

UNESCAP

Financing for SMEs: Korea's Experience

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Public Support in SME Financing

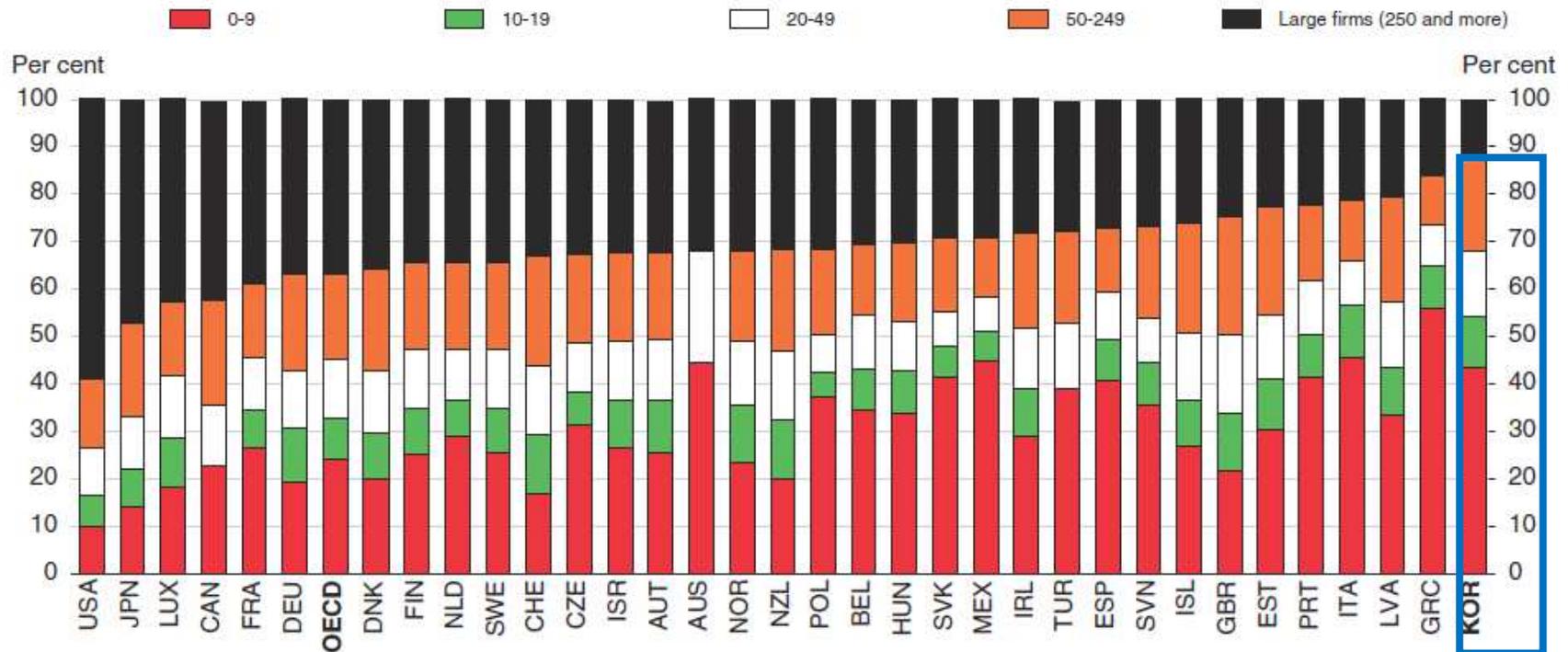


- I. Overview of
SME Financing Programs
- II. Evaluation of Pros and Cons
- III. Remarks

SMEs in Korean Economy (1)

◆ The share of employment in SMEs in Korea is the highest in the OECD

The share of workers employed across different sized firms



88%

Note: Percentage of all persons, total business economy, 2015 or latest available year

Source: OECD Structural and Demographic Business Statistics

SMEs in Korean Economy (2)

◆ SMEs had the largest proportion of sales with the lowest profitability & productivity

A comparison of large firms, mid-sized firms and SMEs

A. Percentage of total in 2014			
	Large enterprises	Mid-size firms ¹	SMEs
Enterprises	0.05	0.12	99.8
Employees	13.5	9.7	76.8
Sales	40.2	14.8	45.0
Exports	67.0	15.7	17.1
B. Percentage growth in 2013			
Sales	0.3	5.8	5.6
Assets	7.9	8.3	3.6
C. Ratios in 2013			
Operating profits margins ²	4.7	4.1	3.2
Debt-equity ratio	133.5	120.2	168.3
Labour productivity ³	100.0	56.2	28.8

