



**OECD/ADBI 7th Round Table on
Capital Market Reform in Asia**

27-28 October 2005

ADB Institute, Tokyo, Japan

**SESSION 4: DEVELOPMENTS IN
VENTURE CAPITAL AND PRIVATE
EQUITY SINCE THE END OF
'TECH BUBBLE'**

**Professor Dosoung Choi,
President, Korea
Securities Research Institute**



Venture Capital and Private Equity in Korea



2005. 10.

Dosung Choi
President, KSRI

- Contents -

I . Innovative Businesses and Venture Capital

II. Venture Capital Industry in Korea

III. Private Equity in Korea

IV. New Measures to Promote Venture Capital

I . Introduction



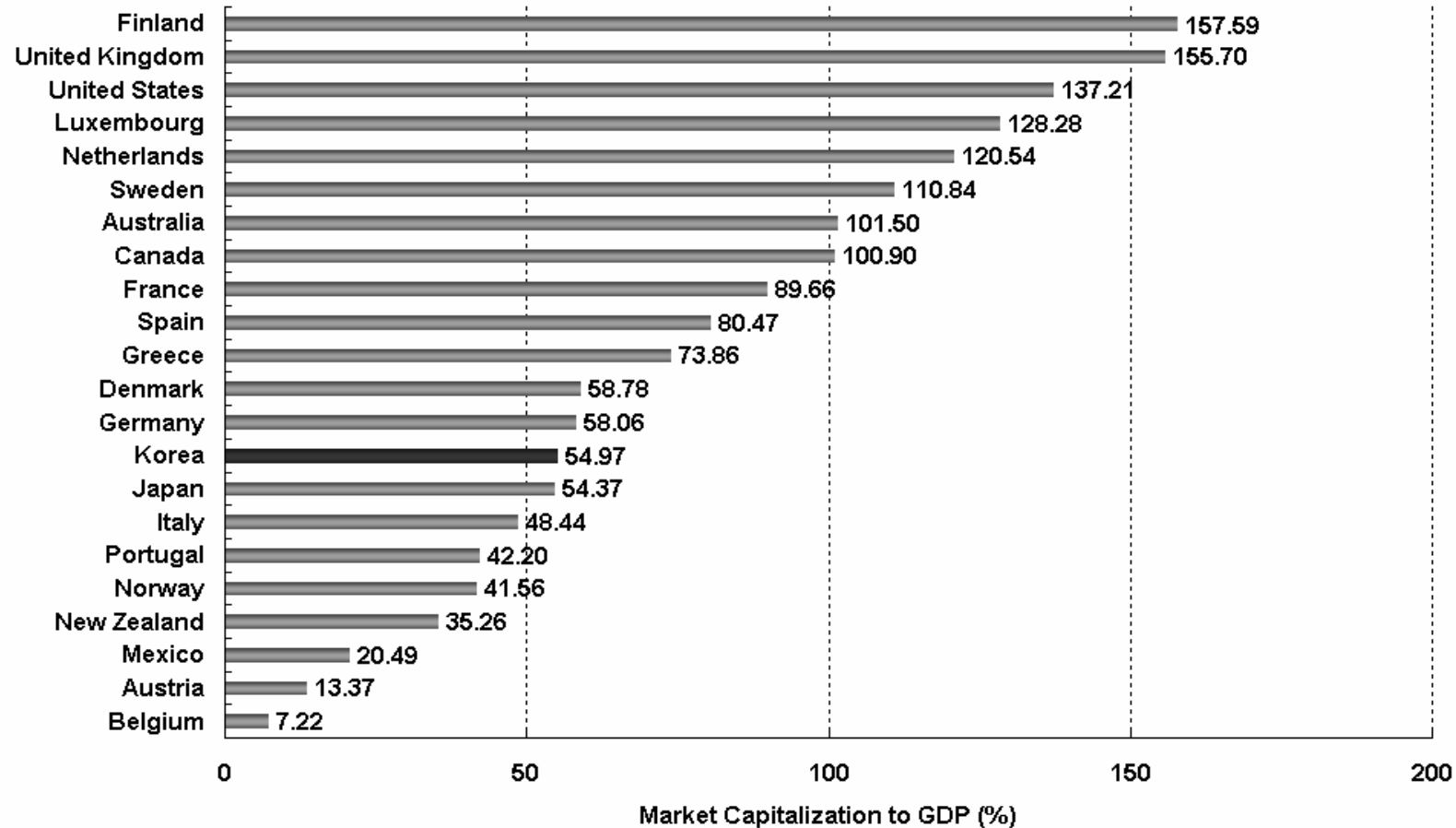
/ . Introduction

- ❑ The future of Korean Economy is in technology-based firms and innovative businesses.**
 - ❑ Technology-based firms are characterized by**
 - High risk - high return
 - Financial structure should reflect risk-taking capacity
 - A bank-based financial system is not appropriate for these industries
 - Need to move toward a market-based financial system
- ⇒ A well-functioning venture capital market/industry is a critical component of the market-based financial system.**



1. Stock Market Development Index

Stock Market Size of OECD Countries in 2001
(World Development Indicators 2003)



/ . Growth Race

Growth of Select Industries

Annual Growth Rates of Real Value Added (%)



