the vice-president of each company were represented on each board.

#### Installation of the Automobile Division Planning Coordination Committee

Because they were producing similar goods, Hyundai and Kia needed to coordinate production, sales, R&D, parts supply, workforce operation and fundraising if they were to maximize the synergy effects of integration. The Automobile Division Planning Coordination Committee was established, with the CEO of Kia and Hyundai serving as chairman.[10] The mandate of the committee was to plan and coordinate marketing, R&D and purchases. Toward these ends, the committee would operate a planning and control center to carry out its duties. It was the committee's job to shift Hyundai/Kia from a dualistic to a unified system in its production and sales divisions.

### Integration of the Business Division

#### Coordination of the Business Division

After the acquisition, Hyundai Motors absorbed and merged Kia's five affiliated automobile companies into Kia Motors and disposed of Kia's eight other affiliated companies through sales and liquidation. Exhibit 5 shows major organizational changes in the reorganization of Kia Motors following the acquisition.

Kia Motech, Kia Corporation, Kia Intertrade, Kia Precision and Kia Electronics were divested through joint ventures or through sell-offs. The sale of Kia Ford Installment Finance and DASCO completed the liquidation procedure. The share of Kisan held by Kia Group (12.1 per cent) was returned to individual employees in cash. Once the process was complete, Kisan applied to the Fair Trade Commission for separation from Kia Group. Kia Tungsten and Daewoo Motors agreed to joint management.

Subsequently, Hyundai established a profit-oriented sales system and began to consolidate sales networks so the system could handle the broadened range of models efficiently. Hyundai Motors merged with Hyundai Motors Service. Hyundai Precision, after dividing off other business divisions, merged its

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*[10] The committee included the CEO, the COO, the president of Hyundai Motors, the president of Kia Motors, the chief strategy officer of the automobile division strategic planning department and one person from the board of directors of each company, appointed by the committee's chair.*

automobile division into Hyundai Motors as well. The heavy equipment part of Hyundai Motors Service transferred its sales and business divisions to Hyundai Heavy Industries, where the manufacturing and sales of heavy equipment were consolidated thereafter. Asia Motors, Kia Motors Sales, Asia Motors Sales and Dajin Motors were merged under the single umbrella of Kia Motors.

Additionally, Kia's A/S business division was moved to Hyundai Mobis, an organizational transfer made to improve the efficiency of A/S business. Mobis was restructured to focus on the sales, while the A/S departments of Hyundai and Kia transferred the control to the corresponding domestic sales divisions, respectively. The head office in charge of overall A/S division coordinated both companies' A/S operations and served as a window to Mobis in terms of parts business.

## Organizational Changes

Upon acquiring Kia, Hyundai for the most part operated the company through a direct management system, but it changed to a horizontal management system after separating the automobile business from the Hyundai Group. Under the direct management system, four team leaders of the automobile division planning coordination committee were appointed, and a system of joint management for Hyundai and Kia was established. Executives were appointed to the boards of Kia's affiliated companies in four divisions — planning, marketing, materials purchasing and R&D — and treated as directors. With the addition of 40 support staff, the planning coordination committee was fully staffed. About 10 managers and vice chiefs in Kia also participated.

Hyundai Motors integrated its R&D division with Kia's after the acquisition and began to develop new models with an emphasis on environmentally friendly engines. Because such investments were best made on a large scale, major automobile manufacturers worldwide were engaging in joint development projects through partnerships and M&As. Hyundai expected to save trillions of Korean won through joint R&D. In the materials division, integration was completed early and parts supply networks were rearranged. In comparison, the integration and consolidation of the A/S division had been carried out gradually.

### Platform Integration

Upon acquiring Kia, Hyundai set in motion a long-term plan to establish the use of common platforms[11] and parts, to reduce the product development cycle and to enable the transfer of application technology between models. Hyundai planned to eliminate model duplication by 2001 and to have fully integrated parts in use. The integration of platforms would lower production costs and thereby strengthen price and quality competitiveness in overseas markets.[12] The 23 platforms in use (13 by Hyundai and 10 by Kia) would be reduced in phases to seven platforms by 2004. Each platform would be the basis for between one and six models.

