VENTURE CAPITAL IN KOREA
CASE STUDY OF ILSHIN INVESTMENT CO., LTD.

By

Hyung-Chul Choi

THESIS

Submitted to
School of Public Policy and Management, KDI
in partial fulfillment of the requirements
for the degree of

MASTER OF BUSINESS ADMINISTRATION

2003

VENTURE CAPITAL IN KOREA
CASE STUDY OF ILSHIN INVESTMENT CO., LTD.

By

Hyung-Chul Choi

THESIS

Submitted to
School of Public Policy and Management, KDI
in partial fulfillment of the requirements
for the degree of

MASTER OF BUSINESS ADMINISTRATION

2003

Professor Seung-Joo Lee

ABSTRACT

VENTURE CAPITAL IN KOREA
CASE STUDY OF ILSHIN INVESTMENT CO. LTD.

By

Hyung-Chul Choi

This study examines the fundamental nature of venture capital investing, the venture capital industry in Korea, and the case of Ilshin Investment Co., Ltd., a Korean venture capital firm. Venture capital is a fund that is available, usually in a form of limited partnership or corporate, for financing of high growth businesses in early stages of their life cycle, taking high risks for high returns over the long term. In typical cases, venture capital firms seek to invest their funds in unlisted equity or quasi-equity, and, hands-on value creation of portfolio companies to maximize returns. Since the first venture capital firm in Korea was established in 1974, the Korean venture capital industry has grown significantly and venture capital firms are now considered major sources of financing small and medium enterprises. The recent changes of the industry are characterized by higher competition among venture capital firms for deal sourcing and fund raising, relatively low concentration of funds among domestic venture capital firms, strong support of the Korean government, and large-cap market dominated by foreign private equity firms. This study also includes a case study of Ilshin Investment Co., Ltd. ("Ilshin") through investigation of internal data and information of Ilshin, and interview with the top management and the investment professionals. Overcoming strong regulations of the Korean government and limited opportunities in high-tech industries

until late 1990s, Ilshin has performed a Gross IRR of 30.2% as of March 2003 for the last 13 years. The excellent investment performance over the long-term is attributable to Ilshin’s proactive deal sourcing especially in retail and film businesses and consistent focus on hands-on value-creation of portfolio companies.

TABLE OF CONTENTS

INTRODUCTION

It has been about thirty years since the first venture capital firm in Korea was established in 1974. Venture capital in Korea became widely recognized as an important financing source by entrepreneurs and one of asset classes to be invested in by large institutional investors.

The industry has significantly grown on the back of development of high-tech businesses and the strong support of the Korean government after the economic crisis in 1997. Driven by potential ultra-high returns from IPO (initial public offering) through the KOSDAQ, many venture capital firms were established, and a number of conventional financial institutions and individuals of high-wealth invested in early-stage companies in 1999 and 2000. However, most of them failed to earn returns and left the market. Although the market is very competitive and risky, and the business process requires highly specialized skills, many investors were inexperienced and even did not understand the differences from other conventional financing businesses.

As competition for deal sourcing and fund raising is higher than before, more sophisticated skills and strategies need to be studied in the Korean context. Some venture capital firms emerging as leading player are worth investigation as role model.

Organization of this study is as follows.

- The second chapter discusses basic concept of venture capital, how venture capital firms work at each step of investment process, and what venture capitalists do for higher returns.

- The third chapter addresses the environment of the Korean venture capital firms.

- The fourth chapter examines the way Ilshin Investment Co., Ltd. has grown dealing with challenges for the last 13 years and its strategic moves going forward.

- The fifth chapter summarizes key findings and presents strategic implication of this study.

I. BASIC CONCEPT OF VENTURE CAPITAL

1. Basic Concept of Venture Capital

Venture capital means funds that are made available for financing of new or expanding privately held business ventures. Melvin Goldman of the World Bank characterizes venture capital as an investment in the form of equity or quasi-equity, expertise, and time contributed by the venture fund manager (or the investor) with hands on assistance. The investment should be long-term and carry a certain amount of risk, portfolios should be unlisted companies, generally relatively young or new companies, and the portfolios should have innovative characteristics, often linked with technology but not exclusively so.[1]

According to the British Venture Capital Association (BVCA), venture capitals are "means of financing a start-up, expansion or purchase of a company whereby the venture capitalist acquires an agreed proportion of the share capital of the company in return for providing the requisite funding."[2] In this definition, venture capitalists are equity business partner looking for more than a financial return on investment in a business - they plan to actively contribute to the success of the business. This definition makes venture capital cover funds for financing management buy-outs (MBOs)/buy-ins (MBIs), by adding "purchase of a company" in the range of investments.

Venture capital operations become a combination of managerial expertise with equity and sometimes debt financing. Such arrangements involve the following three points. One is an equity participation of "outside" investors via a direct purchase of stock, or through warrants, options or convertible securities. The second is a long-term investment, which may span 1 to 10 years. The third is an active, on-going involvement in the investee company.

As originally conceived, venture capital targets were mainly smaller and also

---

[1] Institute of Asian Private Equity Investment. "The Fundamentals of Asian Private Equity Investing", 1999, p. 1

[2] Institute of Asian Private Equity Investment. "The Fundamentals of Asian Private Equity Investing", 1999, p. 1

younger companies with advanced technologies during their early stage as they are developing new products or services. High tech industries exhibit the characteristics, which appeal to venture capital firms: small, innovative, and indicating high growth potential. Such firms have taken a big bite out of venture capital funds in developed countries, despite a broader range of investment interests. Not only are there the inherent risks of being in early days of operation, these companies are not likely to have the collateral or equity base required by traditional commercial lending institutions. Special financing arrangements are needed and that is what venture capital attempts to satisfy.[3]

Venture capital can then be best described as equity investments in businesses by outsiders, not the main owners. Investments are made because these businesses have significant growth potential that over time will yield financial returns for the investors in the form of dividends from profits. Dividends can be slow in coming, so the real returns in capital gain are anticipated through the eventual sale of the business after a period of some years. Little if any return is expected in the early years of the investment, quite unlike the traditional lending where there is continuous income from interest paid on the borrowing. Whereas a lending institution will assess the credit worthiness of a business and the secure a loan with collateral, the financial returns in venture capital financing are tied to the overall success of the enterprise. If the enterprises fail, the investment is lost. Suitable candidates for venture capital have good growth potential over the medium term and need a relatively high level of initial investment. Because venture capital investments are more risky and less liquid than most other forms of financing, the investors seek higher return on investments and only those private businesses with the best growth prospects will be selected. Before the creation of venture capital, equity investments in SMEs had been virtually ignored by institutional investors. Venture capital companies as intermediary fund managers are addressing the gap and making it attractive for many institutional sources of capital to commit money to private companies.[4]

There is a lot of confusion between venture capital and private equity. Some in the investment industry use the term "private equity" to refer only to buyout fund

---

[3] Institute of Asian Private Equity Investment. "The Fundamentals of Asian Private Equity Investing", 1999, p. 2

[4] Institute of Asian Private Equity Investment. "The Fundamentals of Asian Private Equity Investing", 1999, p. 1

investing, such as management/leveraged buyouts, mezzanine (or bridge) financing, and many other types of acquisition financing.[5] Some of them recognize the difference in the expectation level of returns as an important element of a realistic identification of private equity, because they narrow down the meaning just to mezzanine financing.

On the other hand, some investors have been referring to venture investing and buyout investing as "private equity investing." That collides head on with the definition of the British Venture Capital Association (BVCA) about venture capital, which is based on the fact that there are many venture capital firms managing buyout funds in EU.

All the forms of investing mentioned above share common points in the point of type of investment. They all aim to equity or quasi-equity investment with relatively long-term and hand-on approach. In addition, in the point of institutional investment, an institutional investor will allocate 2% to 3% of their institutional portfolio in those kinds of alternative assets as part of their overall asset allocation.

Those kinds of investing can be categorized into an investment class. Because the term "private equity" can be used comprehensively, it is acceptable for that purpose, even though some investments have been made to public (or listed) companies, or some of their transactions have been had in public stock exchange market. The term "venture capital" deserves significant distinction as earlier stage financing than other types of investment.

2. Sources of Capital and Venture Capital Organization

Pension funds have been the largest suppliers of venture capitals in the U.S. and Canada. And other significant sources are insurance companies, banks, corporate investors, private individuals, endowments, and foundations. (Exhibit 1-1)

But, there are several different types of venture capital organizations classified by their management structure, ownership, and manner in which funds are raised for investment. The source of their capitals may affect both the structure of the deals in

[5] Venture Economics, *2000 National Venture Capital Association Yearbook*, p. 81

which they invest and also the management style of the venture capital management firm after it has invested. There may be 3 types of organizations: independent firm, captive type and government organizations.[6]

Independent firms may be publicly listed on a stock exchange or unlisted. Private firms raises their capital from more than one source, usually investment institutions: banks, insurance companies, pension funds, corporate investors, private individuals, government agencies, endowments, foundations, academic institutions, capital markets, etc. They are not legally connected to the organization itself, other than sometimes through minority share holdings.

Captive types are specialist venture capital organizations, which are wholly owned subsidiaries or divisions of larger financial institution, such as banks, pension funds, or other financial institutions. These larger financial institutions usually provide the funding for their venture capital offshoots. Semi-captive firms refer to those organizations captive in terms of their management and ownership but are independent in raising funds externally to their corporate grouping. Government venture capital organizations are those wholly funded either directly or indirectly by government sources.

These types of organizations may be formed as private sector profit-making organizations such as corporations and limited partnerships.

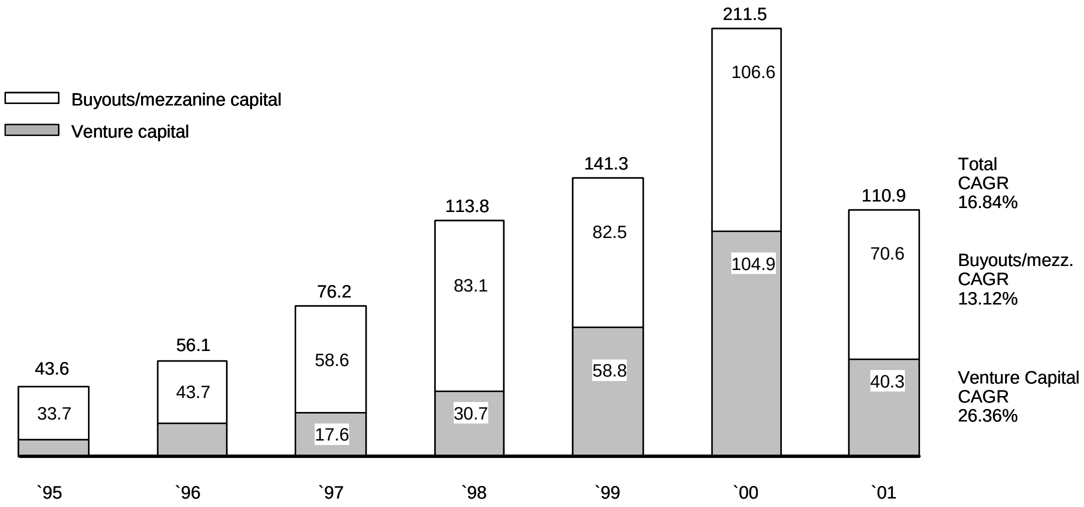
Limited partnership arrangement is most frequently found in the U.S., but also become important in Europe and occasionally in Asia. Under a limited partnership arrangement, each investor purchases limited partnership interests in a venture capital fund placed under the management of a group of experienced venture capitalists (; the general partners) who charge a management fee plus a share of the capital gains as managers. The limited partners have only limited liability while the general partners are fully responsible.