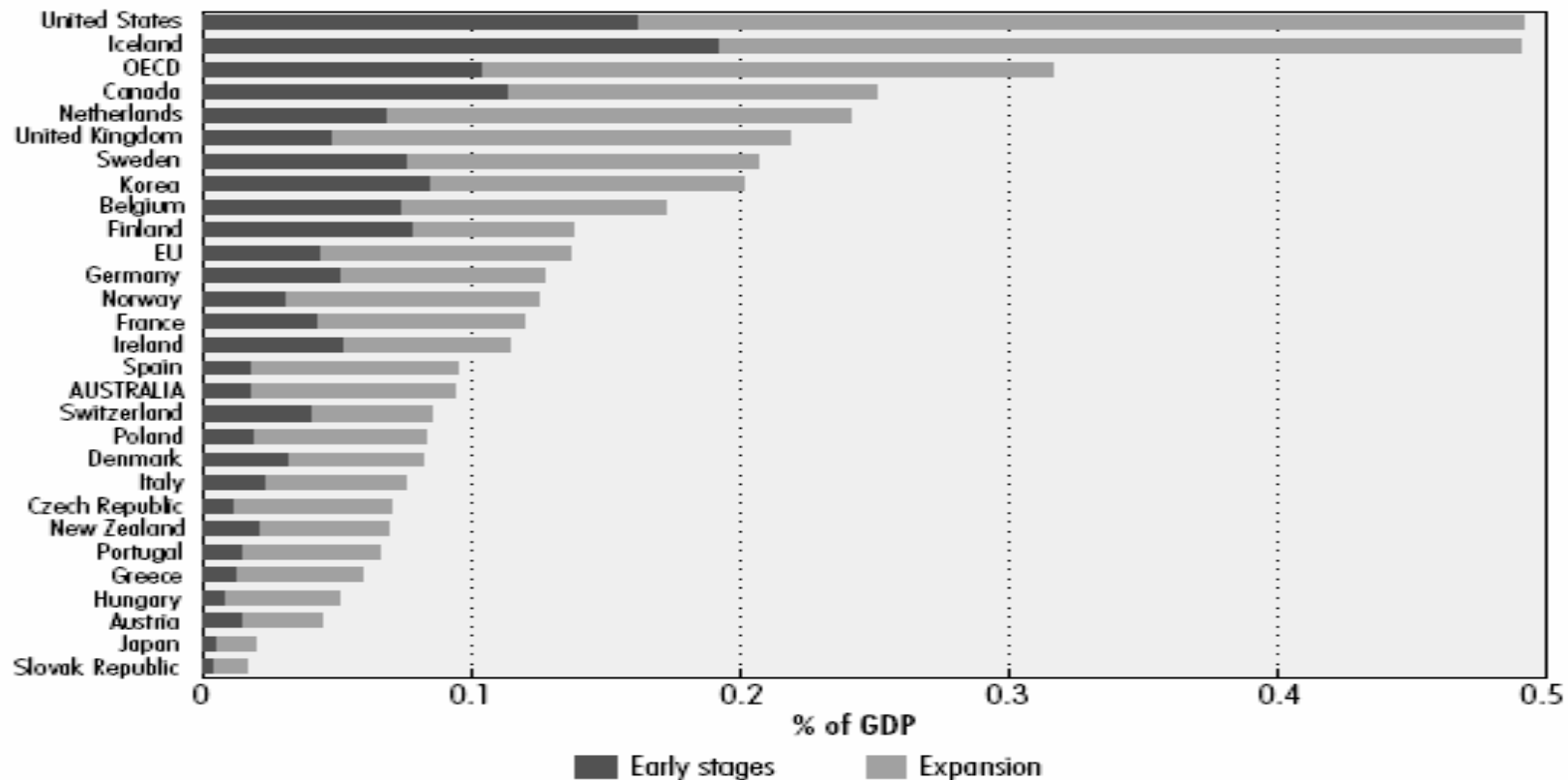
Industry	ISIC	Bank-based	Market-based	Market/Bank
Digital TV/Broadcasting	32+64	1.94	3.84	Market
Displays	26+30+32	-0.22	1.43	Market
Robotics	29+31+32	0.69	3.18	Market
Smart Cars	30+34	-0.92	1.12	Market
Next Generation Semi-Conductors	30+32	-0.93	1.42	Market
Next Generation Mobile Devices	33+64	1.97	2.55	Market
Digital Content/Software Solutions	64+72	6.47	7.85	Market
Next Generation Batteries	31+32	0.53	3.45	Market
Biotechnology	33+24	1.45	1.76	Market
Mean		1.22	2.96	Market

Among 20 countries from the OECD, 1991-2001
Source: OECD STAN database, World Bank WDI

1. Venture Capital Market of OECD Countries

- The relative scale of the venture capital market is 7th among the OECD countries.

Investment in venture capital as a percentage of GDP of OECD countries, 1998-2001



Source: OECD, Science, Technology and Industry Scoreboard, 2003

1. Comparison of Venture Capital Sources of Korea and the U.S.

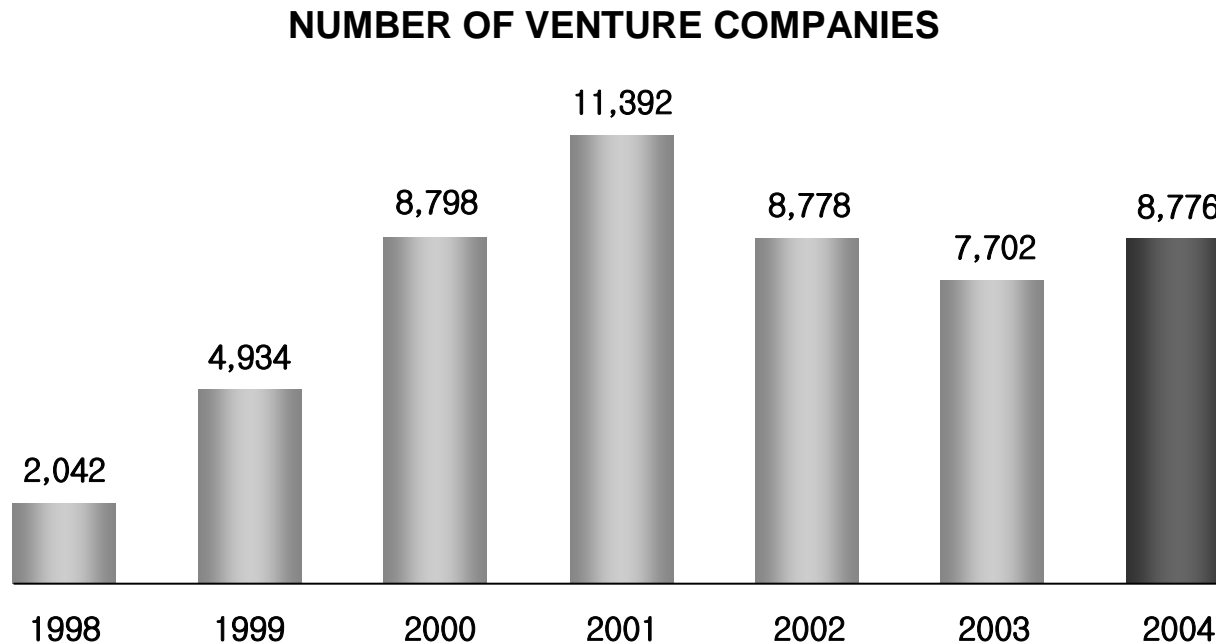
- In 2003, the size of venture capital source relative to GDP is 0.74% (US : 2.34%).