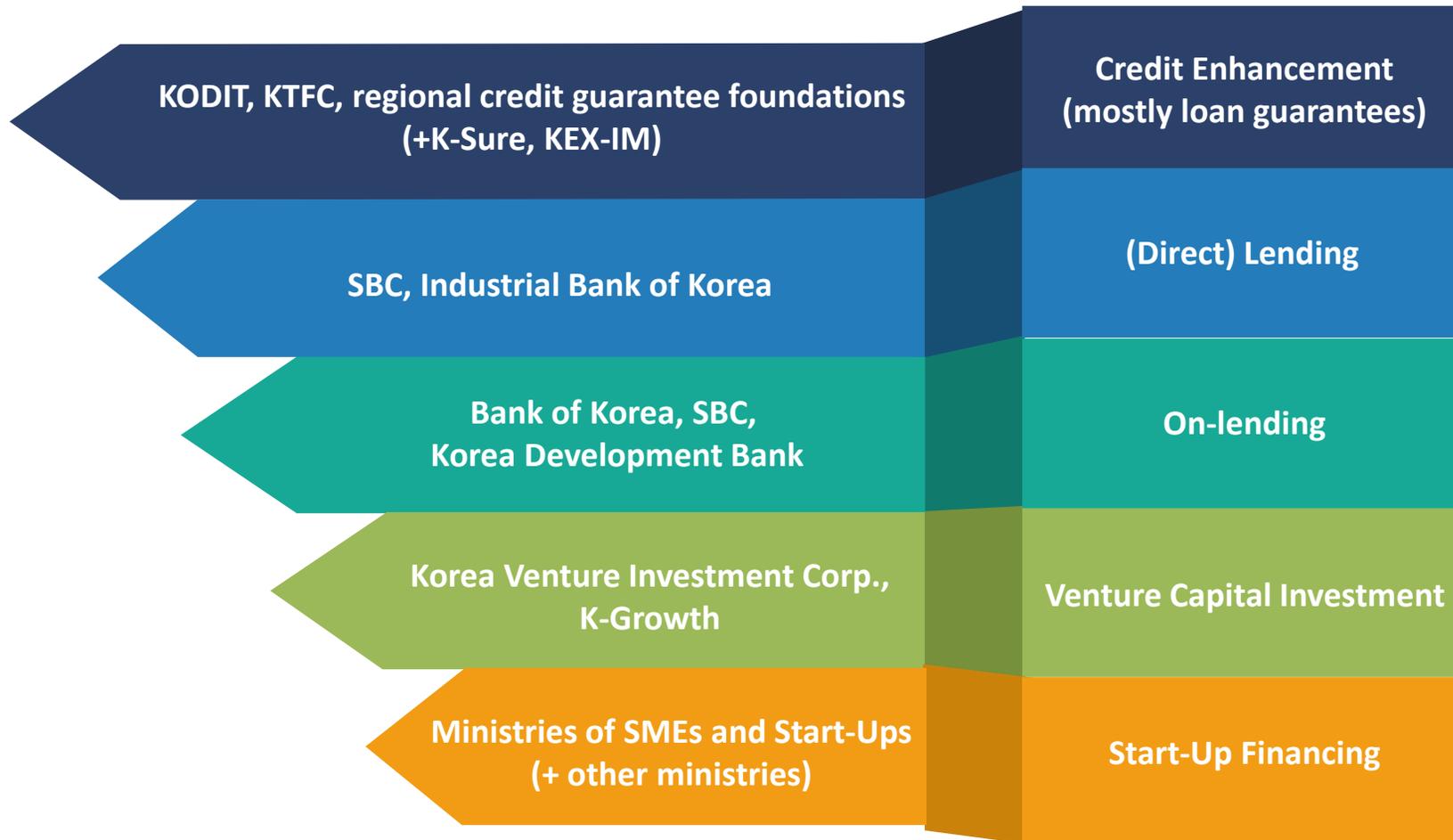
Note: 1. Often referred to as high potential enterprises.