A corporate legal structure exposes the venture capital investors to only limited liability. Such a structure may allow for a frequent and direct involvement of stockholders in management through an active role on the board of directors and the possibility of choosing the management team. This arrangement has predominantly in

[6] Institute of Asian Private Equity Investment. “The Fundamentals of Asian Private Equity Investing”, 1999, pp. 7-8

Europe and presently in developing countries.[7]

Exhibit 1-1: Venture Capital and Private Equity Funds Commitments in the U.S., 1995-2001 (unit: US$ billion)



Source: 2002 National Venture Capital Association Yearbook

3. Stages of Investment

Every venture capital firm can be characterized according to how to build its portfolio of the investments by stages as well as by industries. But there are much more venture capital firms focused on later stages. In usual cases, the portion of later stages in the assets of venture capitals is larger than earlier stages. That is same as in total assets in many countries.[8] (Exhibit 1-2)

---

7 Institute of Asian Private Equity Investment. "The Fundamentals of Asian Private Equity Investing", 1999, p. 7

8 Venture Economics, *2000 National Venture Capital Association Yearbook*, pp. 107-108

Seed

This stage is a relatively small amount of capital provided to an inventor or entrepreneur to prove a concept and to qualify for start-up capital. This may involve product development and market research as well as building a management team and developing a business plan, if the initial steps are successful. This is a pre-marketing stage. Seed capital requires working very closely with an entrepreneur who may have no more than a good idea.

Start-up

This stage provides financing to companies completing development and may include initial marketing efforts. Companies may be in the process of organization or they may already be in business for one year or less, but have not sold their products commercially. Usually such firms will have made market studies, assembled the key management, developed a business plan, and are ready to conduct business.

Early Stage

Other early stage financing includes an increase in valuation, total size, and the per share price for companies whose products are either in development or are commercially available. This involves the first round of financing following a company's start-up phase that involves an institutional venture capital fund. Seed and start-up financing tend to involve angel investors more than institutional investors. The networking capabilities of the venture capitalist are used more here than in more advanced stages.

Expansion Stage

This stage involves working capital for the initial expansion of a company that is producing and shipping and has growing accounts receivables and inventories. It may or may not be showing a profit. Some of the uses of capital may include further plant expansion, marketing, working capital, or development of an improved product. More institutional investors are more likely to be included along with initial investors form previous rounds. The venture capitalist's role in this stage evolves from a supportive role to a more strategic role.

Later Stage

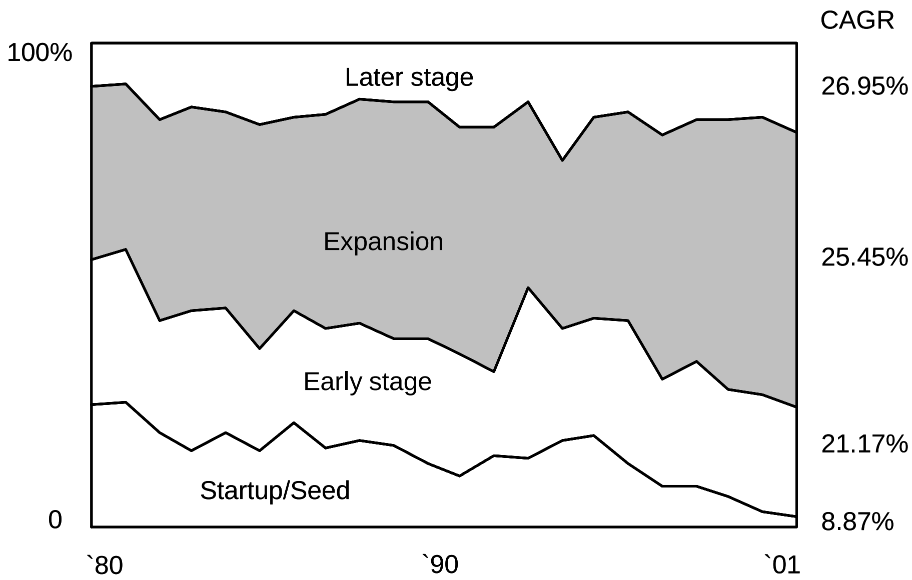
- Late Stage

Capital in this stage is provided for companies that have reached a fairly stable growth rate; that is, not growing as fast as the rates attained in the expansion stages. Again, these companies may or may not be profitable, but are more likely to be than in previous stages of development. Other financial characteristics of these companies include positive cash flow.

- Bridge Financing

This stage is needed at times when a company plans to go public within six months to a year. Often bridge financing is structured so that it can be repaid from the proceeds of a public underwriting. It can also involve restructuring of major stockholder positions through secondary transactions. Restructuring is undertaken if there are early investors who want to reduce or liquidate their positions, or if management has changed and the stockholdings of the former management, their relatives and associates are being bought out to relieve a potential oversupply when public.

Exhibit 1-2: Venture Capital and Private Equity Investments by Stage in the U.S., 1980-2001



Source: 2002 National Venture Capital Association Yearbook

4. Instrument of Investment

Increasingly, investments in common stocks may be combined with other forms and with varying timing so that they have characteristics of equity and straight bond alike.9 Conventional things are preferred stock and debt with warrants or options. Various kinds of options can be attached to preferred stock in relation to dividend payout and conversion to common stock, based on its characteristic of privileged position than common stock. Convertible bond and bond with warrant are also popular types of investment, which are designed so that it may share the growth potential of the company using various options and warrants.

[9] Institute of Asian Private Equity Investment. "The Fundamentals of Asian Private Equity Investing", 1999, p. 21

Typical investment instrument of venture capital is equity share of investee companies. Common stock allows the investor to benefit from upside potential of a company through stock dividends, increased stock liquidity, and finally capital gain. In the event of bankruptcy, common stock provides only a junior claim to assets of the firm. Holding majority share in ownership of the business is not one of the venture capitalists' goals. Their interests are dependent upon the goals of the majority shareholders.

But, it is also routine activity for venture capitalists to purchase senior debt securities, because they can often offer investors better control over the investment than would be available with a minority common stock position, let alone anti-dilution protection and tax shield effects, and liquidation preference. And also venture capitalists often work in conjunction with other providers of finance in putting together the total funding package in a variety of ways, including debt financing from other types of institutions like commercial banks.

Different types of instruments are created and structured for different transactions, because venture capitalists would achieve control over their investments in order to protect their expected return.

5. Investment Strategy

It has become increasingly essential for venture capitalists to have clearly defined strategies for investments they will target.[10] Consequently venture capital fund or organizations are becoming more specialized in investment strategies concerning business sectors, stages of investment, regional preferences, and size of each transaction. Some venture capital funds have highly polished strategies describing detailed characteristics of expected investees, such as sales volume and capital size, and deal structures defining investment instruments, ownership, and monitoring policy.

The sources of their funds are no longer willing to rely on simple opportunistic judgments by venture capitalists in the increasingly complex marketplaces

[10] Institute of Asian Private Equity Investment. "The Fundamentals of Asian Private Equity Investing", 1999, p. 9

where knowledge and familiarity with such markets, the competitors and other critical factors are essential to effectively place an investment. They want such focus to ensure that the venture capitalists maintain a current expertise that is more and more critical to the investment decision and the subsequent monitoring of the investment. And also they would balance their placements to differing types of opportunities.

Such strategies are also considered necessary by the prospective investee. More and more companies inviting investors from outside distinguish the quality of capital much better than before. They expect competent venture capitalists to contribute to their overall business so that they grow faster than their competitors. Venture capitalists can develop and maintain their expertise for adding value to their investee companies by focusing on specific areas.

6. Phases of Investment Process

There are 3 basic phases to the venture capital investment process. The first is decision stage where a decision must be made as to the entry of a venture capital firm into a particular investment. The second is the operating stage where the venture capital firm has entered a deal and began monitoring management. Venture capitalists minimize losses and maximize gains through an advisory role and by providing any necessary new financing while assisting the entrepreneur in making the firm more professional and attractive for outside investors. The third is the exit stage where the investors will seek to profit from their investment.

The process typically involves the components that follow, each of which has its objective to enhance the quality of deals to review by filtering out those deals that are concluded not to meet the venture capitalists' strategic objectives.[11] Often one of the various stages, while its conclusions may necessarily need to be reached in a certain sequence in this filtering process, may actually be undertaken before or after another stage. This overlap ensures the most efficient linking of information and judgments

[11] Institute of Asian Private Equity Investment. "The Fundamentals of Asian Private Equity Investing", 1999, p. 11

between them, as well as the most effective use of the venture capitalists' time and resources.

Deal Flow

Healthy deal flow is one of the most critical resources of venture capitalist. It is a key factor in determining investment strategy and also attracting fund sources. Without a healthy deal flow venture capitalists will not only have difficulty successfully placing the funds at their disposal in viable deals and doing so in the time frame, but will tend also to obtain deals with consequent adverse impact on pricing as well as deal quality.

Developing a healthy deal flow takes significant investment of their time and effort, because deal flow is primarily a function of personal relationships or networking. Fostering such relationships and network to create deal flow means making the effort to become known as an approachable and professional venture capital firm to people in related business to expected investees, other professionals in investment baking, commercial banking, accounting, legal service, and venture capital itself. They would provide referral and sometimes syndication opportunities.[12]

Screening Deals

Given a respectable deal flow, it is obviously necessary to perform a filtering process. It is quick decision by venture capitalists without spending too much of time or effort before due diligence. Venture capitalists determine whether a prospective transaction may be viable to justify further consideration and fits the investment strategy.

Critical questions about the investment are raised in this stage. Some of them are confirmed before due diligence, and those that don’t fit the investment strategy or

[12] Institute of Asian Private Equity Investment. “The Fundamentals of Asian Private Equity Investing”, 1999, p. 11

marginal ones are discarded. Questions that need to be verified from due diligence are defined for the investments that will be processed more.