*[11] "Platform" is a specialized term referring not to the automobile's model but to its wheel base. An assembly line produces a single platform on which several different models may be built. For example, four different Hyundai models, Avante, Tiburon, Sonata and Marcia, share a single platform.*
*[12] An automobile comprises four primary parts: the body, the interior, the power transmission system (engine and gearbox) and the lower structure (the suspension). The platform consists of the latter two parts and dictates the vehicle's basic capacities. With platform integration, two or three models can share a single suspension structure, engine and gearbox. Interior and exterior are thus differentiated and profitability is enhanced through the reduction of development and production costs.*

In the first stage of platform integration, the common use of Hyundai's EF Sonata platform would be established and two models would be produced on that platform at Kia's Asanman factory. Thus, the two models would differ in name and appearance but not in underlying platform. Additionally, Kia, which had never produced a small car, began after the acquisition to produce a new model, Bisto, using the platform for Hyundai's Atoz and another, Carens, using Kia's Sephia platform.

### Downsizing and Culture Integration

#### Downsizing of Overlapping Workforces

In 1999, the absorption and mergers of several companies around Kia and Hyundai made it essential to reduce staff redundancies through layoffs and relocation. Thanks to the acquisition, Hyundai's production ability and manpower both increased by approximately 63 per cent, from 1997 to 1998, but production per worker decreased significantly (see Exhibit 6).

Accordingly, with the approval of the bankruptcy court, the planning coordination committee closed down some Kia factories. It reduced workforces to resolve overlaps caused by the merger and by the abolition of the production division of Hyundai Precision, the sales force of Hyundai Motors, the production divisions of Kia Motors and Asia Motors and the sales division of Asia Motors.

Approximately 1,000 factory workers were let go through voluntary retirement and about 2,000 additional workers left the company with six months' wages and a 300 per cent delayed bonus added to the basic retirement allowance. The measure incited strong protest from labor unions of both companies but was essential to corporate restructuring. In the case of managerial posts, approximately 9,000 positions out of a workforce of 33,000 in the five subsidiaries of Kia Motors were eliminated.

#### Integration of Organizational Cultures

CEO Chung shifted the basic management system to a horizontal system, instituting trust and transparency in management and fostering hands-on management. The system was redesigned to prosecute management strategies and R&D on the basis of field experience and efforts were made to improve communication within the company.

To establish bridges between different organizational cultures, the CEO introduced a work exchange system for managers. After being separated from Hyundai and Kia Group and reborn as Hyundai Automobile Group, 210 managers from Hyundai and 142 from Kia worked in the other company for six days, each over a period of three weeks. The employees, above the rank of deputy manager but below the rank of general manager, worked on the planning, public relations and investor relations teams and in the head offices of management support and finance, excluding production, sales and general affairs. The aim was to expose managers to the strengths and weaknesses of methods used by their counterparts in the other company. The CEO expected that as a result of this exercise efficiency, communication and understanding would improve.

Additionally, the CEO instituted a field work system for executives of both companies. They were dispatched to factories across the country, among them Hyundai's Ulsan and Kia's Sohari factory. Upwards of 180 executives from the head offices and sales departments each participated for three weeks. Assigned to the assembly line, taking on night duties with field operators, executives experienced the atmosphere of the factory floor and felt a sense of community with the workers there. The field work program, part of an effort to resolve conflicts between management and labor and to provide field experience to management, continued for more than two years.

### Changes in Plant Operations and Structure

#### The Daily Ordering System

Prior to integration, Kia had used a monthly ordering system and more recently a weekly ordering system. In December 1999, the company instituted a daily ordering system on some lines. In the early days of integration, the system was applied just to the Asan factory's A3 line and the Sohari Factory's U line, but gradually it was expanded to encompass all lines of both factories.