2. As a percentage of sales. 3. Labor productivity as per cent of that in large companies.

Source: Statistics Korea

Public SME Financing Support Programs

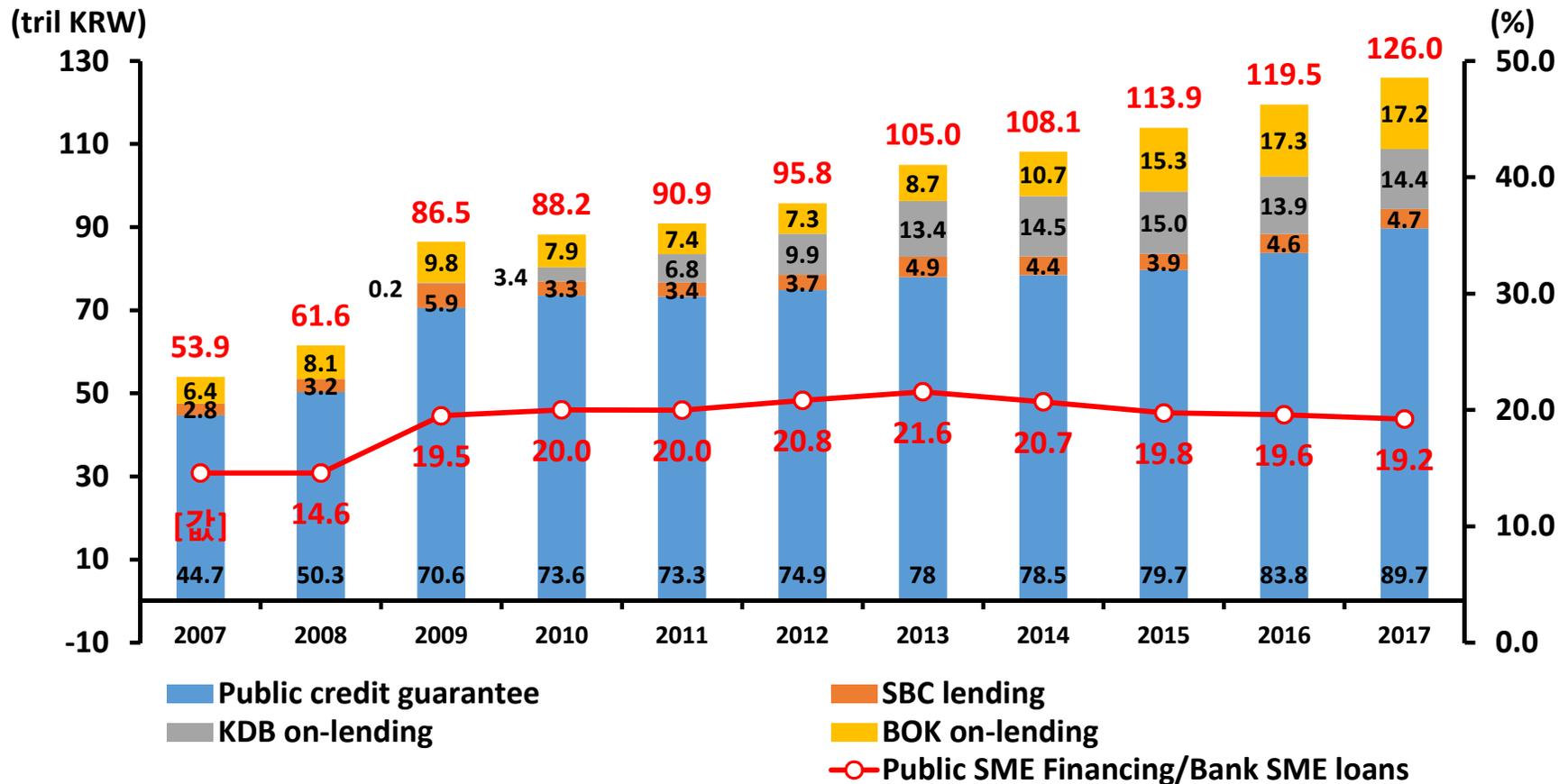
◆ Various programs conducted by different institutions



Increasing Public Support in SME Lending

- ◆ Main SME programs amounting to more than 126 tn KRW (112 bn USD)
- ◆ Portion of publicly supported bank SME loans hovering around 20%