The scale of venture capital : KOREA VS. U.S.

	KOREA (Billion \$, %)			US (Billion \$, %)		
	GDP(A)	VC Source (B)	A/B	GDP(A)	VC Source (B)	A/B
2000	511.8	4.0	0.78	9,817	228	2.32
2001	482.0	4.0	0.84	10,101	256	2.53
2002	546.9	4.1	0.75	10,481	258	2.46
2003	605.2	4.5	0.74	10,988	257	2.34

1. *Venture Companies in Korea*

- ❑ Since the financial crisis in 1997, the number of venture companies increased steadily, until the bust of the tech-bubble in 2001-2.
- ❑ After 2003, the number of venture companies has been rising again.

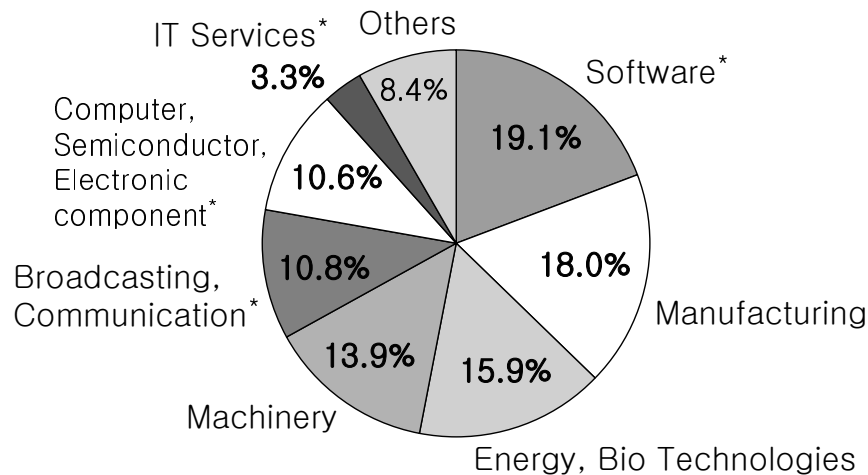


Source : Small and Medium Business Administration (SMBA)

1. Venture Companies in Korea

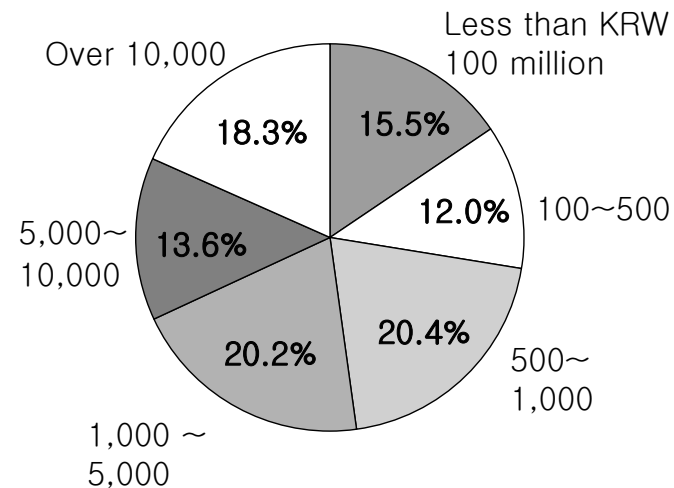
- About 35% of Venture companies are in Software, Energy, and Bio Technologies industries.
- Around 68% of Venture companies shows the amount of sales below \$5million