The most important factor in the overall evaluation of an investment is the investee's managerial qualification. Other typical questions are about objectives of financing, time span to get return from capital gains, contemplated way out of the investment, important factors that will affect the industry, market opportunity of the products or services, projected sales and profit, etc.[13]

Valuation and Pricing

The next step is the financial valuation process to assess the justifiable pricing, both to determine if prospective return fits the strategic financial objectives as well as in preparation for eventual negotiation. Typically it works as the next filter in the process before the expensive and time consuming due diligence process is undertaken in any depth.

At this stage venture capitalists calculate expected return from the investments. Venture capitalists discard deal which is not expected to bring enough return with acceptable risks. However attractive the investment is in its business quality, venture capitalists decline it if proposed pricing doesn't seem to be negotiable one.

Venture capitalists would assess the investment as precisely as possible. Many valuation methods are used by venture capitalists. Valuation using various multiples, such as price earning ratio (PER), price sales ratio (PSR), price book-value ratio (PBR), and EV/EBITDA, is the most simple and useful way in many cases. Another way of valuation is calculation of expected rate of return. IRR is mostly popular method. But, as an investee company is earlier stage is, most of data showing current status is less meaningful. So valuation of those companies largely depends on venture capitalists' perspective on the business.

Proposed pricing is rarely comfortable for venture capitalists. Normally

[13] Institute of Asian Private Equity Investment. "The Fundamentals of Asian Private Equity Investing", 1999, p. 12

management teams of investee companies are highly optimistic and confident in their business, and they want to dilute their share at the minimum level. Competition among venture capitals and bullish stock exchange market enlarge valuation gap between assessed and proposed pricing by enhancing expectation level of investee companies.

Negotiation of pricing is inevitable process in most transactions, and venture capitalists determine how much the gap may be shortened from negotiation and how much it can be compensated by investment structure.[14]

Due Diligence

This stage involves the careful review of features and details of the investment. It is a complicated and time consuming process dealing with legal, financial and management aspects. Venture capitalists solve the problems and questions raised at the former stages, anticipate any possible problems that might arise after investment, and gain confidence in the transaction.

In the legal aspect, venture capitalists examine all legal documents or contingent legal problem that might have an impact on the performance and potential liability of the company. Financial due diligence is a continuing process of inquiry and reappraisal from the first introduction of the company to completion of the deal. Outcome of venture capitalist's scrutiny is crystallized into forecasted financial number.

In the management due diligence, quality of management team, characteristics of the product, the technology used and its vulnerability, and the market potential of a company is identified through comprehensive reference check. Venture capitalists interview with suppliers, customers, existing or potential competitors, and industry exert using their extensive network.

Venture capitalists give different weight on each issue according to characteristic of the business or transaction, so the due diligence of each transaction is conducted in quite different way. If a venture capitalist doesn't have expertise in some

---

[14] Institute of Asian Private Equity Investment. "The Fundamentals of Asian Private Equity Investing", 1999, pp. 13-14

area, professionals from outside, such as accounting and law firm, are often used to assess the investment. But, quality of management team is considered the most important points by most venture capitalists.[15]

Deal Structuring

Deal structure is a set of arrangements negotiated between the investee company and the venture capitalist with the objective of reconciling their different needs and concerns with respect to a specific deal. The issues to be settled are the kind and mix of financial instruments to be used, pricing of the deal, and other terms of the agreement, such as warranties and covenants.

Venture capitalists have a different set of concern from the investee company when negotiating the structure of the deal. These includes earning a reasonable return given the level of risk in the transaction, having sufficient influence on the development of the company usually through board representation, minimizing tax payments resulting from the cash flows of the deal, assuring liquidity in the future, having voting control to be able to replace management in case of consistent bad performance, and the like.

The investee company looks for structure protecting their interests, such as ability to lead the business they are establishing, receiving reasonable financial returns for their initiative, having a flow of resources adequate to run their business, and minimizing tax exposure.

Venture capitalists structure the investment in order to ensure that they enter in the best possible position to insure that your objectives are achieved in the most efficient manner. They would achieve control over their investment to protect their expected return as well as to avoid any unnecessary liabilities.

Syndication of deal may be structured, considering size of the investment, potential risk, existing exposure to a particular sector, or regulatory and accounting liabilities. Venture capital benefits from getting chances to participate in other syndicated

[15] Institute of Asian Private Equity Investment. “The Fundamentals of Asian Private Equity Investing”, 1999, pp. 15-20

deal as well as limiting individual risk. And, the investee company benefits from limiting outside control, being offered combined business expertise, and inducing larger amount of investment.

Negotiating and Closing

In this stage venture capitalists negotiate with investee companies on pricing and deal structure. It is very tough process for both parties. Actually more parties, such as other investors, existing shareholders, deal introducers, and advisers, may have their own interests on the transaction. But, the key is a successful and mutually beneficial relationship that will last for a long time. Both parties prepare and review all related documents and close the transaction.

Proactively Managing the Portfolio Investments

After closing the transaction, venture capitalists get into the long-term value creation process which is to bear superior return. Each venture capitalist decides the degree to which to manage each individual investment. Some prefer to rely on management reports and periodic company visits, while others prefer more pro-active role in the areas of future financial arrangements, strategic decision, planning development, marketing and personnel issues. These kinds of active involvement are mostly performed through membership on the board of directors.

Funds or fund sources may demand certain level of involvement. Most investors hope venture capitalists will spend more time improving the performance of their current portfolios rather than attempting to raise new funds as soon as they are fully invested. In many cases, monitoring policy is stipulated in contracts or investment strategy.

More competent venture capitalists have superior expertise, more experiences, a stronger international network for assisting the investee company in professionalizing the firm as well as financing additional capital. And also venture capitalists may play a decisive role in relieving investee companies of difficult situation. If their activities benefit the investee companies and they bring higher return, they will have easier time raising funds at a later time. Capable venture capitalists are differentiated in that way. [16]

Exits

Exiting from the investment is the last stage of venture capital process realizing return from the investment. It is quite usual for venture capitalists to gradually decrease their shares as realizing partly. An excellent transaction should provide a flexible choice of exit routes that would make venture capitalists promptly respond to the situation. There are five main exit mechanisms: listing on public stock exchange market, trade sale, refinancing, repurchase, and involuntary exit.

Listing on stock market is the most common and profitable route for venture capital, and has several advantages.

First, a growing company can raise more capital by marketing the company shares on the stock market. Listed companies can raise additional capital by further issues of shares, normally by way of right issues to existing shareholders.

Second, listed companies can finance expansion through an offering of its own shares in payment in the acquisition of other business operations. An offer of shares may allow the negotiation of a more favorable price, since the seller may be able to defer tax liabilities on capital gain.

Third, once shares are publicly held, the shareholders can realize the value of shareholding easier by selling their holding. It is possible for venture capitalists, or other shareholders to realize part of it while still maintaining a significant stake in the business if desired. And also, better price may be available in this way, than through a private sale if the company had not gone public. Of course, the owner can also get the same chances.

[16] Institute of Asian Private Equity Investment. “The Fundamentals of Asian Private Equity Investing”, 1999, pp. 27-29

Forth, employees can get a much greater incentive through employee share ownership programs or stock option, since the employees can more easily value their holding in the company. They can also sell their shares more readily if they wish to realize a gain.

Fifth, a company will enhance its status with consequent impact in its markets once shares are publicly traded. Public awareness and visibility to brokers or investors are also considerably enhanced.

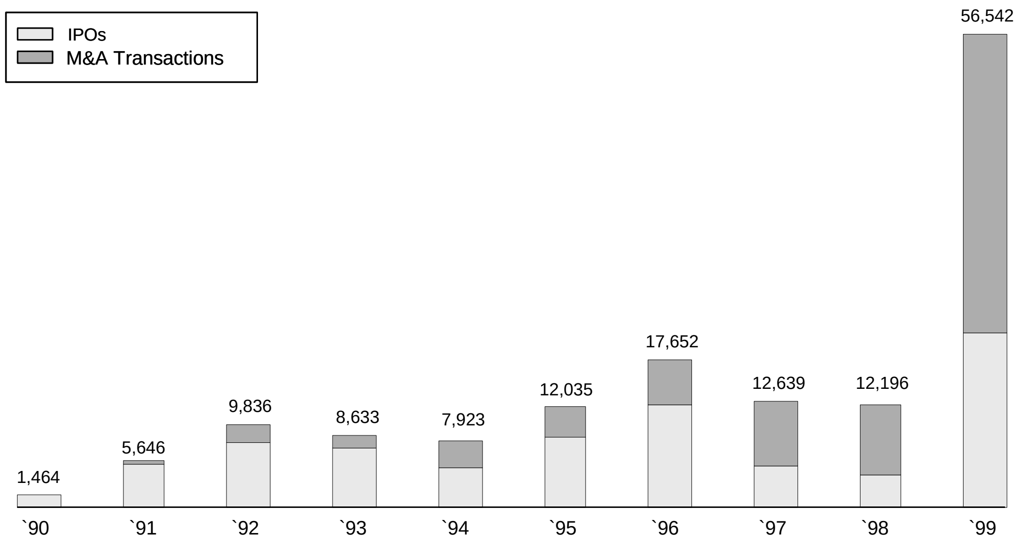
Disadvantages can include the possible loss of control or unwelcome bids, burdensome disclosure requirements, increased scrutiny from shareholders and the press, perceived emphasis on short-term profits, and high costs of gaining quotation.

Trade sale is also the most common way, especially in the U.S. (Exhibit 1-3) It is accompanied with acquisitions or strategic investments. Therefore, the third parties may well be strategic investors. Even though it generates smaller return than IPO, it is popular form of exit, because it is appropriate for relatively small companies that because of their size are not attractive to the large institutional investors.

Refinancing of the investee company can give an exit route, if they are willing to purchase the venture capitalists' share. This can occur when the venture capitalist is looking for an exit but the investee company is unwilling to go for a listing or a trade sale.

Repurchase of the venture capitalists' shares by the investee company or its management can also an exit route. But, this is limited when the company or the management has grown enough to buying the shares. Or, it can occur based on investment structure agreed upon between the investee company and the venture capitalists, in example, if the company doesn't meet managerial targets. If large institutional investors take liabilities on the repurchase provisions, they will buy the venture capitalists' shares.

Exhibit 1-3: Exit of Venture Capital by Type in the U.S., 1990-1999 (unit: US$ million)



Source: Money Tree US Report Q2 2000 Results

Involuntary exit occurs under receivership or liquidation. Write-off of investments is not unusual for venture capitalists at all.

However well a portfolio company has performed in various aspects, for example, high profitability, stable revenue stream, strong balance sheet, and established market position, poor exit strategy cannot ensure corresponding returns from the investment. Therefore, exit strategy for each portfolio companies should be considered when conducting due diligence, structuring the investment, and negotiating terms and conditions.[17] In addition, it is clear that one of most important post-investment activities is to continuously look for better exit opportunities.

