

VENTURE COMPANY BOOM IN KOREA

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A Venture Company Boom in Korea

Recently there has been a boom in venture company start-ups in Korea. Establishing venture companies has been a center of public interest since the "Special Act on Promotion of Venture Companies" was passed in August 1997. The Kim Dae-Jung government has promoted venture companies by giving financial support, regarding venture companies as new sources for economic growth in the knowledge-based economy. As a result, more than 240 venture companies were established monthly in 1999, and the total number of venture companies exceeds 5,000 in 2000, which is double the figure of 1998. Consequently, the weight of venture companies in the GDP increased from 3.3% in 1998 to 4.8% in 2000. Meanwhile, public interest in new venture companies made the Kosdaq stock index rise sharply. As liquidity in the economy- which has been unable to find proper places to be invested due to massive corporate bankruptcies and low interest rates since the financial crisis of 1997- flowed into the Kosdaq stock market, the stock indexes for venture companies in the Kosdaq increased about 13 times, daily transactions volume increased about 151 times, while total market price increased about 6 times during 1998 to 1999.

Characteristics of Korean Venture Companies

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The recent boom in venture companies in Korea is being evaluated as a favorable development to the Korean economy. The "venture" company is a new type of firm that will give vitality to the Korean economy in the 21st century, the era of the knowledge-based economy. This is true especially for newly established Korean venture companies; compared with US venture companies that pursue high-risk, high-profit projects and Japanese venture companies that are established as conventional small- or medium-size companies under the encouragement of the Japanese government, Korean venture companies are usually technology-intensive. The technology-intensive venture company is regarded as one of the most suitable firm types for the knowledge-based economy, due to its flexibility in an uncertain market environment, strong incentives for technological innovation, continuous pursuit of economic efficiency, decentralization, export competitiveness, and the creation of new employment. Actually, Korean venture companies have shown excellent management performance compared to other conventional large firms and small or medium-size companies.

Table 1. Venture Company Statistics

	venture firms	general small & medium companies	large companies
Sales increase rate	71.2	-2.0	2.0
employee increase rate	25.3	-2.3(97)	8.7(97)
ordinary income to sales	4.0	0.6	-2.9
export increase rate	61.5	-1.0	-4.2
R&D to total sales	33.7	0.3	2.1

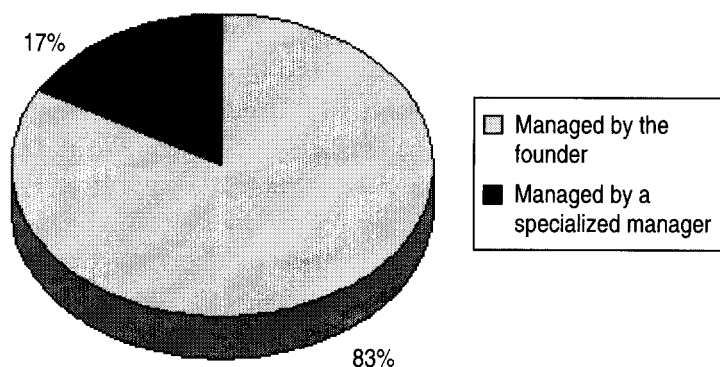
Source : Bank of Korea, National Statistical Office, Korea Federation of Small Business, Small and Medium Business Administration

Problems in the Management of Korean Venture Companies

However, Korean venture companies face some limitations in fully achieving their goals due to problems in their management. First, out of Korean venture companies, only 34% are classified as hi-technology type, which have the highest growth potential. This is because of the government's unclear standards and selection procedure for the financial support of venture companies. Second, in 83% of venture companies, the business owner, instead of an external specialized manager, manages the company personally. In such a personal management system, the synergy effect among technicians, capitalists, and managers- which is one of the merits of venture companies- can not be expected. Specifically, in venture companies, which tend to be established by technicians, company growth can be limited by the founder's limited management ability.

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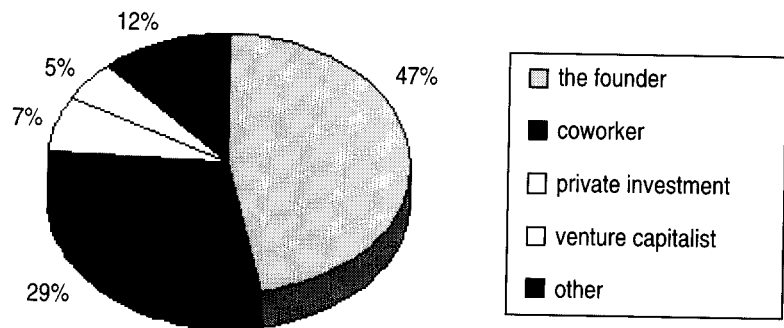
This is the case in many Korean venture companies, because the investor tends to get most of the profit made by a company, while managerial power tends to be concentrated in the firm owner or founder in the Korean-style firm. In that respect,

Figure 1. Management Forms of Venture Firms

Source: Small and Medium Business Administration, Research on the Actual Condition of Venture Firms, 1999. 11.

venture companies in the Silicon Valley, USA, which are operated effectively by a network of technicians (mostly from Stanford University), venture capitalists, and managers, can be good examples for Korean venture companies to follow. Consequently, most of the venture capital in Korean venture firms is supplied by the firm founders, while cases of inflow from outside venture capitalists such “angels” or venture capital investment corporations are still rare. This kind of financing structure creates many serious problems in constructing a base for long-term management and growth due to the restricted conditions for return of financing capital.

Figure 2. Financing Structure of Venture Firms



Source: ibid.

In addition, as most Korean venture companies lack effective incentive systems, there is the possibility that venture companies cannot absorb skilled workers effectively, and that workers may not be motivated to be creative. Also, since the target market of Korean venture companies is the domestic market, it is difficult for Korean venture companies to make technological innovations by adopting up-to-date foreign technologies.

The Future of Korean Venture Companies

Newly established venture companies by young Korean businessmen with new ideas and high technology must be one of the positive factors for the future of Korean economy.

Because of such problems in the management of venture companies, some economists have stated that bubbles may exist in newly established venture companies. They argue that the establishment of insolvent venture companies will result in a waste of assets. However, it will not be effective for the Korean government to coercively regulate the boom in new venture companies, since insolvent venture companies will exit by themselves through the market mechanism. As Kenichi Omae regarded the current boom of new venture companies in Japan as a positive sign for the future of Japanese economy, newly established venture companies by young Korean businessmen with new ideas and high technology must be one of the positive factors for the future of Korean economy. **VIP**