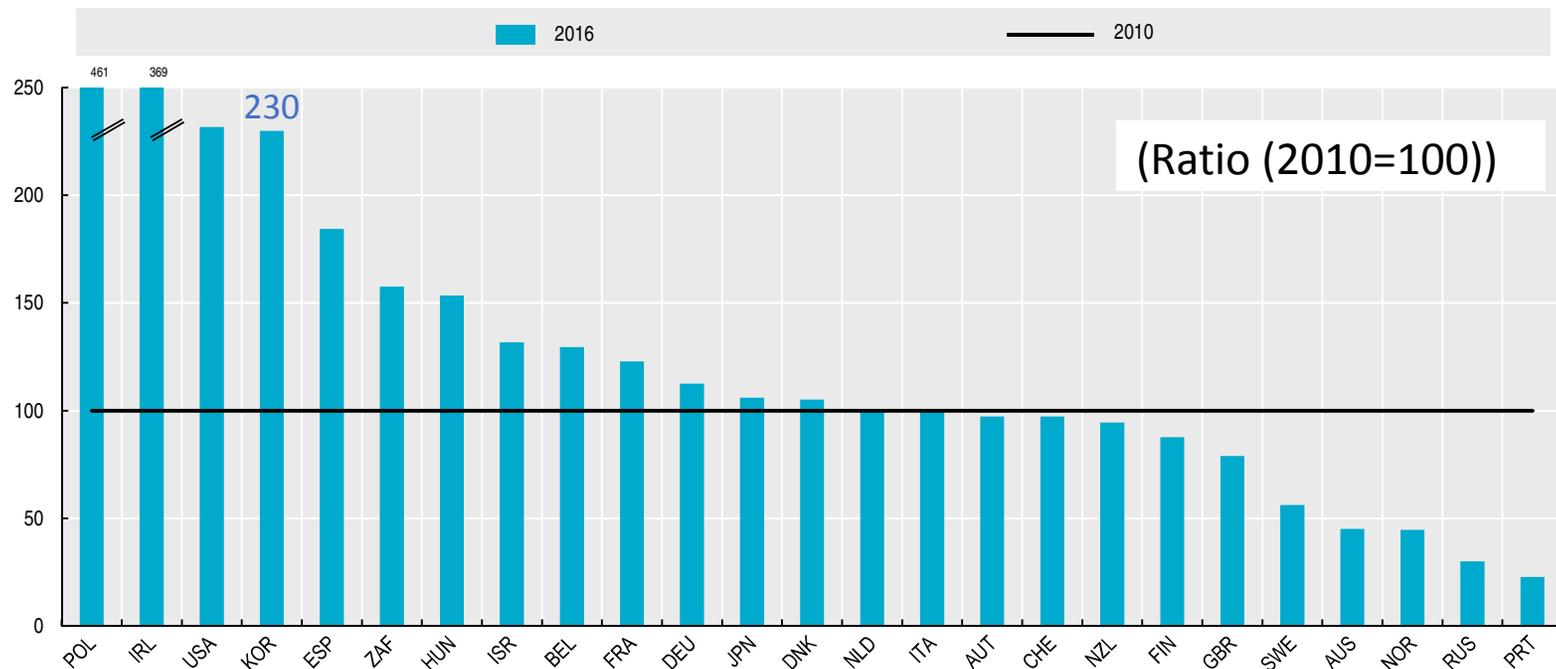
Ratio of Public Support in SME Financing and SME Bank Loans



Larger VC Investment Owing to Public Support (1)

- ◆ One of the few countries with much larger VC investments in 2016 than in 2010
- ◆ Over 30% of VC investments are supported by the public programs (K-VIC & KDB)

Change in Venture Capital Investments



Note: Israel (ISR) in 2014

Source: OECD

Larger VC Investment Owing to Public Support (2)



◆ The public-sector's share of venture capital investment is falling but still high

The public-sector's share of venture capital investment

(Bill KRW, %)

	2012	2013	2014	2015	2016	June 2016	June 2017
Public-sector investors ¹	429.3	822.3	1 050.4	1 114.7	1 207.5	615.5	468.6
Share (%)	47.1	49.3	40.1	42.3	36.0	35.1	33.1
Private investors	481.4	845.8	1 569.1	1 519.9	2 144.0	1 137.5	947.7
Total	910.7	1 668.1	2 619.5	2 634.6	3 351.5	1 753.0	1 416.3

1. The public sector includes central government ministries, local governments, the Korea Development Bank, growth ladder funds and public funds, including the National Pension Fund.

Source: Ministry of SMEs and Start-ups (2017d).