[17] Institute of Asian Private Equity Investment. "The Fundamentals of Asian Private Equity Investing", 1999, pp. 32-36

II. OVERVIEW OF THE KOREAN VENTURE CAPITAL INDUSTRY

1. Historical Background of the Korean Venture Capital Industry

In 1974, Korea Technology Advancing Corporation (KTAC), which is now Kibo Capital, was established by KIST (Korea Institute Science and Technology) as the first venture capital organization in Korea. Its business was to provide capital for simple commercialization of outputs of R&D of KIST. In 1981, the Korean government initiated foundation of Korea Technology Development Corporation (KTDC), which is now KTB Network. Korea Development Investment Corporation (KDIC), which is now TG Venture, and Korea Technology Financing Corporation (KTFC), which was now KDB Capital, were founded in 1982 and 1984, respectively. The venture capital firms established in the early 1980s were considered a means of supporting economic development plan of the Korean government rather than an independent business pursuing profits. They were not active in financing start-ups and early-stage companies and focused on providing debt capitals to areas that the government intended to support, such as heavy machinery and chemical industries, instead.

It was after legislation of ‘Law of Start-up Support Financing’ and ‘Law of New Technology Support Financing’ in 1986 that the Korean venture capital firms had been incentivized by preferential tax benefits and the first privately-owned venture capital firm was established. The companies established in that period include Korea Technology Investment Corporation (KTIC), Dongwon Venture Capital, and Hanmi Technology Investment Company. At the same time, the stock exchange market was activated from the mid 1980s. Venture capital firms expected to have better exit route through IPO. 53 venture capital firms were established until in 1991.

In 1991, OTC (over-the-count) market opened for the purpose of trading stocks issued by small and medium enterprises. But, it did not work efficiently until the KOSDAQ (Korea Securities Dealers Association Automated Quotations) opened in 1996. After that, some high-tech companies were successfully listed on the KOSDAQ:

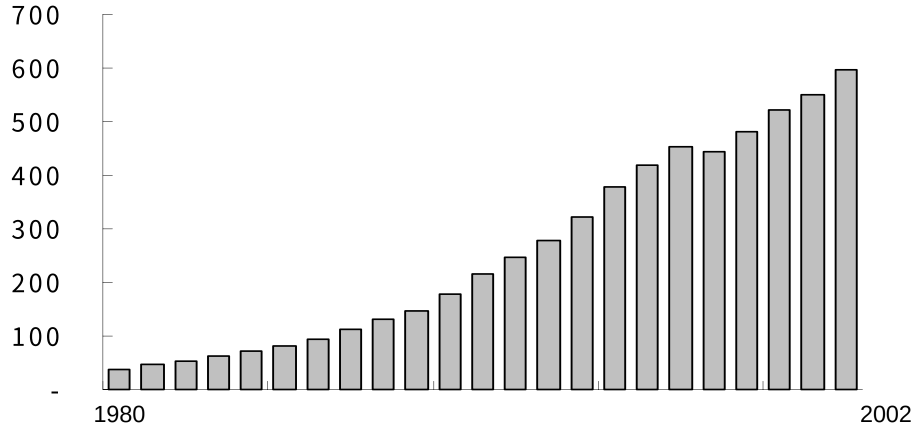
Medison (January 1996), Haan Soft (September 1996), and Mirae Corporation (November 1996). More venture capital firms were established, and the investment amount for high-tech companies increased sharply. But, the large portion of investments was close to mezzanine-stage investment or pre-IPO deals aiming for short-term IPO margin.

After economic crisis in December 1997, the venture capital industry froze and there were no financing sources for entrepreneurs except for foreign investors. Foreign venture capital and private equity firms started to actively invest in Korean companies. Rationale of their investments was low valuation of companies and prospects for appraisal of KRW currency. They focused on large-cap deals over USD 30 million in distressed situation, and therefore, start-up and early-stage companies were not their investment targets. That was beginning of private equity industry in Korea.

Promotion of venture companies was one of the key policy measures for overcoming economic crisis. The government adopted indirect financing through venture capital firms and limited partnerships as opposed to direct financing in the past, encouraged domestic pensions and endowments to invest in venture capital, and expanded tax benefit for venture capital investing. Those strong supports of the government, bullish stock exchange market, Internet fever, and increased entrepreneurship were key factors that contributed to substantial growth of venture capital investing in 2000. The number of venture capital firms and limited partnerships increased drastically, and conventional financial institutions, corporations in other fields, individuals generally called angel investor were also looking for opportunities for investing in high-tech start-ups, expecting high returns. But, after the collapse of stock exchange market in 2000, many players left the market, and the Korean venture capital industry went into a fast decline following worldwide trend.

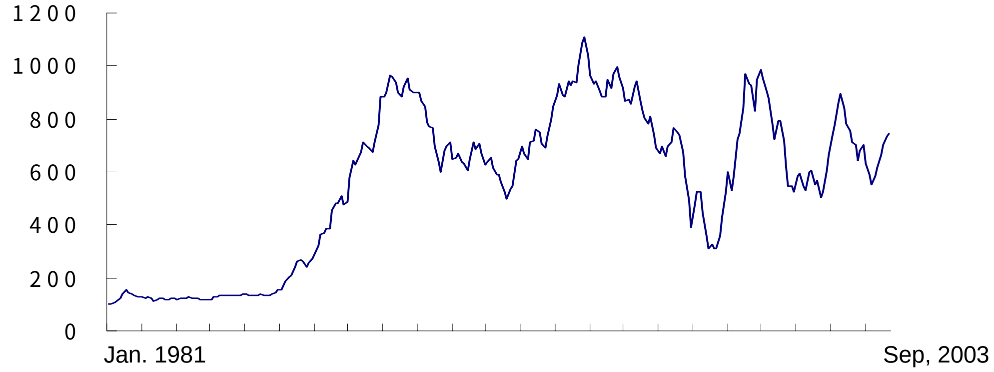
Exhibit 2-1: Economic Growth and Exit Market

A. Nominal GDP (unit: KRW Trillion)



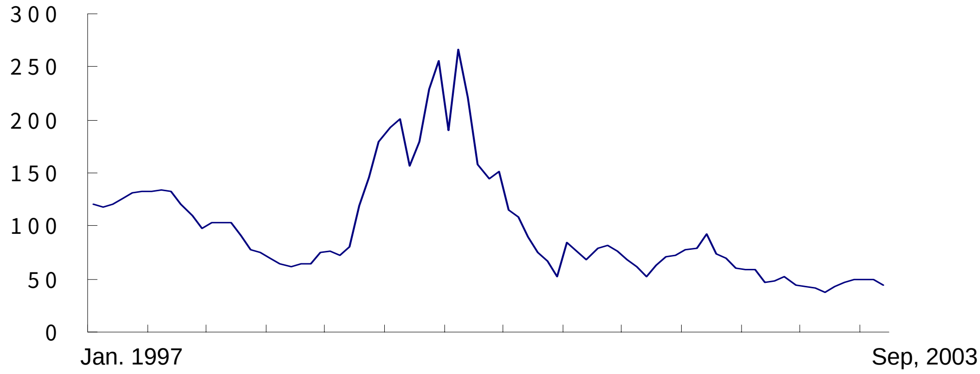
Source: Bank of Korea

B. KOSPI



Source: Korea Stock Exchange

C. KOSDAQ Index



Source: KOSDAQ Securities Co.

2. Regulatory Environment of the Korean Venture Capital Industry

To be a venture capital firm in Korea, government license is required by law. There are two types of venture capital firm in Korea: Small Business Investment Company ("SBIC") and New Technology Support Financing Company ("NTSFC"). The major difference between the two types is that NTSFCs are allowed to invest in more various instruments and assets, including straight bond, lease, and factoring, and venture capital is one of businesses of NTSFCs. But, those two compete for a market and their venture capital businesses are equally regulated and supported by the government. Below is a summary of featured regulations for SBIC.

Exhibit 2-2: Regulatory Environment of SBIC

Venture Capital Firm (General Partner)

- Government license required by law
- Minimum paid-in capital of KRW 10 billion
- Acquisition of stock not to exceed 50% of shares with voting rights
- Mandatory time frame of investment: To invest at least 20%, 30%, and 50% of paid-in capital within the fist one, two and three year period, respectively
- Restriction against investment in large enterprises and listed companies

Limited Partnership

- On-shore fund
- Minimum GP contribution: 5-15% of total commitment
- Initial full drawdown
- Mandatory time frame of investment: To invest at least 20%, 30%, and 50% of total commitment within the fist one, two and three year period, respectively
- Restriction against investment in large enterprises and listed companies

Source: Korean Venture Capital Association

Noteworthy aspects among the listed above are that SBIC should be a corporation with a minimum requirement of paid-in capital, currently KRW 10 billion and that acquiring controlling shares of portfolio companies (over 50% of ownership) is prohibited. Recently, the Korean government selectively adopted the standards of the U.S., for example, call-basis drawdown of committed capital as opposed to initial full drawdown, and general partner in the form of Limited Liability Company ("LLC") as opposed to corporation.

3. Overview of Major Players in the Korean Venture Capital Industry

Small Business Investment Company ("SBIC")

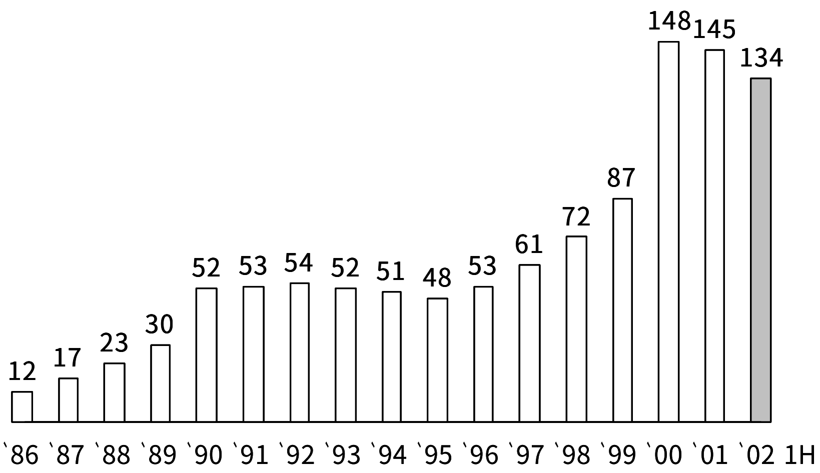
As of June 2000, there are 134 SBICs, and total assets under management are KRW 8.3 trillion. Average fund size is around KRW 62 billion, but the concentration is very high. As a proxy data, average fund size was KRW 36 billion as of September 2000, and 25 venture investment companies accounted for 62% of total fund. Currently, the concentration of funds to leading venture capital firm is higher than that in 2000, as competition for fund raising gets stronger and typical size of a limited partnership to be launched is larger.