No essential difference existed between the monthly and weekly ordering systems other than the production planning cycle. The new daily ordering system was set up with on-demand production rather than planned production. In other words, a vehicle was made when an order was received and not made to fulfill a production schedule. The daily ordering system addressed the existing weakness of planned production — the continuing growth of total stock as production lines responded to the diversification of customer demands.

#### Promotion of Commercial Vehicle Division as a Separate Corporation

After the acquisition, Hyundai redesigned Kia's Gwangju factory as a specialized factory, producing 300,000 commercial vehicles per year. Hyundai Motors also integrated the Jeonju factory, which produced trucks greater than 2.5 tons and special-purpose vehicles. It was intended that this factory would, after the integration, spin off its commercial vehicle division as a separate corporation, of which it would sell a 50 per cent share to DaimlerChrysler, creating a joint corporation for the manufacture of full-size trucks.

In August 1999, the product line of the Pregio, a minivan, was transferred to the Gwangju factory. Six months later, the production line for the Frontier (a one-ton truck), which could produce 100,000 units annually, was transferred to the Gwangju factory and KRW8 billion was invested in upgrades, including state-of-the-art automated equipment that would greatly enhance production rates. To prevent quality problems in the early stages of operation when factory workers would be unfamiliar with the new equipment, education on the assembly process was supplemented by a quality innovation initiative at the end of 1999. By 2000, the Gwangju factory was producing more than 300,000 vehicles annually across a wide range of models, including utility vehicles, small cars, small and mid-size trucks, full-size trucks, mid- and full-size buses, special-purpose vehicles, military vehicles, and commercial vehicles.

## THE OUTCOME OF RESTRUCTURING

### Revitalized Management at Kia Motors

Kia Motors was back in the black in 1999, with profits of KRW135.7 billion — the highest profits in the company's existence — as a result of restructuring and management improvements. Sales were double those of 1998: 820,000 vehicles, of which 350,000 were domestic and 470,000 were export sales. At the end of 1998, Kia had been in complete capital depletion, but a year later it had been reborn as a blue chip company with a sound financial structure and a debt rate of 148 per cent, thanks to the capital increases and improved profitability that followed the acquisition (see Exhibits 7 and 8).

### The End of Legal Management

Kia became a blue chip company in 1999, recording sales of KRW7.9 trillion and a profit of KRW135 billion and reducing its debt rate from 810 per cent to 148 per cent, a figure well within the government's guidelines. It left the state of capital depletion it had been in when legal management began (KRW5.2 trillion) and recorded net assets of KRW3.1 trillion.

On February 16, 2000, the First Department of Bankruptcy of the Seoul District Court decided, with the assent of all creditors, to terminate the legal management status of Kia Motors. The court held that Kia had satisfied the requirements for early termination of legal management as set out in the corporate liquidation law and that the company's business outcomes and financial structure had improved dramatically. Legal management of Kia had lasted 25 months and was terminated 15 months after Hyundai's acquisition of the company. The speed with which legal management was brought to an end and management normalized was in fact unprecedented. The case was held by observers to be beneficial to the government, the companies and creditors alike and of great symbolic value as well to the Korean government's restructuring efforts.

### Domestic Outcome

In 1999, demand rose in the domestic automobile market as the Korean economy entered a period of recovery after the financial crisis of 1997 and subsequent restructuring. With a reduction in the tax rate on automobiles and the release of new vehicle models, a newly energized market sold a total of 1,225,000 new vehicles, an increase of 72 per cent over the previous year. The sports utility vehicle (SUV) market led the domestic recovery, expanding by 230 per cent in two years, from 77,000 in 1998 to 254,000 in 1990, largely thanks to the consecutive releases by Kia of the Carens, Carnival, LPG and Carstar models, all of which emphasized economy and utility. Kia sold 146,000 such vehicles, an increase of 360 per cent over the previous year, accounting for 58 per cent of the domestic SUV market. In the sedan vehicle market, which had stagnated because of high oil prices and job insecurity, 631,000 vehicles sold, a 39 per cent increase over the previous year. Kia released two new small car models, Bisto and Rio, which made strong inroads in their market; meanwhile, thanks to aggressive marketing, 70,000 existing small car models, such as Schuma and Enterprise, were sold, an increase of 51 per cent over the previous year.