VENTURE COMPANIES BY INDUSTRY, 2004
100%=7,609 companies



* IT venture companies account for 43.8%

VENTURE COMPANIES BY SALES, 2004
100%=7,609 companies

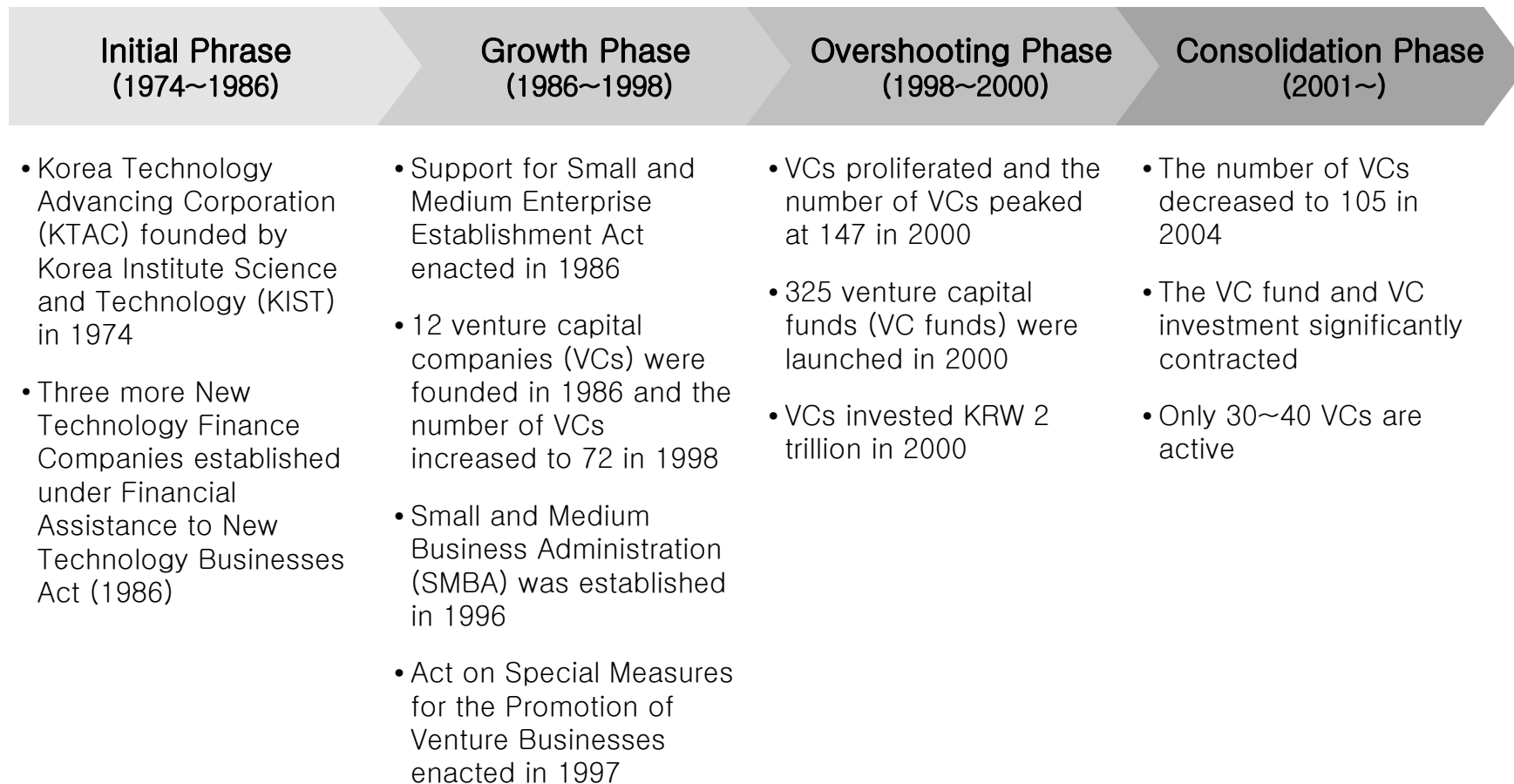


II. Venture Capital Industry in Korea



II. VENTURE CAPITAL INDUSTRY

□ DEVELOPMENT OF the VENTURE CAPITAL INDUSTRY IN KOREA



II. VENTURE CAPITAL INDUSTRY

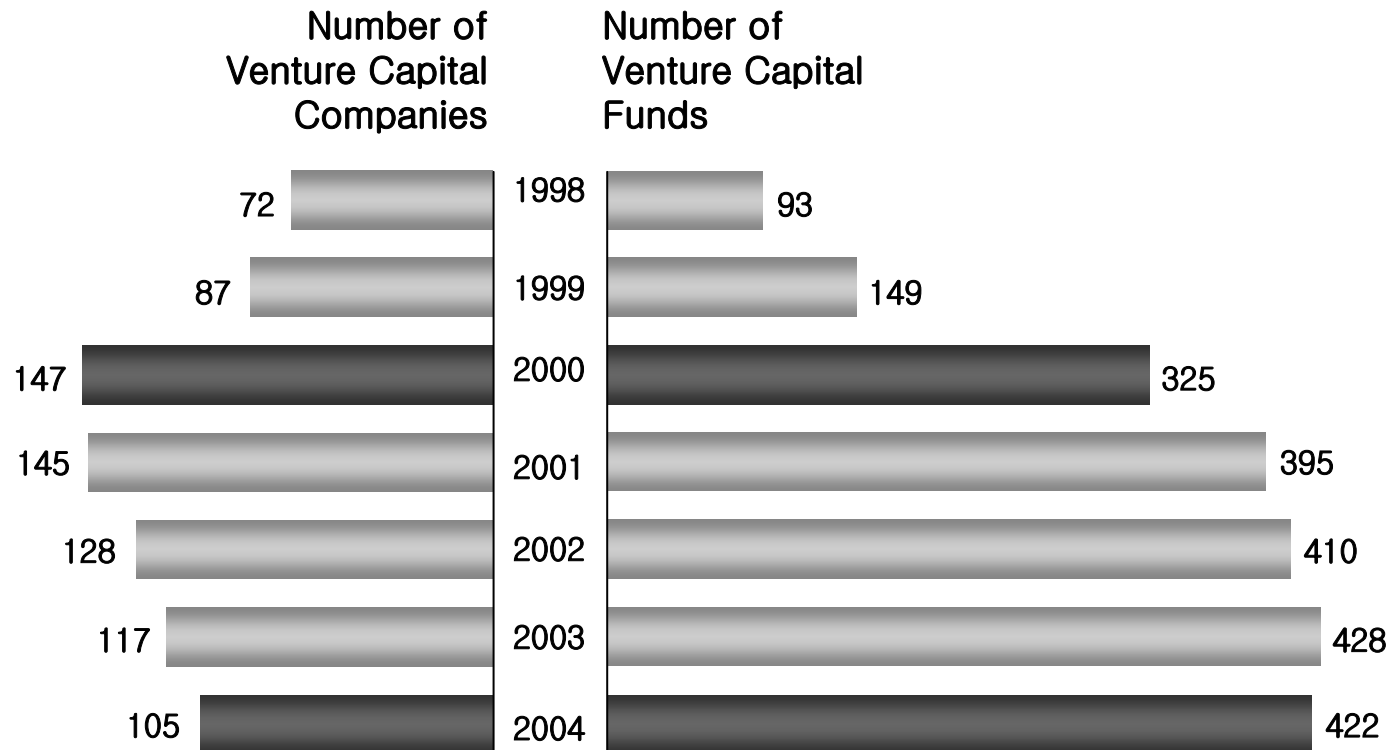
: Venture capital system

□ Venture capital system in Korea

- A venture capital company (VC) acts as a general partner and takes a form of a corporation with a minimum paid-in capital requirement
- A venture capital fund (VC fund) is organized in the form of a limited partnership and managed by a VC

