Korea fund of funds

South Korea
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- Employment
- Financial services and markets

Project Summary

Elevator Pitch

Concise Summary: Help us pitch this solution! Provide an explanation within 3-4 short sentences.

Supporting local Venture businesses and venture capital industry by providing stable capital sources and establishing venture-ecosystem.

Solution: What is the proposed solution? Please be specific!

Korea fund of funds is a unique solution for supporting SMEs because of its role and function in the local VB and VC industries. Experiencing financial crisis and IT bubble bursts in early 2000s, Korean government had to find an efficient solution to support local SMEs that will achieve balanced economic development and create more sustainable jobs. In order to do so, the government decided to integrate all the existing SME supporting systems in the nation to a vehicle, the Korea Fund of Funds focusing on the investment into SMEs. Korea Fund of Funds was incorporated in 2005 with the goal to bring public and financial benefits through investments in venture capital funds (hereafter “the VC funds”) that support SMEs in various aspects. As the first and only government backed fund of funds, Korea Fund of Funds consists of 5 different government related funds especially focusing on SMEs, cultural contents industries and IP/Patents. These funds aim to support the SMEs in related industries by investing in venture capital funds. With the capital from Korea Fund of Funds, VC funds invite more capitals from private sectors to format the funds. This is the very reason why Korea Fund of Funds is unique; government capital creates synergy with private capital to be invested in SMEs rather than providing loans or guarantees. The role of Korea Fund of Funds has become the most efficient vehicle to support those enterprises by selecting the best fund managers for the fund.

Impact: How does it Work

Example: Walk us through a specific example(s) of how this solution makes a difference; include its primary activities.

As the government backed fund of funds manager, KVIC has two objectives for the fund management. Balancing the financial returns and social benefits are those two. In order to create social benefits, KVIC designs several special purposed funds, such as Job creation funds, Regional development funds and Start-ups focused funds. Currently at the end of June 2010, 2 Job creation funds with total size of KRW 53,400 Mil. (approx. USD 45.3 Mil.) are active in the market and Korean government presumes KRW 100 Mil. (approx. USD 0.08 Mil.) creates 2 new jobs in the industry. Besides Job creation funds, 13 regional funds with total size of KRW 133,000 Mil. (approx. USD 112.7 Mil.) are supporting the development of non-capital regions in Korea, and 25 of Start-up focused funds with KRW 313,300 Mil. (approx. USD 280.7 Mil.) are incubating less than 3 years old companies. These special purpose funds help to balance the development of not only the industries but also various regions in the nation. Moreover, investing into small and medium sized companies has high possibilities to increase job capacities and incubating young companies are the key role of the Korea Fund of Funds. These efforts create a healthy venture ecosystem in the country and also lead the development of local VC industry itself by generating good returns from managing those funds.

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The information you provide here will be used to fill in any parts of your profile that have been left blank, such as interests, organization information, and website. No contact information will be made public. Please uncheck here if you do not want this to happen.

Your solution

Country your work focuses on

If multiple countries, please list them here. If your solution targets an entire region, please select it below

Region(s) your solution focuses on:

Range of turnover in your target firms, in USD
$11-20 Million.

Average turnover in USD of your target firm
150mil.

Number of employees in your target firms
50-74.

Average number of employees of your target firm
65

Specify the size, average and range of expected loans or investments in each target firm

Average investment size of Korea fund of funds is USD 7 million, and USD 1 Million is average investment size of each target firms.

What stage is your solution in?

Operating for 1-5 years

Innovation

How does your proposed innovation leverage public intervention in catalyzing private SME finance?

In general VC funds consist of several investors referred to as the limited partners (hereafter "LP") and one fund manager as the general partner (hereafter "GP"). Korea Fund of Funds invests in VC funds only as the anchor investor, which means that the GP needs to invite other LPs to format the funds. In general, VC funds have lifetime of seven or more years with higher risk and returns than other alternative investment vehicles. Also, during the lifetime of investments, LPs normally do not have full access into the fund. The uncertainty on the management and the returns, and long investment period are the traits of VC fund investments, and these are the key issues that make most of private investors stand away from the VC fund investment.

In order to relieve the concerns of private investors and invite them to VC funds, the government incorporated a special firm, Korea Venture Investment Corp., (hereafter ‘KVIC”) in 2005 to manage Korea Fund of Funds. As the government backed fund of funds manager, KVIC has established transparent fund management and investment process by providing stable capital source. With systemized and transparent monitoring process, the returns and management of local VC funds has grown at a healthy pace, and eventually more financial and strategic investors including foreign investors have joined the local VC funds.

What are the effects that Korea Fund of Funds brings to the market?

Firstly, Korea Fund of Funds backed VC funds have certification effect in the market that their performance and transparent management system is guaranteed by the government agency.