Public Support in SME Financing

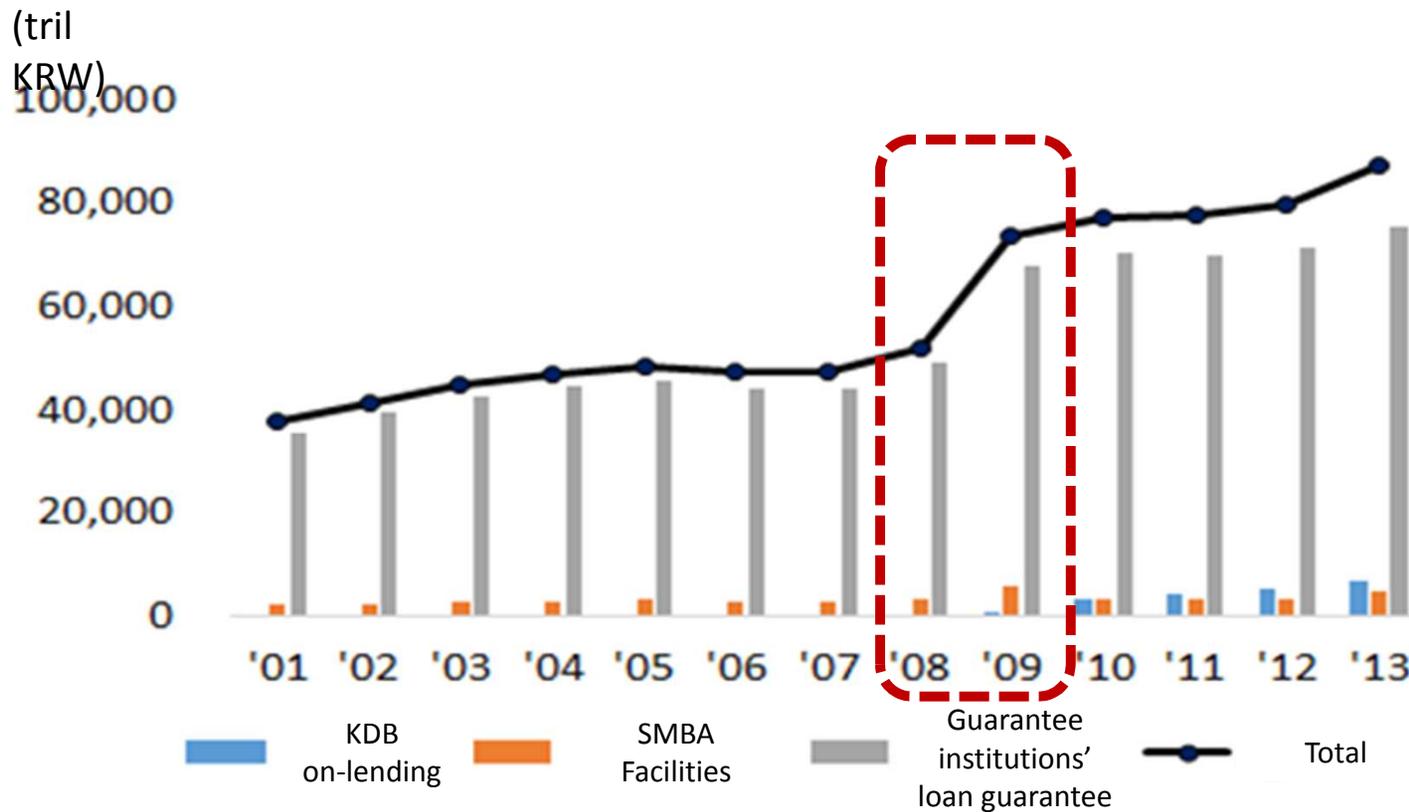


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Public Support Can Smooth the Credit Cycle of SMEs

- ◆ Public support in SME financing had been expanded in response to '98 and '08 crises
- ◆ Alleviating financing gap worsened by credit contraction and bank deleveraging

