MSME Financing in Korea – Innovative ways for financing

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1. Venture Capital Investment in Korea - 2020
2. Sources of Financing for MSMEs
3. Laws and Regulations Concerning MSMEs Financing
4. Recent Regulatory Challenges to MSMEs’ Access to Credit
5. Innovative Solutions
Venture Capital Investment in Korea - 2020
Venture capital investment in Korea hit a record of $3.86 bn in 2020
Number of Venture capital investment has increased in the past 5 yrs
Investment Trends in terms of Funding Industry (Where Volume Available)
Sources of Financing for MSMEs
Fundraising Methods for a Start-Up

- Fundraising
  - Outside capital
    - Loan
  - Equity
    - Issuance of (equity related) bonds
    - Issuance of stocks
Current Trends Regarding Investment Types

- Blurring of Investment Stages
  - Early stage investors move to later stages, Series B or later investors move to earlier stages

- Strong Preference for RCPS
  - Little difference between investment conditions per investment stage

- General Stages of Investment
  - Common stock -> RCPS(CPS) -> Convertible bonds
Laws and Regulations Concerning MSMEs Funding
Act on Special Measures for the Promotion of Venture Businesses

- Ministry of SMEs and Startups
- Startups
- SME Startup Investment Association
- New Technology Venture Investment Association
- Business Incubators
- Companies specializing in new technology startups
Act on Special Measures for the Promotion of Venture Businesses

- Startup Assistance: Leave of absence, exemption for investment in industrial property rights
- Tax Benefits: Corporate, income, acquisition, property tax
- Listing Benefits: Preferential treatment in KOSDAQ registration
- Funding Benefits: Preferential treatment in evaluations of SME Care Services and Korea Technology Finance Corporation
- IPR Benefits: Preferential examination of patents and utility rights
- Aid in Strategic Alliance/Merger: Exchange of shares, short-form merger
- Recruitment Aid: Expansion of stock option subjects/limits
Foreign Investment Promotion Act

- “Foreigner”: an individual with a foreign nationality, a corporation established in accordance with a foreign law, or an international economic cooperative organization prescribed by Presidential Decree

- “Foreign Investment”: (a) holding of stocks or shares of a Korean corporation; (b) loan with maturity of not less than five years; which is provided to a foreign-capital invested company; (c) contribution to a non-profit organization

- Deregulation policy adopted in the 1990s – equal footing with local investors

- Several business areas only partially open to foreign investment, including wholesaling of meat, newspapers, energy industry, maritime and air transportation, telecommunication, and specially chartered banks. Radio and television broadcasting closed to foreign investment
Foreign Investment Promotion Act

- With respect to high-tech businesses, services supporting local industries and foreign companies located in Foreign Investment Zones
  - Corporate/income/acquisition/property tax reduction for the first seven or five years (100% reduction for the first five or three years, 50% reduction for the next two years)
  - National property rent reduction/exemption ranging from 50%, 75% to 100% depending on the investing company, investment amount and type of business

- Foreign Investment Zones

- Change of report-approval process to one-stop notification

- OIO
Act on the Promotion of Venture Investment

• Currently mooring in the standing committee of the National Assembly

• Meant to combine & reorganize current laws relating to venture funds (the Act on Special Measures for the Promotion of Venture Businesses and Support for Small and Medium Enterprise Establishment Act)
Act on the Promotion of Venture Investment

- Possibility of introducing SAFEs – “Investment via share purchase without maturity date or interest that fulfills conditions defined in relevant ordinances”

- Accredited investor verification system >> registration system

- Asset-based investment ratio obligation

- Prohibition on usage of information by VCs and accelerators (up to 5 years of imprisonment or a fine not exceeding 50,000,000 KRW)

- Possibility of establishing venture capital funds by accelerators
Recent Regulatory Challenges to MSMEs’ Access to Credit
Heavy Involvement of the Government
Heavy Involvement of the Government

<table>
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<th>Year</th>
<th>Fund of funds</th>
<th>K-Growth Fund, etc</th>
<th>KDB</th>
<th>Individuals</th>
<th>Private companies</th>
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<td>2014</td>
<td>14.3%</td>
<td>23.2%</td>
<td>6.5%</td>
<td>12.2%</td>
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<td>2015</td>
<td>13.6%</td>
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<td>22.0%</td>
<td>3.0%</td>
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<td>25.1%</td>
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<td>8.9%</td>
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<td>2018</td>
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<td>20.0%</td>
<td>2.9%</td>
<td>9.7%</td>
<td>63.6%</td>
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</table>
Korea Fund of Funds