Secondly, KVIC invests in special purpose funds such as funds targeting special components. In this case, private companies seeking new profits will consider investing into the fund since it means that government wants to support the industry and the VC funds’ transparent management system may provide more access to the small to medium sized enterprises. In fact, many companies in the growth stage invest into the local VC funds and acquire business opportunities along with financial returns.
As well as the certification effect and signaling effect, leverage effect is another key impact that Korea Fund of Funds gives to the market. By the end of June 2010, 145 VC funds have been established with Korea Fund of Funds and its commitment among the total funds is around 28.8%. This explains other 70% of the fund capital is coming from the private side.

What barriers does your proposed solution address?

Asymmetry of information, Unavailability of financial products tailored to SME needs, General barriers to SME development related to investment climate.

If you checked any of these barriers, describe how your solution addresses them

Unlike listed enterprises, venture businesses are not required to disclose their managerial/financial status and without understanding the core technologies, it is difficult to assess their values. As well, since their information is not listed for the public to research, it is hard for private investors to seek companies with special technologies. However, through an investment vehicle called venture investment funds, venture capitalists search an enterprise, assess its technology and value its worth through their own network.

After investment, by taking part in managerial and financial process of the business, VCs help its transparent and healthy growth. This system of virtuous cycle has become possible since Korea Fund of Funds started actively raising venture investment funds. KVIC, as the manager of Korea Fund of Funds, has enabled private investors to participate in venture investment funds by guiding them with firm fund management system and improving investment transparency.

As well, venture investment fund supports entrepreneurs to focus on technology development and management since it takes the form of equity investment, thus not having to secure collaterals, unlike bank loans or guarantees. This benefits both investors and investees; investors receive their returns in the amount of shares they invested when the investee ‘makes it’. This is different from ordinary financing, which makes the investee return interests on top of the amount of collateral. Besides, a relatively small amount of investment into a seed-stage business, but with a promising technology, can bring a large share of returns; venture investment brings better expectation than loans or guarantees with principal and interests only.

Finally, Korea Fund of Funds forms a portfolio that enables investment in various growth stages from early stage to M&A funds. This makes balanced and continuous economic development by taking investment environments into account and preventing collapsing of industries by business fluctuations.

Impact

Provide empirical evidence of your proposed solution’s success/impact at present. If your project is in the idea phase, please provide evidence that speaks to its potential impact

In late July 2010, the number of KVIC-backed funds was 150 with accumulated investment amount of KRW4trillion. Korea Fund of Funds has invested KRW1.3trillion with a leverage effect of 3.6. As well, out of newly raised KRW4.3trillion from 2007 to July 2010, the size of KVIC-backed funds is KRW2.9trillion, which is 68% of total fund amounts; it could be confidently concluded that Korea Fund of Funds is playing a crucial role as an anchor in the funds. These funds are used to finance venture businesses or small & medium enterprises.

According to Korea Venture Capital Association and Science and Technology Policy Institute’s “2008 Venture Capital Policy Assessment and Improvement Measures”, venture capital investment does have positive effect on the enterprise’s managerial improvement and employment increase. For example, the average revenue increased from KRW25.2billion to KRW54.6billion, showing a 132.9% increase. As well, total capital per business increased from KRW12.2billion to KRW26billion: a 137.5% increase.

There is a positive effect to employment as well. 7,239 firms in material related industry were divided into two groups, one that has received VC support (886) and the other without support (6,353). The former group showed annual average growth of 57.5%, while the latter showed 14.9%.

In conclusion, Korea Fund of Funds secures most of venture capital’s finance and this financing does create positive effects on managerial improvement and employment increase.

How many firms do you expect to reach?

For the last five years, Korea Fund of Funds has committed USD1.2 Bil into 160s VC and PE funds, and more than 1,000 SMEs have been invested from those funds. Korea Fund of Funds is expected to cover around 5,000 SMEs by the end of its lifetime.

What is the volume of private SME finance you aim to catalyze?

Unlike the loan or guarantee, Korea fund of funds catalyzes private capitals to invest in SMEs along with its investment into the VC funds. Usually, 3 times of private capital is catalyzed to invest into SMEs and this ratio shall be increased as the returns from the investments get better.

What time frame will be required to reach these targets?

Relevant law states that Korea fund of funds will last 30 years from its establishment to support SMEs and local Venture capital industry. For the last 5 years, KVIC has successfully supported over a thousand of SMEs through venture capital funds investments, and 3 times of private capital has been catalyzed. Based on the given results, we expect that KVIC and Korea fund of funds will be able to reach the targets mentioned above within 30 years.

Does your solution seek to have an impact on public policy?

Yes

What would prevent your solution from being a success?

The leverage effect of Korea Fund of Funds liquidity supply is being accelerated in the market. However, if the investment market is too small, discovery of appropriate investees would be difficult and this will cause imbalance in supply and demand of liquidity. It will be necessary to extend the investment fields from traditional IT and manufacturing to various new technologies and to enter foreign investment markets to establish more broadened market.
Sustainability

List all the funding sources that are required for the sustainability of this solution

To efficiently sustain Korea Fund of Funds, capital from private sectors is the most important component. Without matching with private funds, Korean Fund of Funds will not be able to format the VC funds. Currently, Korea Fund of Funds consists of 5 different capital sources from relevant entities, and these capitals have been the seed money to be invested in VC funds. During its lifetime, the Korea Fund of Funds will act as the stable capital sources for VC funds and its size is expected to keep increasing, and pension funds, corporate and foreign investors are the key funding sources to achieve the successful sustainability of Korea fund of funds.

