

PROSPECTS OF KOSDAQ AND THIRD STOCK MARKET

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Trading volume on the Kosdaq market is now on par with the blue-chip Korea Stock Exchange.

In 1999, the Kosdaq, Korea's tech-heavy second exchange, grew at a startling rate that was unprecedented in the world's stock markets. Monthly trading value exploded from 0.28 billion won in February 1998 to 91.5 trillion won in February 1999. Trading volume on the Kosdaq market is now on par with the blue-chip Korea Stock Exchange (KSE). This reflects the estimation that the venture industry's share of GDP is expected to record 10% this year, with the sector's total sales projected to grow to 50 trillion won. Another development in the Korean securities market is the planned opening of a third stock market on March 27. This market is for companies not listed on the KSE and not registered on the over-the-counter Kosdaq market.

Introduction of Third Market

The third market will probably be a circulation place for premature companies and old companies.

The third market is fairly different from the KSE and Kosdaq market in its characteristics and operation methods. Trading methods are similar to real estate trading, which is based on relative trading rather than competitive trading. Partial of one companies shares can be listed on the third market.

The third market is likely to be a stepping-stone to Kosdaq registration on one hand and a place for companies that have exited from the Kosdaq market on the other. The third market will probably be a circulation place for premature companies and old companies.

Kosdaq's Rapid Growth and Its Prospects

Recently, the value of daily trading on the high-technology and Internet-heavy

Table 1. The Difference among Three Markets

	Business Hours	Minimum Trading Unit	Price Variation Limit	Minimum Capital Requirement	Transaction Tax	Capital Gains Tax
KSE	9am-3pm	10 shares	15%	40-50% of Trading Value	0.3%	No
Kosdaq	9am-3pm	1 share	12%	40-50% of Trading Value	0.3%	No
Third Market	9am-3pm	1 share	Unlimited	100% of Trading Value	0.5%	Yes

Kosdaq has often exceeded that of the KSE. The Kosdaq's surge has positive as well as negative effects.

Table 2. The Effects of Kosdaq Surge

Positive Effects	Negative Effects
-Stimulates the economy to change and restructure	-Overheated investment
-Plentiful market liquidity	-Hinders KSE firms' restructuring due to low share prices compared to the Kosdaq
-Promotes shareholder centered management in non-Kosdaq firms	-Listed firms using their funds to keep their stock prices above certain levels
-Marks the economy's shift from manufacturing to IT and Internet related industries	

Despite continued debate about overvalued share prices, the Kosdaq market is expected to grow further. The prospects for the domestic information technology (IT) market, which is leading the Kosdaq surge, are better than for other sectors. Korea's economy is forecast to grow by 8% this year, and the software, Internet, telecom, and semiconductor sectors - the mainstays of the Kosdaq market - are expected to record double-digit growth.

Because IT and the Internet are becoming leading industries in the world economy, their associated stock prices are rising worldwide. Capital inevitably flows to where the expected profit is the highest, so it is natural that capital is attracted to the IT industry, which is the hottest growth industry. In the US, IT firms are estimated to account for more than 50% of the market. Moreover, the government will provide both direct and indirect support to nurture this "new industry".