II. VENTURE CAPITAL INDUSTRY

ESTABLISHMENT OF VENTURE CAPITAL COMPANIES AND VENTURE CAPITAL FUNDS, 1998~2004



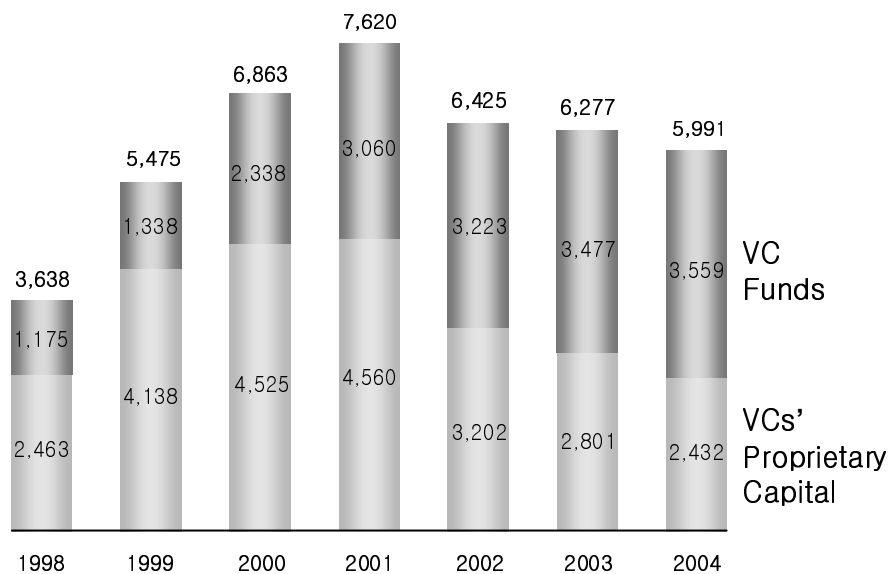
Source : SMBA

II. VENTURE CAPITAL INDUSTRY : Fund Raising

- ❑ Aggregate fund size is 5,991 KRW billion (5.23 \$ billion) in 2004
- ❑ The major limited partner of venture capital funds is the government (31.1%)

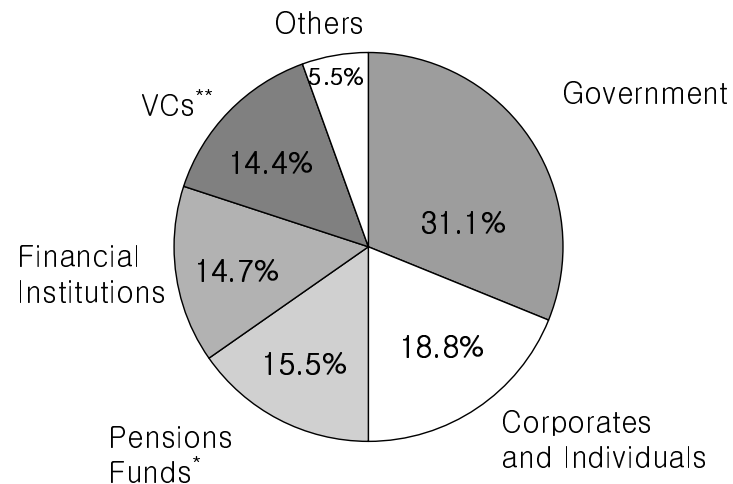
AGGREGATE FUND SIZE, 1998~2004

Total=KRW 3,559 billion



LIMITED PARTNERS OF VC FUNDS
BY TYPE, 2004

Total=KRW 3,559 billion



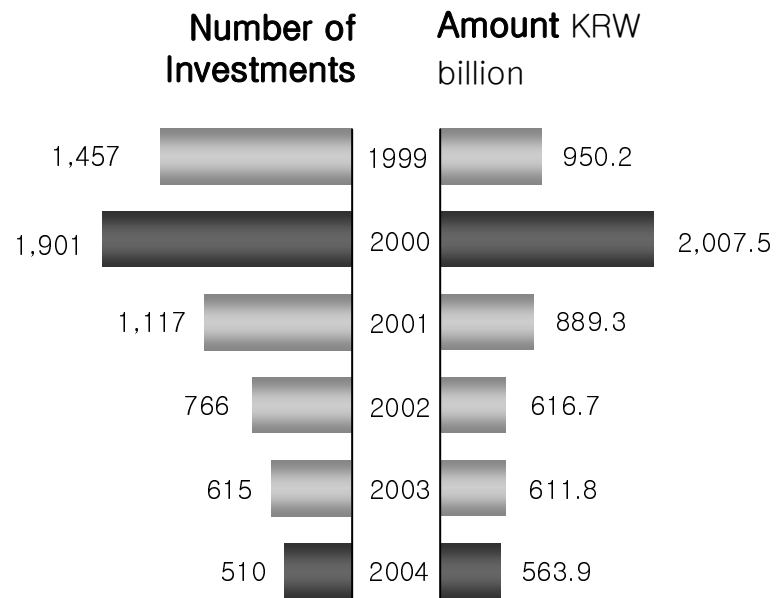
*The National Pension Act was revised in 2001 and the National Pension Corporation started to invest in VC funds in 2002