### Overseas Outcome

Kia recorded its strongest performance on the foreign market since it first ventured overseas in 1975, exporting 469,000 vehicles, an increase of 53 per cent over the previous year. By region, vehicle volumes for North America and Europe were 145,000 and 140,000, respectively, accounting for more than 60 per cent of total export sales. In the Middle East, Africa and other Asian countries, Kia established strong market bases, selling 184,000 vehicles. Of particular note was Kia's solidified position in the United States, the largest market in the world: selling just two different models, Sephia and Sportage, through Kia Motors America, its local subsidiary, Kia exported 140,000 vehicles.

These dramatic export increases were brought about by managing foreign markets closely, introducing and enforcing a system of overseas field management and responding to each region's market environment on its own terms. The refurbishment or replacement of agencies and dealers, after evaluation of their market competitiveness, helped sales increase. Energetic public relations activity overseas, including a successful ad campaign in 54 cities in 30 countries that made comic use of millennial anxieties ("Y2K"="Yes2Kia"), enhanced Kia's image as a strong player on the world automobile market, further increasing sales.

Kia also broke into new markets abroad in Canada, China, Mongolia, Malaysia and South Africa. In China, in January of 2000, Kia took on the Jangssuwieda Group as a field partner in establishing a new factory that would produce 30,000 vehicles a year. The partnership gave Kia a 20 per cent share in the other company, with management rights and an enhanced share rate of 50 per cent.

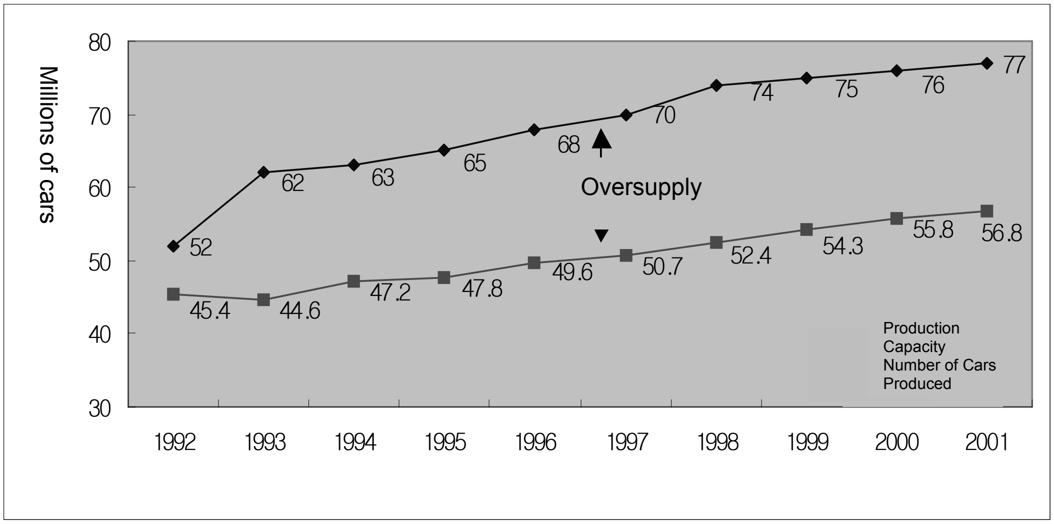
## PROSPECTS

Through their concerted efforts, Kia and Hyundai had remarkable achievements in 1999 and 2000. In 2000, Kia's gross profits were expected to reach KRW459.5 billion, the largest profit in the company's history. Labor and management of both companies had been restructured and integrated successfully. The integration of sales, marketing, production, platforms and R&D had gone well and was almost accomplished.

