A Study on the Current Situation and the Performance of KFoF(Korea Fund of Funds)

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Abstract: Korea Fund of Funds (KFoF) is a public fund in operation for thirty years. It is a venture support policy implemented as a part of government policies for nurturing venture companies in Korea. During a certain period, the government is contributing to the KFoF and after the government support, the management system of KFoF is going to be shifted to revolving investment management. Also, it has become flexible in coping with the market demands as government funding is being managed in the form of fund of funds in comparison with the previous allocation of annual budgets.

Since the source of the KFoF is government finance and it is unavoidable to manage KFoF for policy goals, periodical performance management and monitoring are needed and integral. This study aimed to evaluate the performance and improvement of KFoF management in classifications such as achievement of policy goals, contribution to development of venture capital market, comparison of investment patterns, business performances of portfolio companies and so on. The results of the study are as shown below.

First, the study result on the stable financial support for SMEs and ventures, which is an important policy goal of establishment of KFoF, shows that a multiplier effect of 3.5 times has been achieved as KFoF contribution has attracted domestic and foreign private capitals. Also, the KFoF provides stable investment sources as a new commitment of an average of 200 billion KRW or less has been available annually after its establishment.

Second, as a result of the KFoF's contribution on the development of the Korean venture capital market, it is shown that the size of KFoF-backed funds is relatively large in contrast to the size of non KFoF-backed funds in Korea. Also the KFoF has brought an effect of attracting foreign capitals into the local market.

The results represent that the KFoF contributes greatly to the development of the Korean venture capital market in total. In order to conduct comparative evaluation on the investment pattern of the KFoF, the KFoF committed funds (also called partnership funds) and overall investments in the venture capital market have been evaluated in classifications by type of industry, stage of company and regions. For the type of business, the KFoF committed funds’ proportion of investments in IT, biotechnology, environment, and energy fields is relatively high since the KFoF consistently has created green focused funds by committing some portions due to governmental policy development for green industry and new growth engines.

For the stage of company, similar patterns have been shown in both KFoF committed funds and other venture capital investments as the study shows that the proportion of investments in late stages is high in

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general. Henceforth, it seems that an improvement plan for increasing investments in the early stage is needed for KFoF investment.

Third, the overall S-IRR of KFoF is 1.7% as the end of 2009 based on the KFoF venture investment index called the VI Index and the multiplier is 1.05X recording performance of expecting returns higher than the principal. Also, the VI Index representing variability in KFoF annual performance is 106.64 which increased by 3.56 in comparison with the index of last year. The study shows that the business performances of KFoF-backed funds’ portfolio companies are generally improving. Growth indicators, such as growth rate of sales, growth rate of total assets, growth rate of employment and so on are maintaining a high level but profitability indicators such as ratio of operating profit to net sales, ordinary income rate on selling amount, return on equity and so on are low yet. These are because the present profitability of venture capital investment is low but it invests in companies with future growth potential which is a primary characteristic of venture capital.

The usually duration of KFoF-backed funds is long-term of more than 5 to 7 years and for the companies that were newly listed on KOSDAQ in 2009, the average period of time for listing on the KOSDAQ was 11 years after their establishment, in which IPO is a typical exit strategy of Korean venture capital. Therefore it is difficult to evaluate the performance of KFoF at this point for it has been only a short time since the KFoF was created. Also, since private equity investment, such as venture capital, focuses on unlisted companies, there is a limitation on the evaluation of performance and management of the KFoF due to the difficulties in gathering data, uncertainty of materials and evaluated profit management based on estimated data. There can be limits to evaluate the business performance of KFoF-backed funds’ portfolio companies since the number of targets is too small to be an appropriate representative sample. Also, it is hard to know the exact time when the investment effects take place, since evaluations are conducted annually not considering the timing of initial inflow of capital investment.

Also, a limitation can occur when drawing the correct interpretation about the study results and in-depth evaluation since the data used for the study do not reflect the actual time when the invested capital is used, the purpose of its use, the current status of portfolio company management and so on.

For the present, the KFoF is composed of 100% government finances. Thus consistent evaluation on performance and proper management of KFoF management are essential. Hereafter it is necessary to build more delicate evaluation systems based on present evaluation systems such as VI Index. Also, venture capital is in dire need of expanded participation in pension funds, development funds of universities and so on, which are available for long-term investment considering the characteristic of venture capital investment. It is needed to consider the improvement of systems like an increase in available information such as transparency, profitability and risk of venture capital market, tax incentives for the expansion of capital sources, and incentives for performance evaluations. Also, supporting local venture capital firms to expand overseas and the advancement of management systems are important.

[Keywords] KVIC(Korea Venture Investment Corp), Private Equity, Korea Fund of Funds(KFoF), Venture Capital Market