**Equivalent to general partner contribution to VC funds

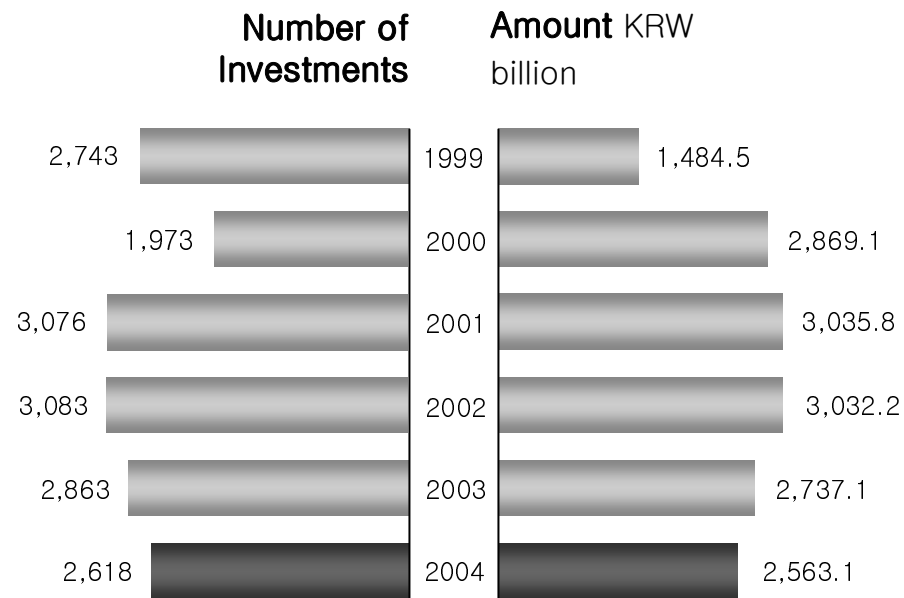
II. VENTURE CAPITAL INDUSTRY : Investment

- ❑ The amount of investment has been falling since 2000
- ❑ In 2004, \$ 0.5 billion was newly invested
- ❑ Aggregate investment in 2004 is \$ 2.24 billion

INVESTMENT BY YEAR, 1998~2004



AGGREGATE INVESTMENT BY YEAR, 1998~2004



Source : SMBA

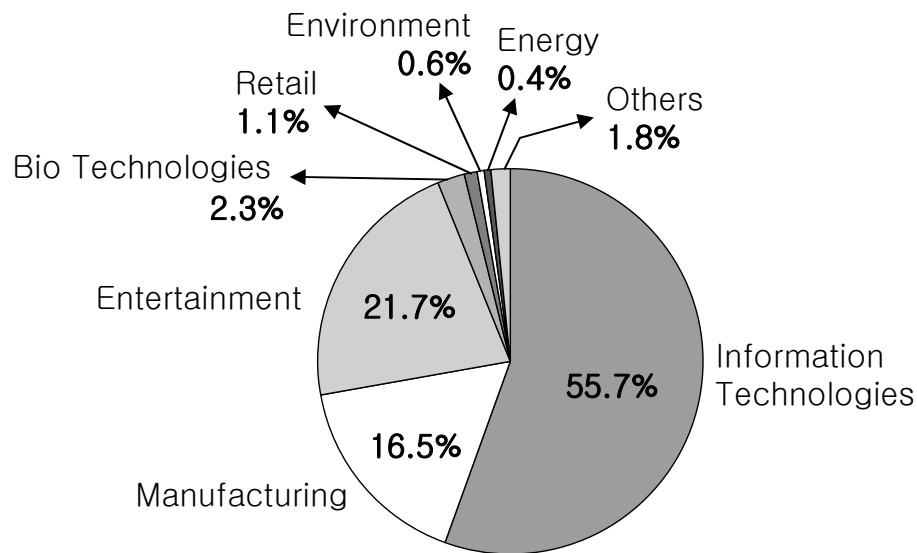
II. VENTURE CAPITAL INDUSTRY : Investment

□ Investment by Industry and Stage

- Nearly 60% of all the investment are made in information technologies sector
- More than 70% are invested in venture companies of the age of 3 years or younger