There were issues that nonetheless remained unresolved. Most urgent was the need to deal with redundant and overlapping equipment. The relocation of workers and workforce reduction also remained incomplete. Also important was addressing employee complaints, not entirely unjust, that the upper echelons of the restructured Kia were now all Hyundai. In fact, most of Kia's executives, its department managers and deputy general managers, had been brought over from Hyundai. And Hyundai's culture was hierarchical, valuing order and obedience, top-down decision-making and competition between colleagues, whereas Kia's culture had valued shared decision-making, input from subordinates, worker autonomy and a team mentality. With regard to organizational culture, then, the two companies, though joined, were hardly integrated. It would take patience and skilful communication to bring these two cultures into a single harmonious whole.

## Exhibit 1

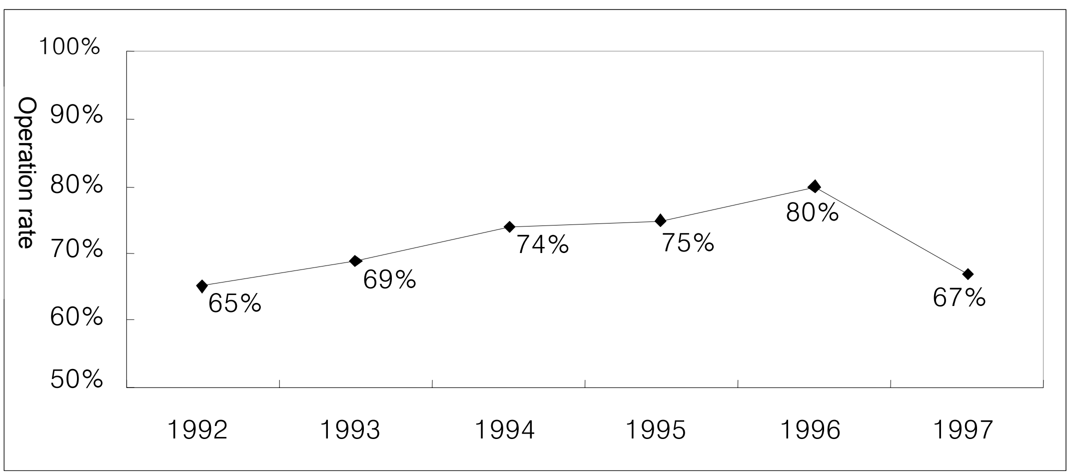
### OVERSUPPLY IN THE GLOBAL AUTOMOBILE INDUSTRY




*Source: DRI, World Car Industry Forecast, February 1997.*

## Exhibit 2

### OPERATION RATE OF KOREA'S AUTOMOBILE INDUSTRY




*Source: Korea Automobile Manufacturers Association.*

**Exhibit 3**

**THE POWER GAME SURROUNDING KIA MOTORS**

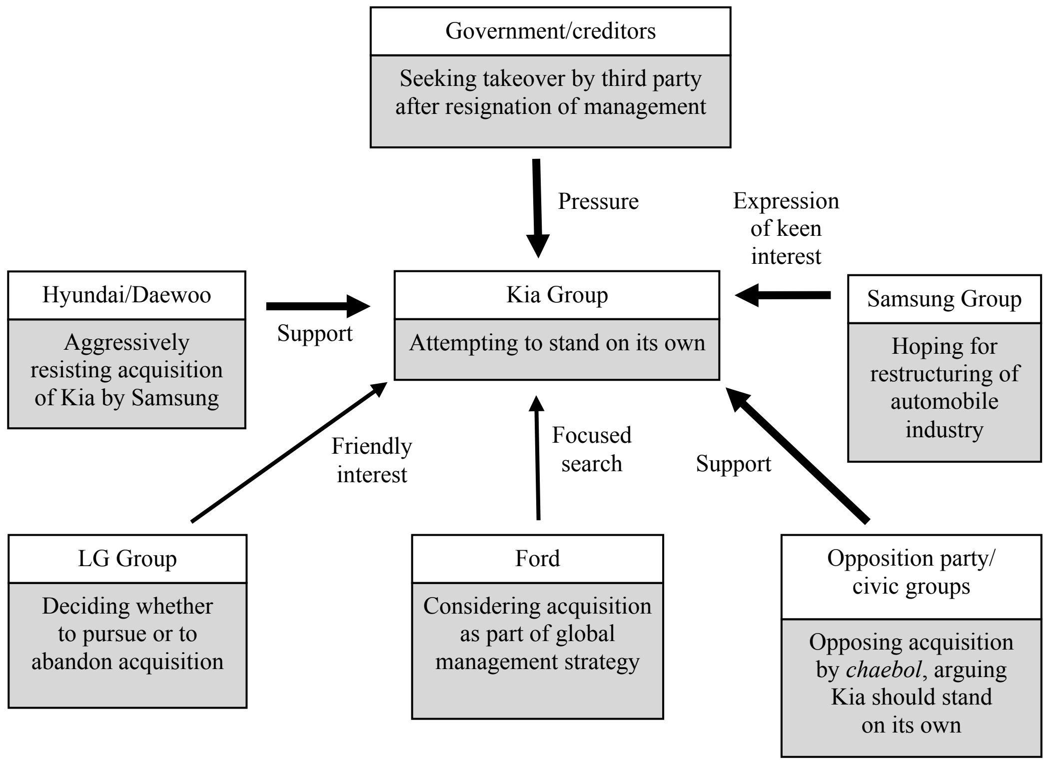