The fund sources are mostly paid-in capital of SBIC (46%), limited partnership accounts for 39%, and debt financing accounts for 23% of total funds. Comparing with the U.S. and other developed countries, the portion of debt financing is large, mainly because providing loan to SBICs at a low interest rate is still an important policy measure of supporting venture companies.

The fund sources of limited partnership are diversified. Corporation is the largest fund source accounting for 29%, and the government is the second (18%). But pension funds and foundations account for only 2%. The portion of limited partnership in total capital under management is expected to grow as pensions and foundations allocate more to venture capital class and invest more in limited partnerships.

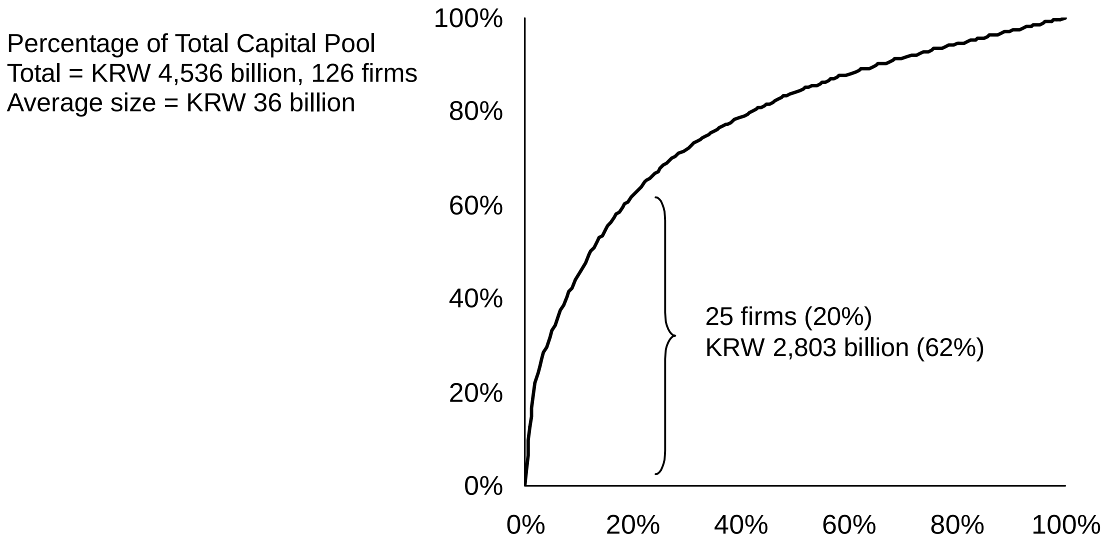
Korean venture capital firm predominantly invests in equity (59.6%), and investments in convertible bond and bond with warrant (23.2%) or other types of investment (17.6%) are relatively small. Recently, various types of preferred shares that enable more flexible deal structuring are preferred to common shares.

Exhibit 2-3: Number of Small Business Investment Companies, 1986-2002 1H



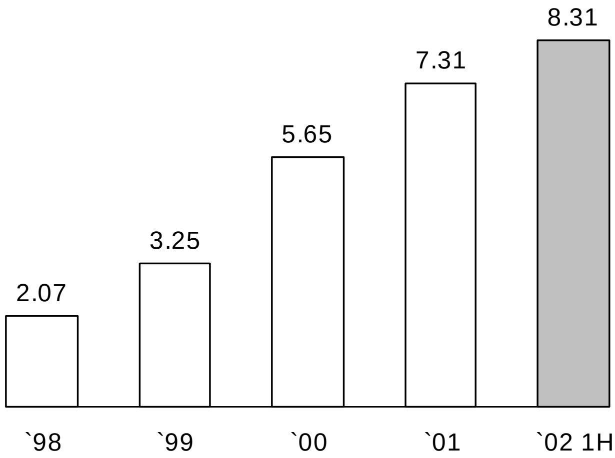
Source: Korean Venture Capital Association

Exhibit 2-4: Concentration of Capital, 2000 Q3



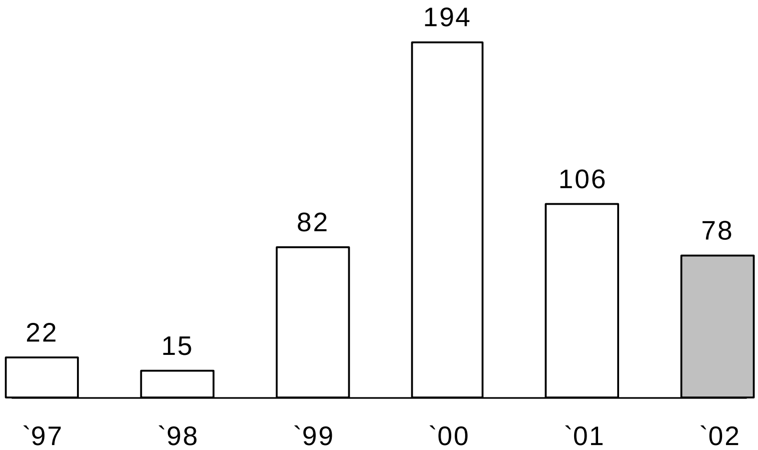
Source: Data from Korean Venture Capital Association

Exhibit 2-5: Aggregate Fund Size, 1998-2002 1H (unit: KRW trillion)



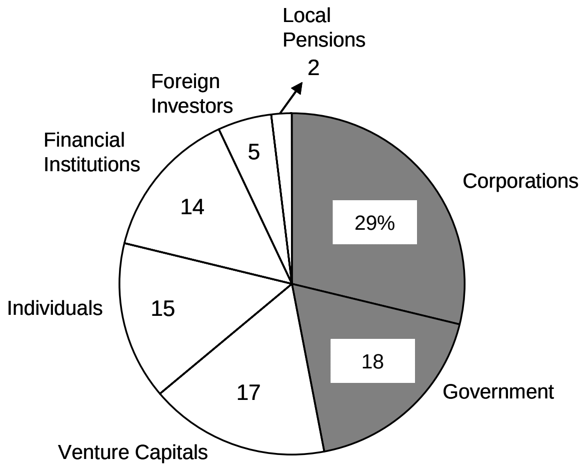
Source: Korean Venture Capital Association

Exhibit 2-6: Organization of Limited Partnerships by Year, 1997-2002



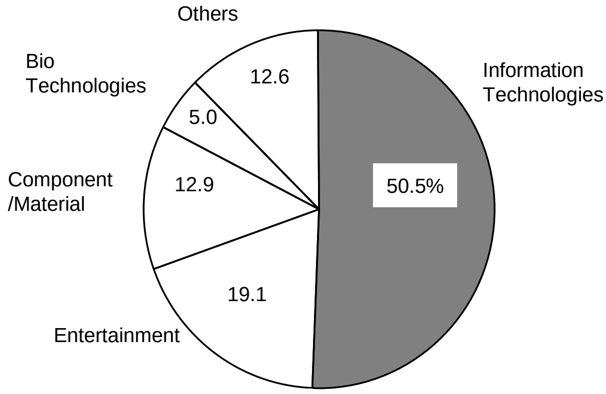
Source: Korean Venture Capital Association

Exhibit 2-7: Limited Partners by Type, June 2001 (Total = USD 2.16 billion)



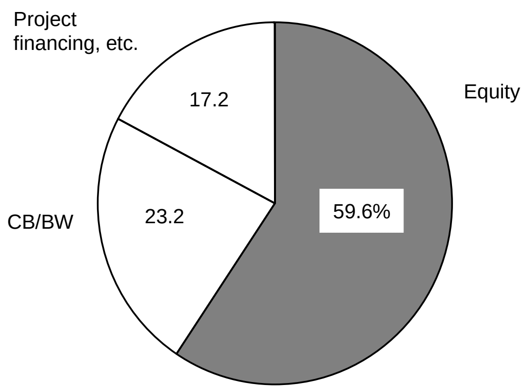
Source: Korean Venture Capital Association

Exhibit 2-8: Investment by Industry, 2002 (Total = KRW 565 billion)



Source: Korean Venture Capital Association

Exhibit 2-9: Investment by Type, 2002 (Total = KRW 565 billion)



Source: Korea Venture Capital Association

Individuals (Angel Investors)

In 1997, angel investors emerged as another group of investors in the Korean venture capital industry. Total amount of angel funds substantially increased to around KRW 29 billion in 2000, and much more amount of capital was directly invested in unlisted companies. However, unlike typical angel investors in the U.S investing in start-up companies, angel investors in Korea pursued later stage or pre-IPO investment. Venture companies also prefer institutional investors to individuals, since investee companies expect more than money from investors. Therefore, as venture capital industry became more competitive, angels had more difficulty in deal sourcing[18]. Recently, few individual invest in venture companies, but, still remains potential large sources of venture capital.

Exhibit 2-10: Korean Angels

	1997	1998	1999	March 2000
Number of angels	105	349	4,253	15,371
Investment Size (unit: KRW billion)	1	2	52	101
Angel Fund Organized (unit: KRW billion)			14	29

Source: Small and Medium Business Administration, Venture White Paper

Corporates

As it is the case in other developed countries, corporate are one of the largest sources of venture capital in Korea. Many corporate investors began to directly invest in venture companies in 1999 and 2000. For example, Korean four largest chaebols

[18] Small and Medium Business Administration. *Venture White Paper,* p114.

announced that they would invest around KRW 1 trillion in venture companies for the next three years in 2000[19].

The rationale of their direct investments is potential of strategic synergies with their existing businesses in most cases. Therefore, corporate investors are usually more patient about exits than financial investors and are inclined to expand their existing businesses even at the sacrifice of financial returns.

Because the government do not provides corporate investors with preferential benefits, large corporate investors establish their subsidiary venture capital firms or simultaneously invest indirectly in limited partnerships managed by existing venture capital firm, and smaller investors usually indirectly invest through limited partnerships.

Exhibit 2-11: Venture Investment Plan Announced by Chaebols (unit: KRW billion)

Chaebol	Company	Amount
Samsung	Samsung Corporation	30
	Samsung Electro-Mechanics	20
	Samsung Venture Investment Company	300
Hyundai	Hyundai Corporation	10
	Hyundai Electronics	-
	Hyundai Venture Investment Corporation	28
LG	LG International	-
SK	SK	10
	SK Global	10
	SK Telecom	18
	SK Evertec	5

Source: Hyundai Research Institute (www.hri.co.kr)

Financial Institutions

Venture capital is also an attractive product to large financial institutions that manage huge amount of assets, because expected return is higher and correlation to public financial market is lower than conventional asset classes. In 2000, many financial

[19] Heung-Ki Baek,, *Current Status of Venture Investment of Korean Large Corporations*, www.hri.co.kr (Hyundai Research Institute)

institutions, such as commercial banks, securities firms, pensions, and insurance companies, began to directly invest in venture companies. They competitively allocated certain portion of their assets to venture capital and set up in-house management teams dedicated to direct investment.