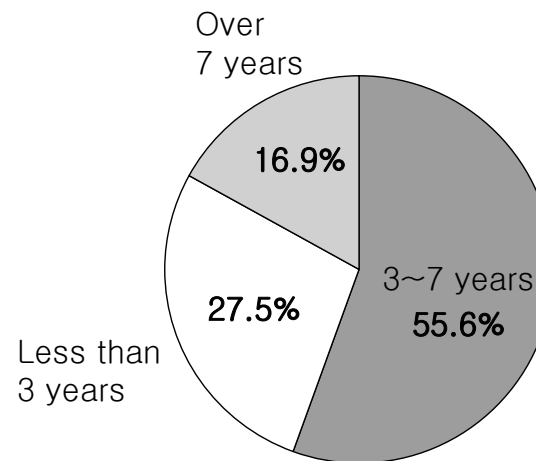
INVESTMENT BY INDUSTRY, 2004

100%=KRW 563.9 billion



INVESTMENT BY STAGE, 2004

100%=KRW 563.9 billion

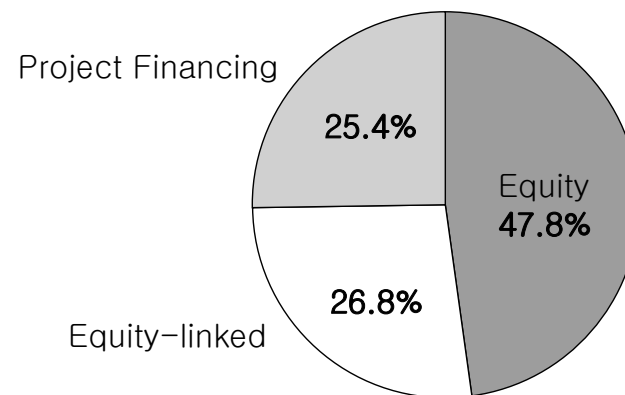


Source : SMBA

II. VENTURE CAPITAL INDUSTRY : *Investment*

- ❑ The common form of an equity investment has been common equity.
- ❑ Recently, VCs started to employ preferred stocks.
- ❑ The project financing is usually used for financing the production of films, games, and music, etc.

INVESTMENT BY INSTRUMENT, 2004
100%I=KRW 563.9 billion



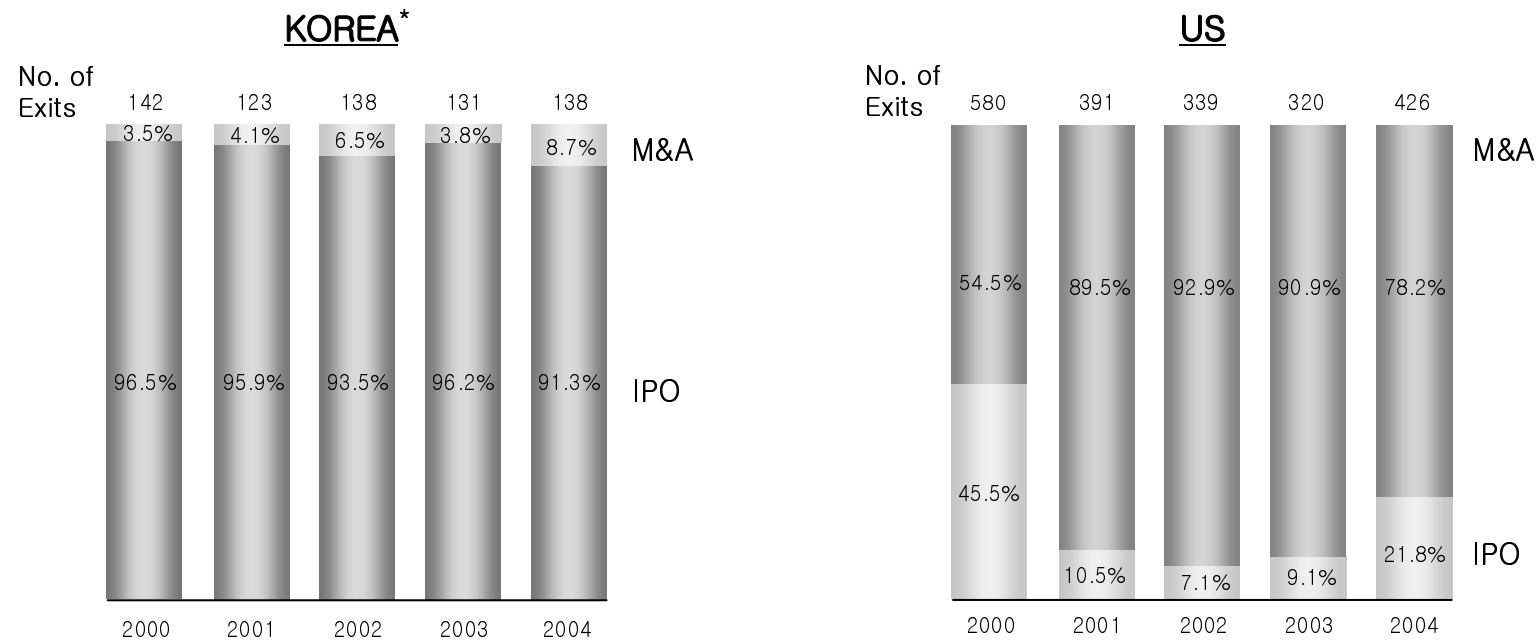
Source : SMBA

II. VENTURE CAPITAL INDUSTRY : Exits

❑ Most exits in Korea are through IPOs (91.9%, 2004)

- It takes 9.2 years on average for a venture company to the stage of IPO (2004)

EXIT BY TYPE, 2000~2004 : Number of Exits



*Based on survey data from 43 VCs

Source :KVCA; National Venture Capital Association (NVCA)