**Exhibit 4**

**FINANCIAL STRUCTURE OF KIA MOTORS**
**(in hundreds of millions of Korean won)**

| Item | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | June 2000 |
|---|---|---|---|---|---|---|---|
| Current assets | 22,459 | 23,370 | 26,002 | 44,430 | 21,408 | 23,749 | 28,002 |
| Fixed assets | 22,576 | 26,463 | 29,123 | 45,098 | 28,523 | 53,062 | 52,396 |
| Total assets[1] | 55,621 | 63,011 | 69,447 | 89,528 | 49,931 | 76,811 | 80,398 |
| Current debts | 29,159 | 32,735 | 36,818 | 24,742 | 55,387 | 23,714 | 25,809 |
| Fixed debts | 16,824 | 17,097 | 19,454 | 54,988 | 18,854 | 22,126 | 22,810 |
| Total debts | 45,984 | 49,832 | 56,273 | 79,730 | 74,242 | 45,840 | 48,619 |
| Equity capital | 9,639 | 13,179 | 13,175 | 9,799 | 24,310 | 30,972 | 31,778 |
| Sales amount | 47,308 | 56,885 | 66,071 | 63,815 | 45,107 | 79,306 | 48,060 |
| Sales gross profit | 6,680 | 9,000 | 11,030 | 9,873 | –3,434 | 11,878 | 8,544 |
| Operating profit | 1,180 | 2,445 | 3,256 | 1,670 | –19,980 | 488 | 1,469 |
| Net profit | –696 | 115 | 70 | −3,829 | –66,496 | 1,357 | 825 |
| Debt rate | 477% | 378% | 427% | 813% | –305% | 148% | |

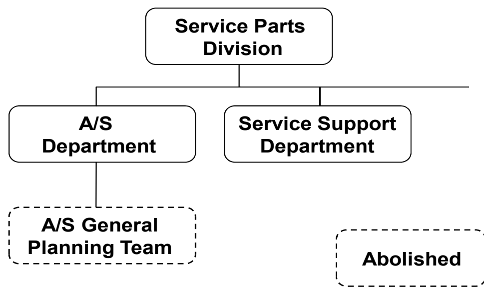
*Source: Korea Automobile Manufacturers Association, Automobile Business of Korea, 1998-2000.*