Size of Public Financing Programs

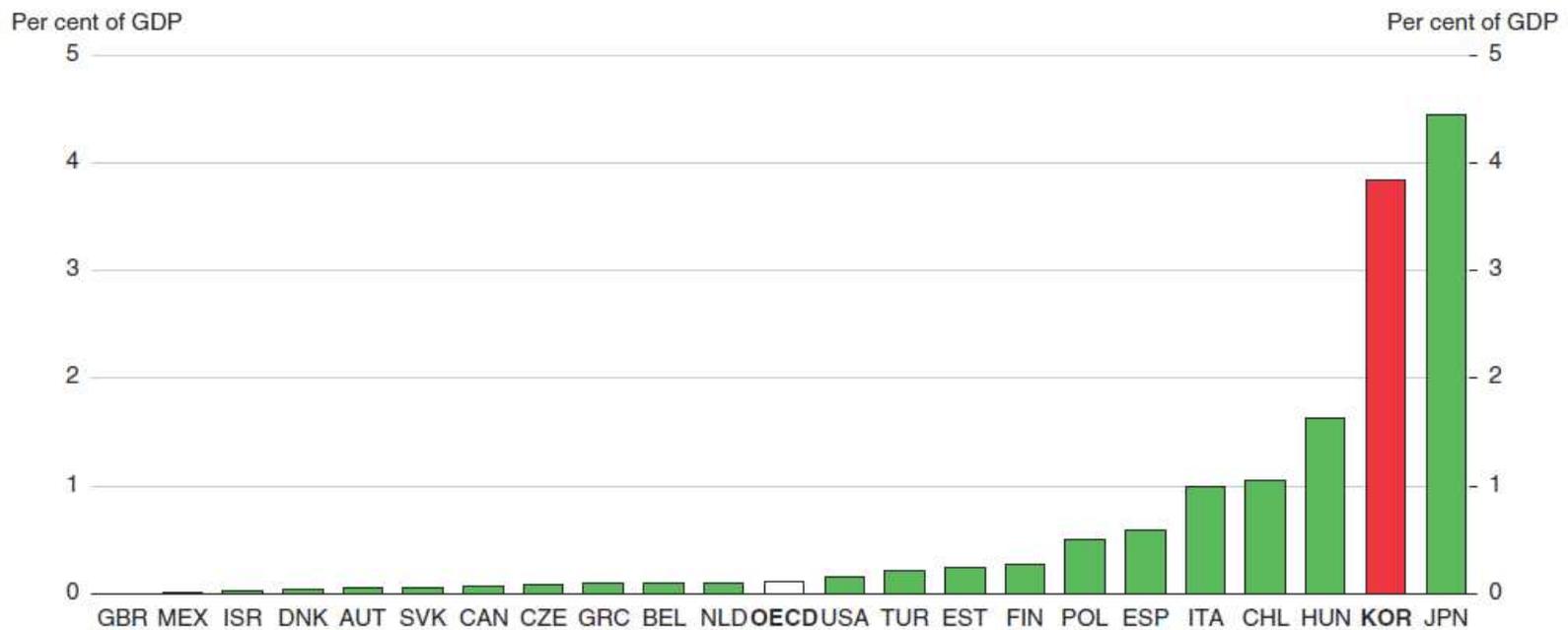


Note: USD/KRW exchange rate is around 1,087

Public Support Can Help to Close SME Funding Gap

- ◆ Active individual and small business sector backed by public support
- ◆ Public facilities contributing to vibrant manufacturing sector

Size of Public Credit Guarantee Schemes over GDP (2016)



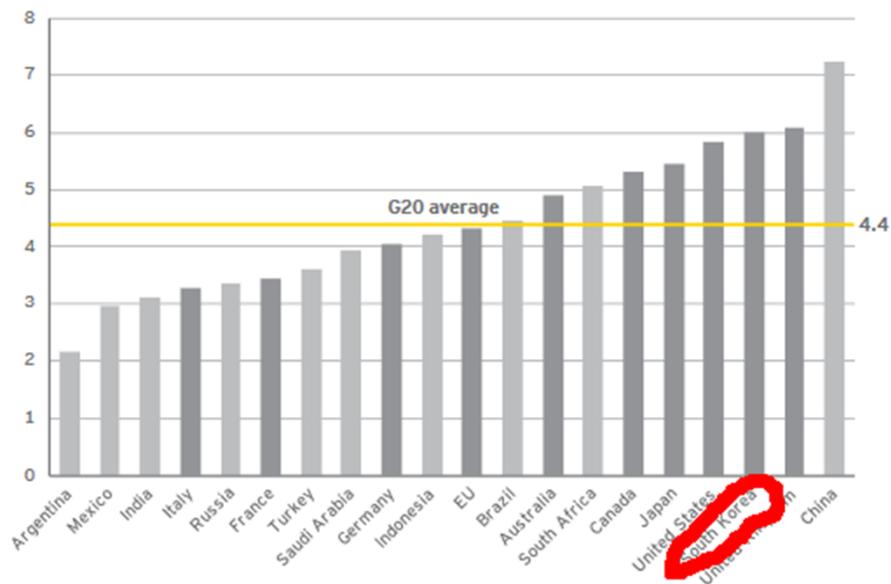
Source: OECD (2018).