However, their organizational culture and process in many aspects including due diligence, decision making, and post-investment management, have been primarily for eliminating high risks from their portfolios rather than for taking and actively managing risks. They tried to adopt and internalize new systems for their venture capital business, but that would not be achieved in a short time frame.

Some large financial institutions established subsidiary SBICs or NTSFCs, but in most cases they invest indirectly through limited partnerships managed by venture capital firms and directly invest by selectively participating in consortiums led by venture capital firms.

Exhibit 2-12: Fund for Venture Investment Announced by Major Banks (unit: KRW billion)

Bank	Amount
Korea Development Bank	150
Kookmin Bank	100
Industrial Bank of Korea	100
Cho Hung Bank	50
Shinhan Bank	30~40

Source: En@ble

III. CASE STUDY OF ILSHIN INVESTMENT CO., LTD.

1. Introduction

Ilshin Investment Co., Ltd. ("Ilshin" or "the Company") is one of the leading venture capital firms in Korea. The performance of Ilshin for the last 13 years is surprising. Since established in 1990, Ilshin has recorded net profits for 13 consecutive fiscal years and an IRR of 30.2% as of March 2003. Ilshin has managed or has advised 13 limited partnerships, the total commitment of which amounts to KRW 189.2 billion and has made 105 investments worth KRW 117.1 billion. Those performances of Ilshin over the long-term rank among the best in the Korean venture capital industry.

Ilshin has invested mainly in information technology, retail, and movie sectors. Unlike many venture capital firms in Korea focusing solely on information technology, Ilshin has accumulated experiences and expertise in retails and movie sectors. Ilshin's success cases in Giordano Korea (retailing casual apparel) and Body Shop Korea (retailing cosmetics) are unique in the Korean venture capital industry. That approach of Ilshin is worth studying as a role model for Korean venture capital firms. This part is to analyze what are the key factors to Ilshin's unparallel success and its investment strategy facing major issues going forward.

2. Early Stage (1990 ~ 1993)

Establishment and Recruitment of Key Members

Ilshin was founded by Ilshin Spinning Co., Ltd. in 1990. Ilshin Spinning has been a leading spinning company in Korea since it was founded in 1951. Focusing on its core businesses since its establishment, Ilshin Spinning has been stable and strong financially until now. In 1990, Ilshin Spinning decided to get into financial industry, and established Ilshin as the first step. In 1991, it recruited Jeong-Suk Koh as president who is a family member of Ilshin Spinning. Before joining Ilshin, he had worked for a leading management consulting company, McKinsey & Co., as a consultant. By the end of 1991, Ki-Min Nam and Seung-Bum Kim joined Ilshin. Ki-Min Nam had been experienced in launching and building up start-up businesses by running his own businesses during his college days, and Seung-Bum Kim had been a consultant in a leading management consulting company, Monitor Company. All of the three founding members studied management in graduate schools.

Participation by Foreign Capital and Formation of Limited Partnerships

Ilshin's active businesses with foreign investors already began in its early days. Sit/Kim International, a venture capital in the U.S., has been a shareholder of Ilshin since Ilshin acquired and merged with Samdo Venture Capital in 1993. Ilshin also succeeded to a limited partnership of Samdo Venture Capital, to which Sit/Kim International has contributed significant amount of capital. The second and the third partnerships were launched in 1993, and total fund size amounted to KRW 27.7 billion as of December 1993. Bankers Trust participated in the second partnership, which is the first venture investment partnership in Korea that was invested in by a major foreign investor.

Though fund raising was very active compared with other venture capital firm, Ilshin's investing was not the exception. For the first four years, Ilshin conducted just seven equity deals, and the total size of investments was only KRW 1.4 billion. And there were no successful investments. That was common among venture capital firms in early 1990s. Investment opportunities were scarce mainly due to lack of entrepreneurship and underdeveloped high-tech industries. Risk was too high, and, in contrast, expected return from investment was too small. Like other venture capital firms, Ilshin invested a lot in bridge financing.

3. Building Core Competences (1994 ~ 1997)

In this period, the unfavorable environment did not change in overall. That is evidently proved by the fact that there were no venture capital firms established in 1994 and 1995. Over-the-count (OTC) stock exchange market before the opening of the KOSADQ didn't work as a market, and deal opportunities are scarce. But, Ilshin built up its core competences in retail and movie sectors and expanded to information technologies and media sectors.

Investments in Retail Businesses

Despite Ilshin's continuous efforts to find investment opportunities in high-tech industries, Ilshin could not consummate any quality high-tech deals until it invested in Ace Antenna in 1995. Potential start-ups and early-stage companies were scarce in the market. Ilshin's professionals realized that their academic and professional backgrounds did not fit high-tech areas. They thought that their network and capability for deal sourcing, due diligence, and value creation for high-tech deals needed to be established over the long-term.

Investment in Giordano Korea in 1994 was based on the judgment of Ilshin's professionals about their resources and capabilities. Obviously, retail business in Korea is not a fast growing sector. But, value creation by Ilshin's professionals could be more effective in retail sectors than in other sectors. They noticed that Ilshin Spinning had supplied threads for many years to Giordano, a branded retailer of casual apparel in Honk Kong. Ilshin started thorough market researches including customer analysis, competitor analysis, and potential value creation, and decided to establish intro duce Giordano in Korea. Ilshin was confident of great opportunity for marketing middle-price casual apparel, as a niche market. After the decision, Ilshin directly approached Giordano through its network based on Giordano's relationship with Ilshin Spinning, and indirectly made Ilshin referred by a venture capital in Hong Kong. Ilshin's exhaustive investigation and preparation for doing the business in Korea moved the top management of Giordano. Ilshin and Giordano decided to launch business in Korea. Each party invested KRW 2.5

billion at a ratio of 50:50 in ownership. Jun-Seok Han, who advised Ilshin on the overall process as an industry expert, was appointed as CEO of the new company jointly established by Ilshin and Giordano.

From the start-up stage of Giordano Korea, Ilshin actively took part in the major decisions. Ilshin recruited Jong-Ho Park, and sent him to Giordano Korea as a full time secondee responsible for close monitoring. Ilshin's contribution was mainly about building marketing strategies, such as establishment of effective distribution channels. For instance, Giordano Korea was the first middle-price casual apparel brand that opened shops in major department stores. The shops in department stores need to be spacious enough to give customers impression of quality brand. That kind of effort was accompanied by narrowing down products line-up, key of which is careful quality control. Another key strategy was to control inventory turnover. By drastically cutting down turnover days through real-time data transmission from shops to headquarter, it could maintain competitive pricing and constant sales volume, and was not pressured by regular bargain sale which was common among casual apparel brands in Korea.

Those effective strategies led by Ilshin was based on thorough due diligence of Ilshin's professionals. Sales volume has grown by 140% annually on average, even during economic crisis in 1997 and 1998. Return on investment in Giordano Korea is expected to be over 18 times of initial investment amount.

Based on experiences in Giordano Korean, Ilshin made a series of investments in retail sectors, including Body Shop Korea (cosmetics, 1996), Topko (ladies apparel, 1996), Blue Elim (upholstery, 1996), and Madarina Duck (accessories, 1997). Jong-Ho Park took charge of Body Shop Korea and Madarina Duck, and became a full time secondee at Body Shop Korea. Post-investment activities of Ilshin were always hands-on as is the case with Giordano Korea. And Body Shop Korea is expected to be another great success following Giordano Korea.

Investments in Movies

In 1996, Ilshin decided to invest in movies, and Seung-Bum Kim took responsibility for the sector. It was Ilshin's first step toward media and contents sectors that are currently a major category of target sectors. The background of Ilshin's decision is that Ilshin's role in value creation was clearly defined upfront.

Ilshin identified investment opportunities in production and distribution of quality Korean movies in consideration of increasing income-level, high growth potential of the movie market, and increasing demands for quality Korean movies as well as short investment cycle of movie project investments.

Ilshin also noticed that the Korean movie industry is closed and under-developed in many ways but could be more industrialized within short period of time if supported by active investments by financial investors and more thoughtful production based on systematic approach. After Ilshin's pioneering investment in movies and the big success of "The Contact" in 1997, movie investments by financial investors and production of Korean movies have sharply increased and the market share of Korean movies has also increased from 20% level in 1995 to 50% level in 2002.

Ilshin often participated in all phases of movie production from planning and preproduction to marketing and distribution for the purpose of putting more emphasis on commercial aspects of a movie and systematic approach to identify customers' demands and inclination. In 1995, Ilshin formed a consortium with Kookmin Venture Capital and invested in "Ginkgo Bed". Nationwide admissions of Ginkgo Bed were around 680 thousand, a record high number, and Ilshin gained 81.78% rate of return from just one year investment.

Active Fund Raising and Investment in High-Tech Areas

Though environment for investment was still unfavorable and fund raising from domestic institutions was virtually impossible, Ilshin launched four limited partnerships from 1995 to 1997 by raising KRW 62.3 billion, significant portion of which came from large foreign institutions. Through international and proprietary network of

Ilshin's professionals, Ilshin targeted and approached large foreign investors who were thought to have interests in the Korean venture capital market and long-term growth potential of the Korean high-tech industries.

Salomon Brothers participated in Ilshin No. 4 Venture Investment Partnership as a major limited partner, Itochu Corporation in Ilshin No. 5 Venture Investment Partnership, and Capital Balanced Fund in Ilshin No. 6 Venture Investment Partnership and Ilshin No. 7 Venture Investment Partnership, respectively. The amount of seven limited partnerships managed by Ilshin was KRW 90 billion in total.

Ilshin needed more professionals with diverse backgrounds for efficient management of the new limited partnerships. Expertise in technologies or financial engineering was the first thing to be added to Ilshin, because the backgrounds of Ilshin's existing professionals were management consulting and operation. In 1996 and 1997, Ilshin recruited three professionals who had worked for investment banks and brokerage houses.

Being confident of upcoming bullish stock market, Ilshin heavily invested in later-stage technology deals with secure exit within one year through IPO or trade sales. Turbo Tech (1996), Humax (1996), Dooin Electronics (1996), Hwang-kum ST (1997), and Samlip Precision (1997) were the representative deals done during this period.

Investment in Cybertech Holdings

Cybertech Holdings is a leading Internet security company specializing in e-commerce infra-software including network security solutions, e-payment assurance solutions. Currently, Cybertech Holdings is leading the Internet security solution industry with 40% market share in the firewall segment and is also a major player in many other sub-segments of Internet solution.