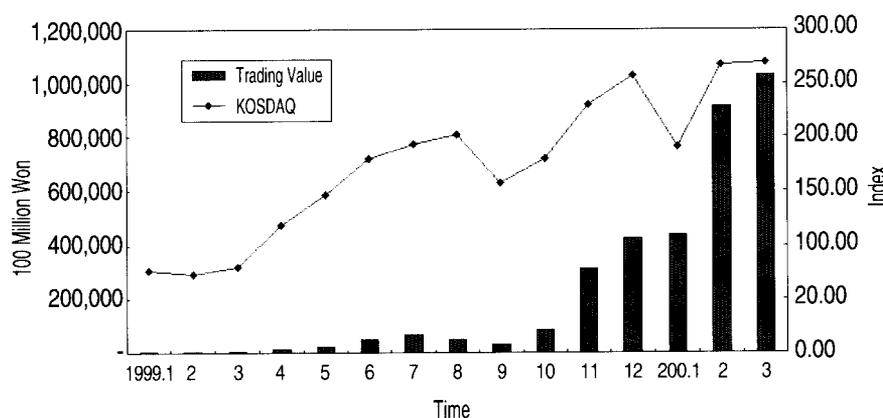
Many equity-type investment trusts can invest 20% to 30% of their assets into Kosdaq stocks. Institutional investors are expected to put a greater weighting on the Kosdaq market. However, about 5 to 6 trillion won will be supplied to the registered companies in March and April by raising capital in the Kosdaq market. And most recently, institutions, especially investment-trust companies, continued to sell heavily in the Kosdaq market on concerns over the recent fall of the Nasdaq Composite Index and their customer's redemption of funds. Therefore, the descending adjustment is likely to continue in the short term. The Kosdaq market is expected to maintain high growth in the mid- and long-term, led by knowledge based venture companies. The Korea Venture Business Association also issued an optimistic forecast recently, saying that the number of local venture firms will expand to 40,000 by 2003 and account for one third of GDP.

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Third Market's Slow Start

The opening of the third stock market has already been postponed two times. The market will finally open in March 27th. There seem to be several problems.

Figure.1 Kosdaq's Average Monthly Trading Value



*The expected trading value and Kosdaq Index in March of 2000 is calculated by the average during the period of March 2nd to 20th.

Companies to be listed on the third stock market will be selected by the Korea Securities Dealers' Association. However, details of the selection criteria were not provided. Only seven new companies have applied for listing on the third market and two of them have been accepted so far. Companies which are expected to exit from Kosdaq might be listed in the third market in mid-April.

The third market will not allow day trading and will not have daily permissible limits. It will impose a transaction tax of 0.5% and a capital gains tax of 20% on large companies, and 10% on small and medium sized companies. Investors have to pay tax as well as bear the high investment risk.

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The third market might be activated at most in late April or May and will largely depend on registration conditions in the Kosdaq. Out of 142 companies that have applied for the Kosdaq so far this year, 19 of them were approved while 12 were rejected. Three companies withdrew their applications. For the remaining 108, approval for Kosdaq registration is pending. The number of companies that have been rejected or have exited from the Kosdaq, and their decision whether to list in the third stock market will be important factors in forecasting the third market's future.

Problems To Be Solved To Activate Two Markets

The 21st century stock market will see global alliances, mergers, and new electronic ventures. The stock market will be multi-dealer, computer-screen based, technology-driven and open to all, because people will have access to information that they want to act on. This new market will bring benefits to investors, listed companies, and economies. Trading will cost less for consumers. The market will

have more liquidity, and raising capital for companies will be easier and more efficient. Entrepreneurial businesses in both established and developing economies will be encouraged. It is likely that the flow of funds from the KSE to the Kosdaq and the third stock market will continue in the future. However, the government will need to maximize this trend's positive effects while minimizing its negative effects. Without an efficient market system, a country's financial market will not be able to exist in the global economy.

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Continued listing of new companies will provide new burdens as well as dynamism to the market. Considering that most Kosdaq companies are venture firms, discretion is needed when dealing with companies with doubtful business plans, low competitiveness or an overly diversified business portfolio.

The KSE and Kosdaq should aim for complementary and balanced growth while trying to protect small investors. The Kosdaq is a high-risk and high-return market that emphasizes a firm's growth potential, the market where many venture firms raise their funds. Meanwhile, the KSE lists medium and large blue-chip firms. The two markets should aim for balanced growth along with healthy competition.

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In addition, collusion and illegal transactions should be detected and heavily penalized, and Kosdaq registration requirements and rules for public disclosure should be strengthened. Also, the selection criteria for the third market should be provided quickly. **VIP**

— **Figure 2. The Economic Role of Kosdaq and The Third Stock Market** —