Challenge: Supporting Early Stage SMEs



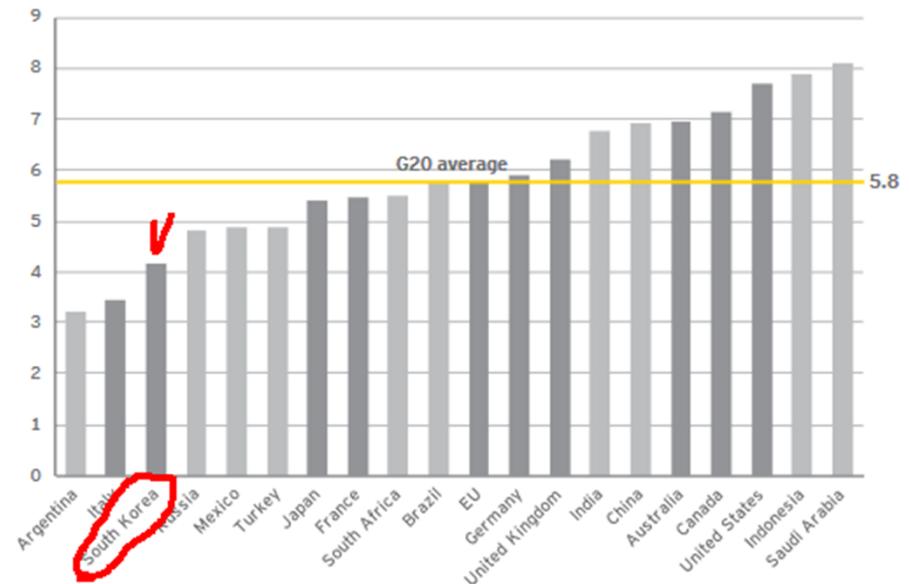
- Start-ups and early stage SMEs still experience financing gap
- How to make public programs focus on the SMEs in financing gap but with growth potential

Accessibility to Expansion Capital



One of the best market for expansion capital

Accessibility to Start-up Capital



Yet, one of the worst market for start-up capital

Note: The higher the score, the better the accessibility
Source: Ernst & Young (2013)

Upside of the Coin: Contribution of Public Programs

Contribution to the industries development

- Industries relying on the complex networks of vendor or supplier (e.g. automobile, shipbuilding, steel, etc.) have a lot of help

Good financing condition

- Financing condition of Korean SMEs is regarded as superior to most other markets
 - Korean SMEs are hardly credit rationed(Lee and Lim (2017)): the portion of loans with the credit rationing probability larger than 80% is estimated to be consistently less than 0.4%
 - The average spread of lending rate of SMEs over large firms has fallen: from 0.74%p in 2007 to 0.34%p in 2017

Effectiveness

- Few public programs are loss-making on the surface

Flip Side of the Coin: Side-effects of Public Support (1)

Oversupply of public support

- Public financial institutions compete with each other by trying
 - To copy-cat other's programs
 - To add more programs and to provide more financing every year
 - At the same time, to minimize the loss

Coordination & performance evaluation

- They end up providing financing to (legally categorized) SMEs with low default risks, which are not the main target of public support in the first place
- Public support needs to focus on the high-risk/high-growth potential younger/smaller firms that find it difficult to finance in the private market
- As the programs are getting larger and larger, the marginal effectiveness of the programs is said to be declining
 - => receiving overlapping supports for longer periods (even some unprofitable 'zombie' SMEs)
- Yet it is hard to contain this expansion, because
 - there is no single control tower to check the growth and effectiveness of public institutions' programs and
 - the programs are being run in a way that makes quite difficult for researchers to evaluate the effectiveness ex-post.

Flip Side of the Coin: Side-effects of Public Support (2)

Crowding out private sector

- (Private) markets of SME financing are getting every more reliant on public supports, esp. because public financing programs are provided at a much lower cost than private market
- Since public institutions themselves mostly decides which firms to support, private financial institutions have little incentive to strengthen their firm evaluation capacities

Dilemma

- Now, a trade-off between the marginal increase of public supporting programs and the marginal increase of enterprise value (and/or credit risk) evaluation capacity of private institutions occurs

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Now Going Forward

Mandates and Program Design

- ✓ Clear mandates/goals
 - enabling rigorous & quantitative evaluation*
 - promoting effective competition within SMEs*
- ✓ Incentive-aligned design
 - recipients/inst./government's agent problem*
 - risk-sharing with private sector*