As Internet was widely diffused in Korea, security of data transmission through the Internet network became a critical issue, especially in the area of e-commerce. Sharing a vision on the future of Internet and e-commerce security business, a ground of established off-line companies decided to fund the set-up of Cybertech Holdings in August 1995. TriGem Computer, a leading Korean computer manufacturer was the anchor shareholder that initiated the idea of establishing Cybertech Holdings. Ilshin was invited into the consortium because of its financial engineering and venture capital expertise. Ilshin acquired 5% of total 70 million outstanding shares at the price of par value. The other shareholders were Narae Telecommunication (TriGem's affiliate, 10%), CJ (consumer goods, 5%), Taeyoung (major shareholder of SBS Broadcasting, 5%), Kyung Bang (textile and retailing, 5%), Isu Chemical (chemical products, 5%), and Nasan (apparel, 5%).

The beauty of the deal was the strong growth strategy backed by synergetic shareholding structure. Every shareholder of the company was a leading company in various sectors, including information technology, computer, consumer products, construction, retailing, textile, apparel, broadcasting, and chemical. Ilshin identified value creation opportunities in coordinating the existing shareholders and adding new shareholders in other industries. Above all, the solutions of the company were competitive in terms of technology and price and the management team was experienced and well organized.

Cybertech Holdings outperformed its competitors. Supported and advised by Ilshin, the company obtained joint venture license from Check Point Software Technologies, a globally leading developer of security solutions in Israel, and established a subsidiary company in the U.S. to be used a distribution arm. A key solution, firewall program specialized to stock trading system, was successfully developed.

In 1996, Ilshin increased its shares to 6.67% by subscribing stock offering. Before the company was listed on the KOSDAQ in December 1999, Ilshin brought in Shinhan Bank for a pre-IPO investment, which later became a major client of the company. Total amount of Ilshin's investment in the company was KRW 100 million, 0.1 billion and the investment recorded 175.9%.

4. Economic Crisis and Reorganization (1998 ~ 1999)

Opening of Private Equity Market in Korea

Following the economic crisis in 1997, private equity market emerged in Korea as conventional debt and equity financing froze in overall market. Troubled with distressed portfolio companies, most Korean venture capital firms that had focused on high-tech companies of start-up and early stage nearly stopped new investments. However, foreign private equity investors with abundant capital were attracted to the Korean market by expected appraisal of Won currency and low valuation caused by temporality distressed situation. Main categories of targeted investments in this period were acquisition of spin-off companies from Chaebols and providing turnaround capital to mid-sized companies which were not affiliated to Chaebols.

In Search of New Alternative

After breakout of the economic crisis in 1997, Ilshin looked for alternative opportunities instead of investing in high-tech companies which was deemed to be extremely risky considering doubtful recovery of the Korean economy in the short term. The first targeted company sourced by Ilshin was Anam Instrument, one of the affiliates of Anam Group which had serious liquidity problem caused by aggressive capital expenditure through debt financing. Anam Group planned to sell controlling ownership of Anam Instrument to third party and approached potential investors. Proposed by HSBC, Ilshin formed a consortium with a subsidiary of HSBC dedicated to private equity investments in Asian regions and conducted in-depth due diligence on Anam Instrument. HSBC had extensive experiences in private equity investing in many Asian countries, but was unfamiliar with the Korean market. On the other hand, Ilshin had an established team of competent professionals with local experiences and knowledge, but did not have detailed procedures of private equity investing for later-stage companies. After Ilshin and HSBC completed due diligence on Anam Instrument, the deal was revoked by Anam Group due to their internal reasons undisclosed to potential investors. Nevertheless, Ilshin experienced the whole process of private equity investing in later-stage companies through intensively co-working with HSBC. Afterwards, many other foreign private equity investors visited Ilshin from Wall Street, Hong Kong, Singapore, and London and some of them proposed Ilshin to co-manage private equity funds in the form of joint venture. AMP, the largest life insurer in Australia, was one of them who proposed joint venture to Ilshin.

Strategic Alliance with Dacom

Almost two years of Ilshin's hibernation since 1997 ended with entering into strategic alliance with Dacom, a leading Korean company in telecommunication services and an affiliate company of LG Group. Targeting Internet-related businesses for growth in the future, Dacom planned to invest in early-stage companies in line with its strategies and to spin off some divisions promising as independent operations. Pressured by rapidly changing environment of Internet businesses, Dacom wanted to stabilize investment business in the short time frame and minimize trials and errors. To this end, additional capital to leverage on and expertise in nurturing start-ups needed to be sourced from outside. Dacom decided to form strategic alliance with an established venture capital firm by investing in limited partnerships and to make direct investments as a co-investor simultaneously. After strong competition with many venture capital firms, Ilshin was able to launch Ilshin & Dacom Investment Partnership in the late 1999.

Ilshin tried advanced investment processes for Ilshin & Dacom Investment Partnership, such as advisory board and two-tier investment committee. Ilshin organized advisory board that consisted of executives at Dacom and industry experts from other limited partner companies. Each member of advisory board was asked for opinions on proposed investments from the point of strategic fit for the partnership, up-front value-creation strategies, and conflict of interests with existing businesses of the limited partners. Investment decisions were made at two-tier investment committee. At the first investment committee, proposed investment was approved for in-depth due diligence so that Ilshin minimize wasted time and efforts as well as professional fees paid to external advisors. Final decision was made at the second investment committee after reviewing results of due diligence and opinions of the advisory board.

Ilshin shared overall procedures with Dacom's direct investment team from deal sourcing to exit, and frequently teamed up with them for various projects such as market research. In order to source quality deals, Ilshin leveraged on Dacom's business network and strong brand name which was appreciated by high-tech companies. Supported by Dacom, Ilshin categorized Internet businesses into sub-segments, listed up target companies in each segment, and approached them. Internet infrastructure of Dacom such as Internet data centers constituted incubation platform that provided differentiated and substantial assistance to early-stage companies engaged in Internet businesses.

As a corporate investor, Dacom aimed at potential synergies with its strategic objectives rather than financial return on investment. To harmonize different interests of two parties, Dacom aligned compensation of its direct investment team with Ilshin, and Ilshin made two professionals exclusively responsible for the partnership. Throughout all the processes, Ilshin's experiences across various industries and Dacom's knowledge about Internet-related businesses were successfully mixed. Proposed by Dacom, Ilshin & Dacom No. 2 Investment Partnership was launched in 2000.

5. Transformation to Private Equity Investor (2000 ~ Present)

From January 1999 to March 2000, the KOSDAQ provided extraordinary exit opportunities to venture capital firms. The KOSDAQ index rose from 76.40 Point (January 4, 1999) to 283.44 Point (March 10, 2000), and the trading amount also exceeded Korea Stock Exchange. As almost every IPO at the KOSDAQ brought record high returns to investors, investments in pre-IPO high-tech companies became the most attractive opportunity. Many venture capital firms also got out of troubled situation, earning significant amount of capital gains from IPOs of portfolio companies. Numerous investors in various fields including conventional financial institutions and high-wealth individuals entered into venture capital businesses and invested mainly in later-stage high-tech companies expecting short-term capital gain from IPOs. This resulted in ultra-high valuation of later-stage high-tech companies.

Ilshin was contrarian in this period as well. It continuously focused on investments in start-ups or early-stage companies through the partnerships managed with Dacom and new partnerships launched thereafter, and continued its efforts of value creation of portfolio companies. In addition, Ilshin decided to launch private equity funds to invest in mid-cap companies which are larger than typical late-stage companies that Korean venture capital had invested in so far, but smaller than large-cap companies that foreign private equity investors invested in. After extensive study and thorough preparation since 1999, Ilshin launched Henderson Korea Partners, L.P. (“HKP”) with the fund size of USD 34.6 million in 2001, which is the first private equity fund managed by Korean venture capital firms. HKP is jointly managed with AMP Group, and is named after AMP Group’s asset management subsidiary, Henderson Global Investors, to leverage on Henderson’s strong brand name. After launching HKP, Ilshin added two more main categories of investment to the existing high-tech, retail and movie sectors. Those are investing in controlling shares in mid-cap companies across various sectors and providing larger amount of expansion capital to high-tech companies competing in the global market.

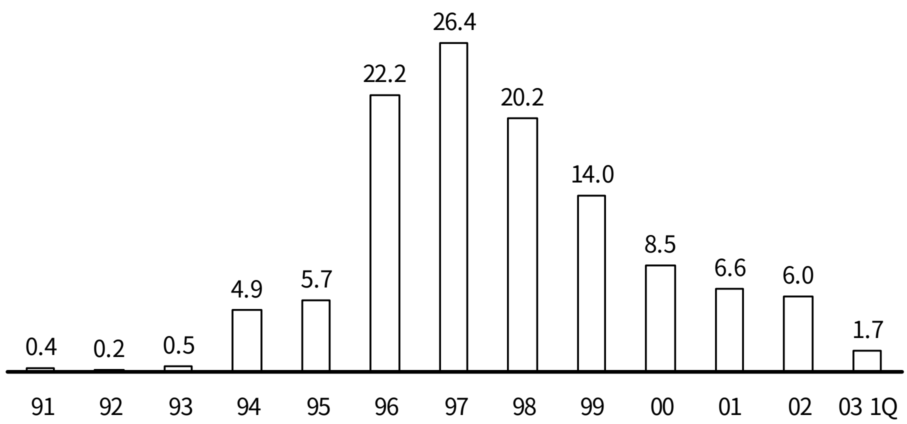
Exhibit 3-1: Performance of Ilshin

A. IRR

	Number of Investments	Total Capital Invested	Value of Investments	IRR*
Realized	65	89.9	112.9	23.77
Unrealized	40	27.2	100.9	35.47
Total	105	117.1	213.7	30.21

* Gross annual internal rate of return of equity investments from October 22, 1991 to March 31, 2003; Verified by Anjin & Co, a member firm of Deloitte Touche Tohmatsu.

B. Investment Amount, 1991-2003 1Q (Unit: KRW billion)



C. Investment of Ilshin by Sector and Stage (Unit: KRW Billion, %)

	IT		Contents*		Others		Total	
	Amount	Ratio	Amount	Ratio	Amount	Ratio	Amount	Ratio
Seed	8.6	15.3	24.3	92.0	11.8	34.1	44.7	38.2
3 years or younger	17.8	31.7	-	-	1.7	4.9	19.5	16.7
Older than 3 years	29.7	52.9	2.1	8.0	21.1	61.0	52.9	45.2
Total	56.1	47.9	26.4	22.5	34.6	29.5	117.1	100.0

* Movie investment and other contents investments categorized under seed investment.