Demonstrate how your proposed solution has the capacity to graduate from dependence on public finance. What is the time frame?

Currently, Korea Fund of Funds is being sponsored by government bodies such as Small & Medium Business Corporation, Korean Intellectual Property Office and Ministry of Culture, Sports and Tourism.

For more secure finance, it is making hard efforts to anchor more various financial sources. It is especially necessary for private investors to broaden their roles; gradually involving pension funds, corporations and foreign investors in fund of funds will increase venture funds pools. This will result in venture capital cycle being controlled by the private market with public finance only acting its role to benefit public and achieve policies.

Their participation as strategic and financial investors in funds of funds will completely depend on Korea Fund of Funds’ management performance, transparency and reputation. It is the year 2011 when the Korea Fund of Funds’ investment period expires and its performance is assessed objectively and in the next three to five years, inflow of private capital will be accelerated.

Demonstrate how your proposed solution will survive a potential loss of its largest private funding source

One way of resolving the absence of private funding in venture funds is;

Stage 1: Inducing additional financing from government-affiliated institutions, which is currently limited to government related funds only.

Stage 2: As well, it will be necessary to broaden the scope of investors to major pension funds, endowments, corporations, and strategic investors such as successful venture firms and SMEs.

Stage 3: Attracting foreign financial institutions and global conglomerates to be strategic investors should increase the variety of investors in venture funds.

Stage 4: After these steps, sharing accumulated industry knowledge with underdeveloped countries could be another way of securing more finance.

As you can see, these suggestions to broaden the scope of investors will enable quick response and resolution in case of the absence of private investors.

Please tell us what kind of partnerships, if any, could be critical to the greater success and sustainability of your innovation

It is necessary to enhance Korea Fund of Funds’ status by building strategic relationships with KVIC and its investors such as pension funds, private corporations, wealthy individuals and foreign investors. As well, creating partnerships with foreign investment institutions through active participations in events such as forums and conventions is also important.

The co-advancement of venture businesses, venture capitals, and their investors will be maximized if an interactive cooperation system between research institutions, academic society, advisory institutions, political financial institutions and both national and foreign corporations.

Are there non-financial issues that could threaten the sustainability of your proposed solution?

Currently, the only vehicle for collecting returns in Korean venture capital market is going on IPO on KOSDAQ; its market condition is critical in venture ecosystem’s virtuous cycle. Therefore, it is necessary to constantly vitalize the KOSDAQ market and develop and implement other collecting methods.

To increase participations of private investors such as pension funds, corporations, wealthy individuals and foreign investors, it is important to flip the negative perception of the venture capital market and develop its communicating ability by

a. emphasizing that VCs are profitable, safe, professional partners of small and medium businesses that will work together with them from discovery to incubation and managerial support,

b. changing VCs’ image of being a group risk-averse investors, and

c. growing global communication skills to increase foreign investors’ attention and participation on domestic market.

Please tell us if your proposed solution aims to scale up through a high growth sector, expand immediately to multiple sectors, and/or scale up geographically

Initially, Korea Fund of Funds was designed to support local high-tech oriented start-ups only, but it has diversified the investment scope from start-up focused funds to Mid-sized M&A funds and cross border investment funds to meet the market needs following the growth of venture industries in Korea.

Not only the asset classes and the regions have diversified, but also the investment target industries have been broadened. The high growth sectors such as ICT, life-science, clean-tech industries have become one of the main investment targets of the VC funds, and IT convergence sector is also the hot topic for the fund investments.

Technology developments and market changes require different investment strategies. Even though it had started with specific purposes to support local high-tech SMEs, Korea Fund of Funds has adjusted its investment strategies to answer the market needs.

Achievements of such new approach of Korea fund of funds management can be easily concluded. With the help of Korea Fund of Funds, Korean high-tech industries have been able to develop at a balanced healthy growth pace. In the early 2000s, a few of big conglomerates such as Samsung and LG were the only Korean companies in the global market, however, after a decade, there are numerous Korean players in the overseas market and they are the frontier players in the related sectors. This was possible because of timely basis technology developments and
continuous R&D investments.

For instance, semiconductor companies have reformed themselves to solar cell, display related tech firms. Materials and components manufacturers have become the advanced material providers. These are the results of active R&D investments and searches for new growth engines, and Korea Fund of Funds has provided stable capital sources to these venture firms through VC fund investments.

The investment target regions have also been broadened. Korea Fund of Funds backed VC funds are now seeking more opportunities outside of Korea. Cross-border M&A funds, overseas market expansion funds, China funds, and other VC funds targeting overseas markets are being established in the market with the support of Korea Fund of Funds.

Venture investment is the work of nurturing hidden champions. Unlike other solutions, Korea Fund of Funds supports technology oriented SMEs and according to the developments of technologies, Korea Fund of Funds transforms its investment strategies to provide most suitable supports to the venture firms.

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