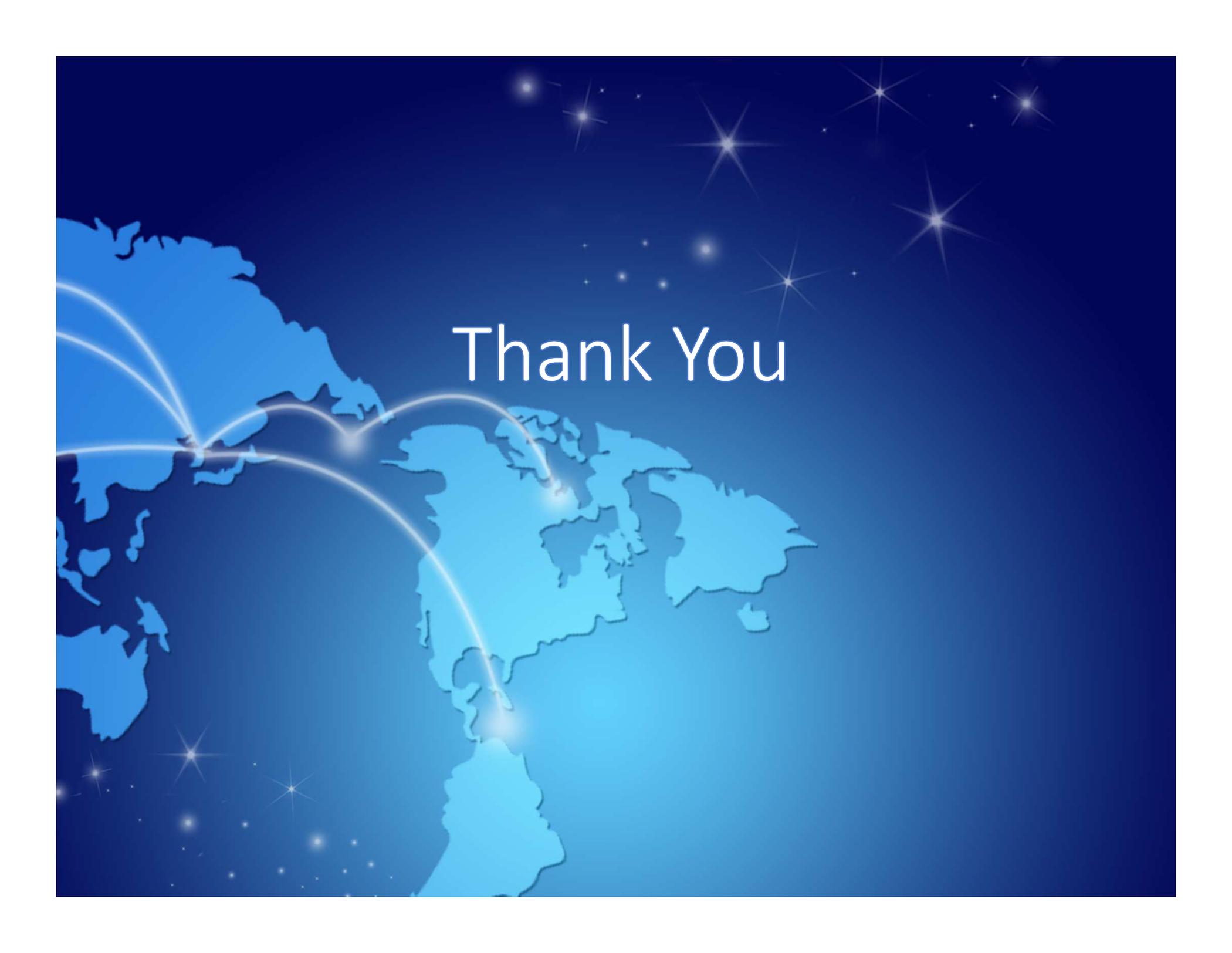
Note: After the revision of SME Act in 2015, SMEs in most manufacturing sectors can have annual sales of about 130 mil USD and still be categorized as an SME. (In most countries, an SME needs to have fewer than 250 employees and 1~5 million annual sales)

Efficient Execution

- ✓ Setting up control tower to coordinate roles/responsibilities of public institutions
 - managing the risk concentration*
 - reducing overlapping*
 - support/SME information collected/centralized*

Performance Evaluation and Feedback

- ✓ Evidence-based approach
 - focusing on where performance is high*
- ✓ Adjusting the size of public support
 - select and concentrate*
- ✓ Meeting new demands
 - new technologies, sustainable investments, etc.*

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Thank You