Exhibit 3-2: Limited Partnerships managed or advised by Ilshin (Unit: KRW billion)

Year of Launch	Name	Size	Major Limited Partners
1990	Ilshin No. 1 Venture Investment Partnership	5.0	Sit/Kim International, Small Business Corporation, Shindong, Ilshin Spinning, Chohung Securities
1993	Ilshin No. 2 Venture Investment Partnership	13.4	Bankers Trust New York
1993	Ilshin No. 3 Venture Investment Partnership	9.3	Ilshin Spinning, Aekyung Petrochemical, Small Business Corporation
1994	Ilshin No. 4 Venture Investment Partnership	20.0	Salomon Brothers Asia
1995	Ilshin No. 5 Venture Investment Partnership	3.0	Itochu Corporation
1995	Ilshin No. 6 Venture Investment Partnership	25.0	Capital Balanced Fund
1995	Ilshin No. 7 Venture Investment Partnership	14.3	Capital Balanced Fund, Ilshin Spinning
1999	Ilshin & Dacom Investment Partnership	11.0	Dacom International, CJ, Humax, Small Business Corporation
2000	Ilshin & Dacom No.2 Investment Partnership	10.3	LG Telecom, Doosan, Korean Government
2000	Ilshin Animation Investment Partnership	5.0	Koko Enterprise, Korean Government, Korean Film Commission, Animation International
2001	Henderson Korea Partners, LP	44.9	AMP Life, Koram Bank
2002	Ilshin & Koko Contents Investment Partnership	12.0	National Pension, SNU Foundation
2003	2003 KIF-Ilshin IT Fund	16.0	Korea IT Fund
	Total	189.2	

Exhibit 3-3: Profile of selected professionals of Ilshin Investment Co. Ltd.

Jeong-Suk Koh, President & CEO

Dr. Koh has been President of Ilshin since 1991. Dr. Koh has been fundamental to the development and execution of Ilshin's strategy. Prior to joining Ilshin, he worked at McKinsey & Co.'s Los Angeles office for two years as a consultant serving several Fortune 500 companies and major Korean conglomerates. Dr. Koh holds a BA from Seoul National University, an MS in Management Science from Korea Advanced Institute of Science and Technology, and a PhD in Management from the Sloan School at Massachusetts Institute of Technology.

Kwang-Hee Oh, Executive Vice President, Private Equity Investment

Before joining Ilshin, Mr. Oh worked as Managing Director at National Information & Credit Evaluation Inc. (NICE), responsible for all of the firm's credit rating and consulting businesses. Mr. Oh worked in the field of credit rating for over twelve years and provided numerous advisory services on restructuring and reorganization of financially distressed companies including Kia, Jinro, Daenong, Kabool and Nasan for the government and financial institutions. Mr. Oh holds an MBA from Claremont Graduate University and a BA from Hankuk University of Foreign Studies, Korea.

Jong-Ho Park, Chief Investment Officer, Retail

Mr. Park joined Ilshin in 1994 and has worked on various investment activities of Ilshin including leading Ilshin's investment activities in the retailing sector. He has succeeded in establishing joint ventures with international brand companies such as Giordano and The Body Shop. Mr. Park was formerly a project manager and financial analyst with Korean AirLines Ltd. before he joined Ilshin. Mr. Park received his MBA degree from New York University and has a BA from Yonsei University.

Mr. Sang-Uh Kim, Chief Investment Officer, Private Equity

Mr. Kim was a senior investment officer for the Citicorp Capital Asia Limited and Citicorp Capital Korea Limited for four years, where his major role was a technology specialist in electronics, computers, and information areas. He also was in charge of all of Citicorp's portfolio investment efforts in Korea with a major focus on the banking sector. His previous experiences include corporate finance and portfolio management and he served for another six years as product manager at Seoul branches of Citibank N.A. and Citicorp International Securities Limited. Mr. Kim earned BS in Computer Engineering from Seoul National University and studied at Pennsylvania State University.

Hak-Beom Kim, Chief Investment Officer

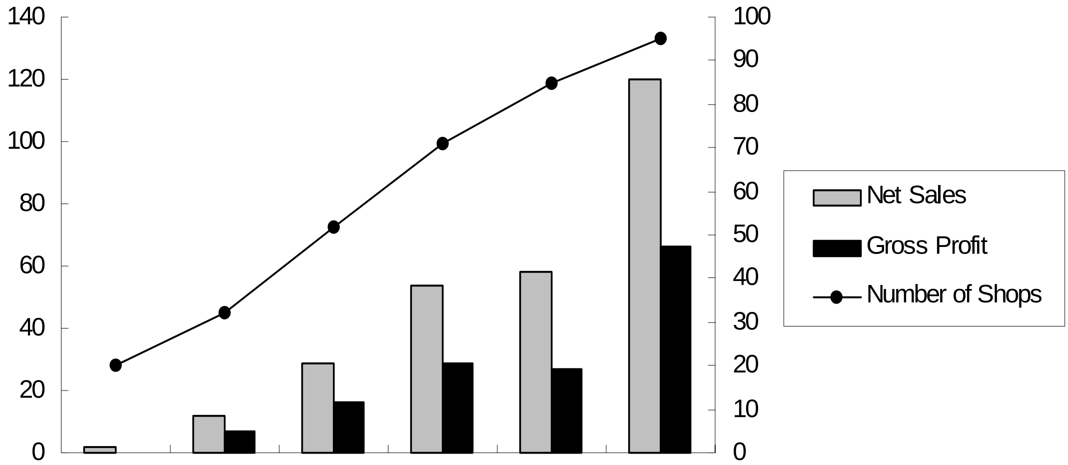
Mr. Kim has worked on late-stage and pre-IPO deals since his joining Ilshin in 1999. He is currently involved in the management of Ilshin&Dacom Fund which invests in early-stage Internet companies. Prior to joining Ilshin, he was a manager at Samyang Merchant Bank for 4 years with responsibility for investment banking, during which time he worked on international finance including loan syndication, funding through offshore vehicles and proprietary overseas investment. He has also worked on international technology transfer business at Samsung Corporation from 1993 to 1995. He obtained a BA degree from Korea University.

Kang-Soo Lee, Senior Investment Officer
Mr. Lee joined Ilshin in 2000 and has been involved in the management of Ilshin&Dacom Fund. Prior to Ilshin, he worked as a project engineer at Eli Lilly & Company from 1998. He participated in KORDIC, a government-owned scientific database institute, as an information provider for two years. He performed a research project on control engineering with the Government and KEPCO from 1996 to 1997. He received an MS from Korea Advanced Institute of Science and Technology and a BS from Korea University.

Byung-In Kim, Investment Officer, Movie Sector
Prior to joining Ilshin in 1999, Mr. Kim worked at McKinsey & Company in Seoul as a consultant for two and a half years. While at McKinsey, he was involved in various projects, such as long term strategy setting for a construction company, an aerospace M&A deal, restructuring of a Korean conglomerate based on chemical and heavy machinery manufacturing business, and evaluation of a new car development process. Mr. Kim received his BA degree from Korea University.

Exhibit 3-4: Performance of Giordano Korea

A. Company Growth



B. Comparison of Inventory Turnover

Company	Number of Days
Giordano Korea	69
A Company	130
B Company	295

IV. CONCUSION

1. Summary of Key findings

Key findings of this study are summarized as follows.

Venture capital is fund available for new or expanding business ventures with considerable growth potential and executable exit route. It is characterized by equity or quasi-equity participation, long-term investment, and on-going involvement in the investee company. Key factor of success for venture capital is long-term value creation of investee companies in conjunction with clear strategy for investment and divestment, efficient allocation of time and funds, strong network for deal sourcing, due diligence, and value-adds, and successful realization.

Korean venture capital industry has significantly grown for the last thirty years. The recent development was based on enhanced entrepreneurship, activated exit market, and strong support of the government. Sudden increase of venture capitals and participation of other conventional financial institutions and corporates made the market competitive. Therefore, more sophisticated skills, more extensive networks, and more active and creative approach to opportunities are required. The further development of the industry is expected to come from evolution of exit mechanism, which is accompanied by a market for merger and acquisition.

Since its foundation in 1990, Ilshin Investment Co., Ltd. ("Ilshin") proactively looked for alternative opportunities in retail and movie sectors to overcome unfavorable environment. Superior return in those two areas was definitely based on proactive value creation for and hands-on control of portfolio companies.

With investment market for high-tech companies more competitive, Ilshin decided to move into less competitive battleground, mid-cap private equity market. Where intensive due diligence and felicitous value creation are critical to successful investment, its experience and accumulated expertise and network in divers sectors can differentiate itself from other players in Korea.

2. Management Implications and Recommendations

The analysis of basic concept of venture capital, the Korean venture capital industry, and case of Ilshin provides a few general management implications and recommendations. To be successful over the long-term, venture capital firms should:

1) have clear and long-term investment strategies with multiple sectors focused on, and continuously accumulate expertise and network based on pre-designed investment strategies. Considering limited sized of domestic market, strategies focused on a single sector are not recommended at the level of a firm unless a sector uniquely provides plenty of opportunities over the long term;

2) be creative and contrarian in selection of sectors, approach to deal sourcing, design of deal structures, and finding exit routes; and

3) be a complete insider of portfolio companies and bring expertise to portfolio companies.

BIBLIOGRAPHY

AVCJ Holdings Limited. *The Guide to Venture Capital in Asia 1993/94 Edition.* Hong Kong: AVCJ Holdings Limited, 1993.

Bygrave, William D., and Timmons, Jeffry A. *Venture Capital at the Crossroads.* Boston: Harvard Business School Press, 1992.

Cooke, Darryl J. *Venture Capital: Law and Practice.* London: FT Law & Tax, 1996.

Coyle, Brian. *Venture Capital & Buyouts*, Chicago: Glenlake Publishing Inc., 2000.

Barlett, Joseph W. *Fundamentals of Venture Capital.* Newark: Medison Books, 1999.

Gompers, Paul A., and Lerner, Joshua. *The Venture Capital Cycle.* London: The MIT press, 1998.

Lipman, Frederick D. *Venture Capital and Junk Bond Financing*, Philadelphia: American Law Institute, 1996.

Lerner, Joshua. *Venture Capital and Private Equity: module 1*. Boston: Harvard Business School, 1996.

Lerner, Joshua. *Venture Capital and Private Equity: casebook.* New York: John Wiley & Sons, 1999.

McKinsey and Company. “U.S. Venture Capital Industry Overview and Economics”. 1998. Available: www.mckinsey.com.

Onorato, Nicole R. *Trends in Venture Capital Funding in the 1990s*, Washington, D.C.: U.S. Small Business Administration, 1997.

PricewaterhouseCoopers LLP. “Money Tree US Report Q2 2000 Results”. 2000. Available: www.pwcmoneytree.com.

Small and Medium Business Administration. “Venture White Paper”. 2000. Available: venture.smba.go.kr.

Venture Economics. *2000 National Venture Capital Association Yearbook.* Newark: Venture Economics, 2000.