**Investors**
- SBC
- MCST
- KIPO
- KOFCI
- MSIT
- ME
- MOE
- MOEL
- MHW
- KSPO
- MOE
- ME
- MOF
- MOLIT

**KFoF** (Korea Fund of Funds)
- Commit to KFoF

**Fund Management Company (KVIC)**
- Manage KFoF

**Investment Management Committee**
- Establish and amend KFoF management plans

**SME, Venture Companies**
- Invest

**MSS**
- Submit KFoF management plans
  - Report on KFoF performance
  - Guidelines on KFoF Management

**Partnership Funds**
- Commit
1. Difficulties in Attracting Foreign Investment

• Time spent on negotiations for investment agreement
  - Typically takes more time than domestic investment, utilized in cases when the investee has time to spare for attracting investments
  - Foreign investors are generally likely to undergo basic procedures such as accounting / legal due diligence

• Necessity of foreign investors’ understanding of Korean Commercial Act and investment structure
  - Investment agreements provided by foreign investors abide by foreign commercial laws; has to be revised extensively in compliance with Korean commercial laws
  - Necessity of promoting understanding of Korean investment practices and startup management affairs
2. Difficulties After Attracting Investment

- Performance of obligations under investment agreement
  - Cumbersome to understand procedural obligations such as consent and notification
  - Necessity of explaining regulation issues such as foreign direct investment and foreign exchange
- Difficulties in registration and other administrative procedures
- Difficulties in communicating due to time and language differences
  - Complex notification procedures necessary for receiving consent
Innovative Ways for Financing
“K-Venture”! Initiative by the Korean Government (Ministry of MSEs)
Innovative Policies and Government Support

1. Globalization

- Expanding global venture funds and overseas VC networking
- In 2021, an additional KRW 1 trillion was created in the global fund and invested in Korean startups overseas.
  - Establish and operate ‘Global Venture Investment IR
- Support accelerating K-startup centers for technical cooperation of overseas ventures and startups and establishment of joint corporations
Innovative Policies and Government Support

2. Fostering ESG Venture Companies

- Review of new climate response guarantees for climate technology companies, etc. through carbon value evaluation.

- Carbon Value Assessment: Financial support (developed in 2019) through evaluation of the amount of greenhouse gas reduction expected to occur through commercialization of climate environment technology in monetary units.
Innovative Policies and Government Support

3. Public-private cooperation

- Encourage the private sector to actively participate in venture investment by strengthening incentives for private investors in the FOF (Fund-of-Funds).

- Expanding ‘preferential loss compensation’ incentives to all fields of parent funds
  - Transferring up to 30% of excess profits from parent funds.
  - Granting call options to purchase equity shares in parent funds, etc.

- When a venture fund invests in a venture fund, it is counted as one person (revision of the Enforcement Decree of the Venture Investment Act
  - Deregulation of fund investors

1. Monetary Policy
   - The Bank of Korea purchases of local bonds, to help prevent a possible liquidity crunch, including bonds issued by public enterprises.
   - The Bank of Korea lowers benchmark interest rate to 0.75%.
   - Korea lowers interest rates applied to its loan facility for MSMEs smaller companies, and add bonds issued by banks to its open market operations to enhance liquidity.

2. Digital New Deal
   - Fostering the ‘Untact’ Industry – 2.5 trillion won to be invested by 2025.
   - Digitalization of Social Overhead Capital (SOC) – 15.8 trillion won to be invested by 2025.
Government’s Response to COVID-19

1. Financial Support directed at SMEs worth EUR 2.1 billion. Ministry of SMEs and Start-ups provides support worth EUR 1.2 billion as supplementary budget, including the following measures:
   - An Emergency Fund, providing direct financial support to SMEs and self-employed, aimed at encouraging these firms to keep their employees;
   - Government guarantees, and insurance on loans.
   - Sanitary support for the reopening of SMEs that closed due to exposure to infected patients;
   - Encouraging brick-and-mortar shops to open their business online.
   - Simplification of procurement processes by limiting on-site inspections.

2. Priority is given to regions that were affected the most.
   - Government to provide further USD 39 billion for emergency financing for MSMEs
   - Government to provide loan guarantees for MSMEs less than USD 78,000 in annual revenue to ensure access to credit.
   - Domestic commercial banks and savings banks also allow loans to be rolled over for MSMEs.
New Ways for Financing

1. Impact Fund
2. Crowd Funding for maker MSEs
3. Local Assetization