[1] *The total assets for 1994 to 1996 include intangible assets.*

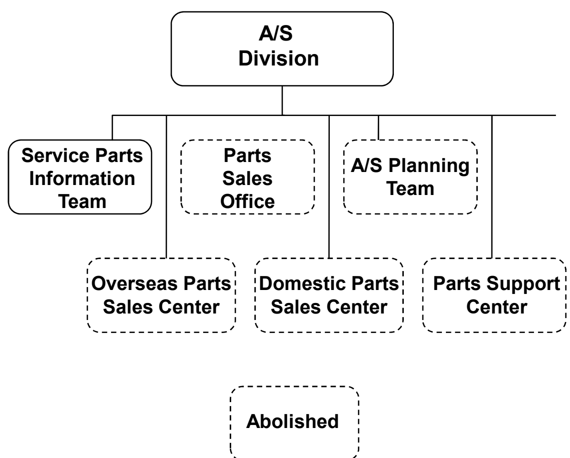
## Exhibit 5

### REORGANIZATION OF KIA MOTORS AFTER ACQUISITION

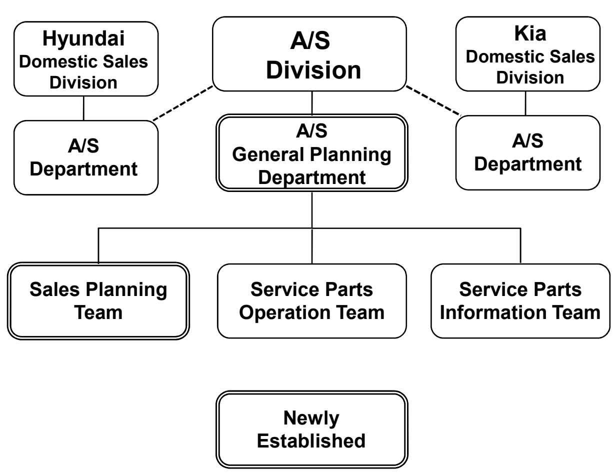
#### (a) Hyundai Motors before M&A




#### (b) Kia Motors before M&A




#### (c) Hyundai & Kia Automobile Group after M&A




*Source: Compiled from company press releases.*

## Exhibit 6

## PRODUCTION AND EMPLOYMENT CONDITIONS AT HYUNDAI AND KIA

| Year | Production Ability* | Production Outcome* | Operation Rate (%) | Number of Employees | Number Produced per Employee |
|---|---|---|---|---|---|
| 1997 | 180 | 124 | 68.9 | 46,254 | 26.8 |
| 1998 | 293 | 123 | 42.0 | 75,447 | 16.3 |
| Increase rate | 62.8% | –0.8% | | 63.1% | –39.2% |

** Unit: 10,000s of vehicles.*
*Note: Figures for 1997 include only Hyundai; those for 1998 include Hyundai, Kia, Asia and Hyundai Precision.*

*Source: Compiled from company press releases.*

## Exhibit 7

## SALES RECORDS FOR KIA MOTORS
## (in number of vehicles, in KRW100 millions)

| Division | 1998 | 1999 | 2000 |
|---|---|---|---|
| Total sales | 438,118 | 819,167 | 857,724 |
| Domestic sales | 130,913 | 345,438 | 408,338 |
| Exports | 307,205 | 473,729 | 449,486 |
| Total revenue (KRW100 million) | 52,833 | 79,306 | 108,060 |
| Net profit (KRW100 million) | –94,890 | 1,357 | 3,307 |

*Note: Figures are totals for the five companies merged into Kia Motors at the end of June, 1999: Kia Motors, Asia Motors, Kia Motors Sales, Asia Motors Sales and Kia Daejeon Sales.*

*Source: "The Propulsion Process of Restructuring," Hyundai Motors website.*

## Exhibit 8

## CHANGES TO THE FINANCIAL STRUCTURE OF KIA MOTORS
## (in KRW100 millions)

| Division | 1998 | 1999 |
|---|---|---|
| Assets | 63,012 | 76,813 |
| Debts | 98,964 | 45,841 |
| Capital | 35,952 | 30,972 |
| Debt rate | (Capital depletion) | 148% |

*Note: Figures are totals for the five companies merged into Kia Motors at the end of June, 1999: Kia Motors, Asia Motors, Kia Motors Sales, Asia Motors Sale and Kia Daejeon Sales.*

*Source: "The Process of Restructuring," Hyundai Motors website.*