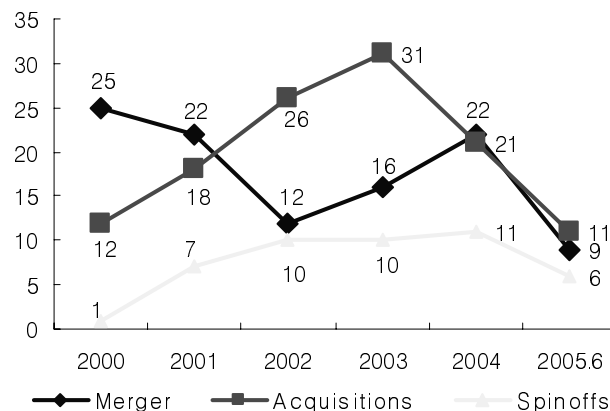
II. VENTURE CAPITAL INDUSTRY : Exits

❑ Venture Capital Exits in Korea

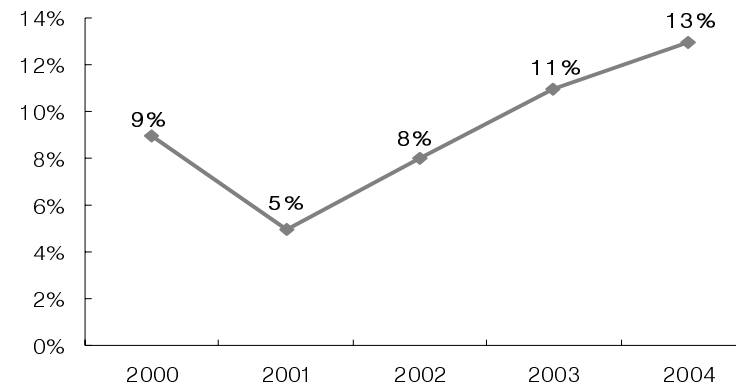
➤ Inactive M&A Market

- Negative image attached to M&As
- Unfavorable tax treatment on equity swap
- Ceiling on conglomerate's total shareholdings discourages business groups from acquiring venture companies

KOSDAQ M&A



Venture capital exit through M&A



II. VENTURE CAPITAL INDUSTRY : Exits

KOSDAQ Market in Korea

	1997	1998	1999	2000	2001	2002	2003	2004	2005.4
Number of Listed Companies*	359	331	453	604	721	843	879	890	880
Total Market Capitalization* (KRW trillion)	7.1	7.9	98.7	29.0	51.8	37.4	37.4	31.1	37.1
Number of IPOs	83	8	164	231	177	157	71	52	16
Number of IPOs of Venture Companies	NA	NA	65	117	137	108	59	37	11
Number of IPOs of VC-backed Companies	NA	NA	NA	NA	NA	59	36	26	11

* As of each year-end

Source : Korean Stock Dealers Association

III. Private Equity in Korea



III. Private Equity in Korea

❑ Private Equity Investment Vehicles

- Venture Capital Funds
- Vulture Funds
- Buyout Funds (PEFs) introduced in 2004

❑ Purpose of PEF legislation

- Revitalizing corporate buyout market
- Mobilizing domestic investment capital

❑ The aggregate size of PEF is \$20 billion in 2005 (until Sep.)

❑ Problems Associated with PEF Activities

- Lack of targeted firms
- Lack of experts (M&As, valuation, industry analysis, restructuring)
- Being over-regulated
- Being urged to show short-term results



III. Private Equity in Korea

PEFs in Korea

PEF Name	Fund Size (Million \$)	General Partner	Process
MAPS 1 PEF	140	MAPS Investment Management	Contracting MOU to acquire Shinwoo
Woori 1	210	Woori Bank	Being Liquidated
Devonshire	30	Devonshire Korea	Investment Failure
MARS 1	49	Woori Investment and Securities	LP: Korean Corporations
Consus 1	390	Consus Asset Management	LP: 2 Pension Funds, 1 Financial Company
KDB 1	300	Korea Development Bank	Investing 100 billion Wons to acquire Jinro
Kiuo Bank-KTB	120	Industrial Bank of Korea/ KTBnetwork	LP: 2 Pension Funds, 4 Financial Companies
Vogo	501	Vogo Investment	LP: 12 Financial Companies, 1 Corporation
Shinhan PEF	300	Shinhan Private Equity	LP: National Pension Fund
MBK Partners PEF	300	MBK Partners	LP: Foreign Corporation
Macquarie Korea Opportunities PEF	25	Macquarie Korea Opportunities Management	LP: Foreign Corporation
H&Q PEF	385	H&Q AP Korea	LP: National Pension Fund

IV. New Measures to Promote Venture Capital



IV. New Measures to Promote Venture Capital

Nurture and strengthen venture capital

□ Weaknesses in the structure of VC fund

- Severe dependence on Government
 - The scale of funds from Institutional investors (including Pension and financial institutions) is very low
 - In case of US, investments from pension funds are over 40

□ Steady and secure resource of venture capital fund

- Expansion of Fund-of Funds investing in Venture Capitals

IV. New Measures to Promote Venture Capital

□ Few investments in early-stage venture companies

- The short duration of venture capital companies (5 years)
 - For successful exits, VCs focus on firms with the age of 5 years or under

□ Encouraging VCs to invest in early-stage firms

- The financing proportion of Fund-of Funds for the early-stage firms is raised from 30% to over 40%, depending on management outcome
- Policy funds (including KDB loans)-VCs joint fund investing in start-ups
- Expand the duration of VCs from 5 years to 7-10 years

IV. New Measure to Promote Venture Capital

Enhance management efficiency, transparency, and reliability

❑ Encourage staged financing to venture companies

- Financing rounds are related to significant stages in the development process and at every stage, new information about the company is released (Sahlman, 1990).

❑ Reform corporate governance of venture firms

- Venture capital may require its appointee to sit on the board of a venture company

IV. New Measure to Promote Venture Capital

Promote M&As as an alternative means of exit

❑ Market exit opportunities are limited

- About 92% of venture capital exit is through IPOs on Kosdaq market, which has recently come out of slump

❑ Revitalize KOSDAQ

- Only 4% of venture companies(385 among 8776, total number of venture companies in 2004) are presently listed on Kosdaq
- Ease limits on price fluctuation
- More tax benefits to listed companies
- Alleviate tax burden on venture M&As (tax on unrealized capital gains)

IV. New Measure to Promote Venture Capital

□ Promote the Free Board

- Switch the trading system to “competitive bidding” to enhance liquidity and reliability
- Allow tax exemption on capital gains for Free Board stocks
- Encourage institutional investors to invest in venture funds and/or venture companies

□ Promote Venture M&As

- Ease the legal procedure for M&As of venture companies
- Amend the appraisal right provision (the put option is at times overpriced)
- Eliminate tax penalties on merging venture companies

The End of Presentation

