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## **1. Background**

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# What is financial inclusion?

## ■ Definition

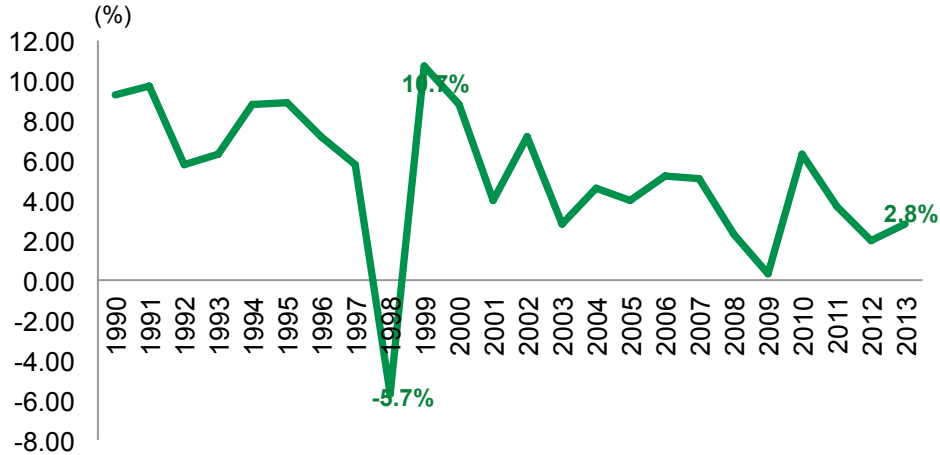
- Financial inclusion or inclusive financing is the delivery of financial services **at affordable costs** to sections of **disadvantaged and low-income segments** of society

## ■ Goal

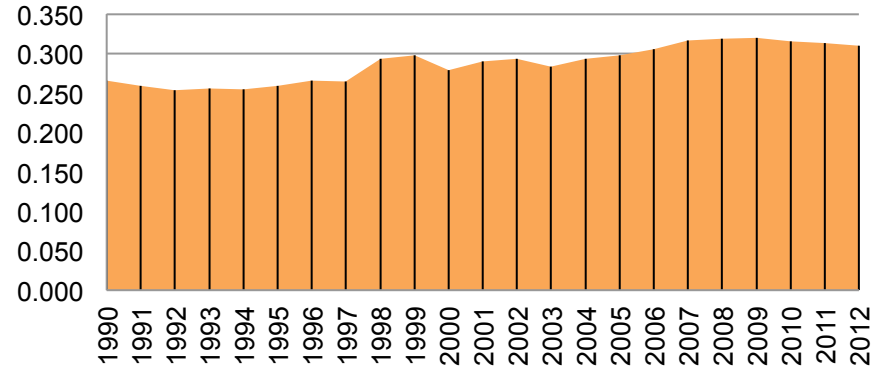
- Access at a **reasonable cost** for all households to a full range of financial services, including savings or deposit services, payment and transfer services, credit and insurance;
- **Sound** and **safe institutions** governed by clear regulation and industry performance standards;
- Financial and institutional **sustainability**, to ensure continuity and certainty of investment;
- Competition to ensure choice and affordability for clients.

# Why we need it?

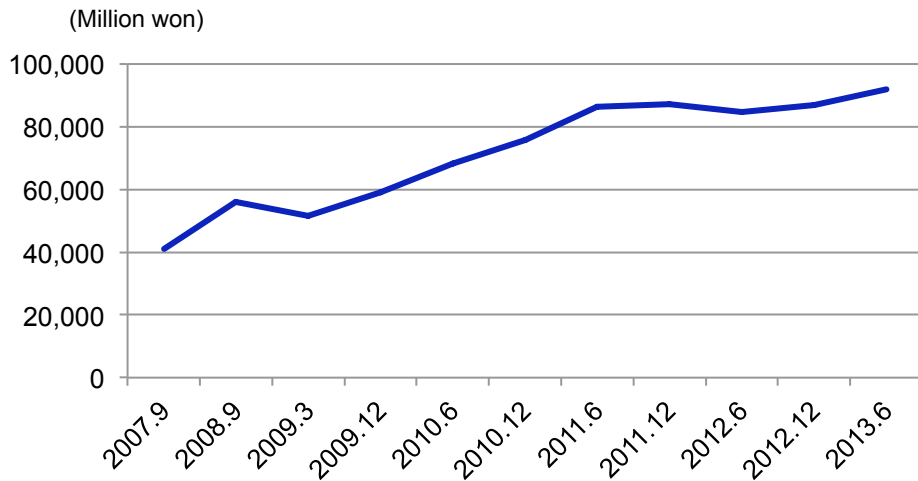
## GDP Growth



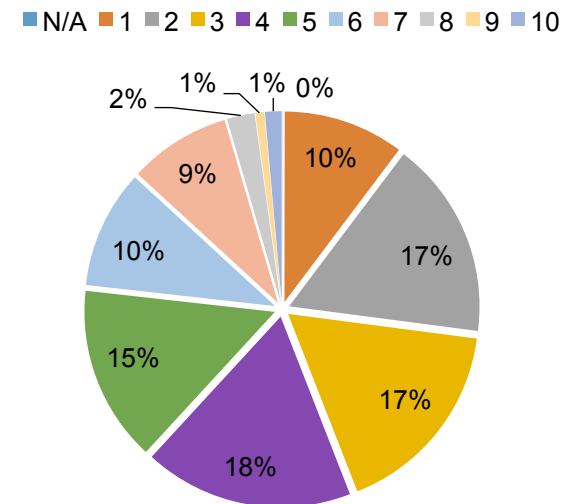
## Gini Coefficient



## Private Lending Market



## Bank Loans by Credit Rating



# SMEs and low-income households have limited funding access because ...

- ✓ Since the global financial crisis, financial institutions have put more emphasis on “**asset soundness**”
  - More conservative asset management
- ✓ Financial institutions become more **risk-averse**
  - Preference for collateral-backed lending
  - Limited funding access for SMEs and low-income borrowers
- ✓ Affordable, credit-backed loans → high-income-high-credit borrowers  
Expensive, credit-backed loans → low-income-low-credit borrowers
- ✓ Financial exclusion of SMEs and low-income households with poor credit status and no collaterals
  - Disproportionate growth of private lending market
- ✓ Deepening wealth polarization → Growing funding needs of SMEs & low-income class  
FI’s Stronger risk management → Dwindling credit supply to SMEs & low-income class
  - Widening supply-demand gap in funding

# How to fill the funding gap

- **As the market falls short of meeting the funding needs,**
  - More People are **excluded** from financial services
  - Private lending market continues to grow
  - Burden of interest payment **becomes heavier** for poor borrowers
  - Limited funding **restricts economic activities** of SMEs and low-income households
  
- **The need to set up a financing scheme to mitigate wealth polarization**
  - ☞ **Supply of policy-based loans for low-income borrowers**

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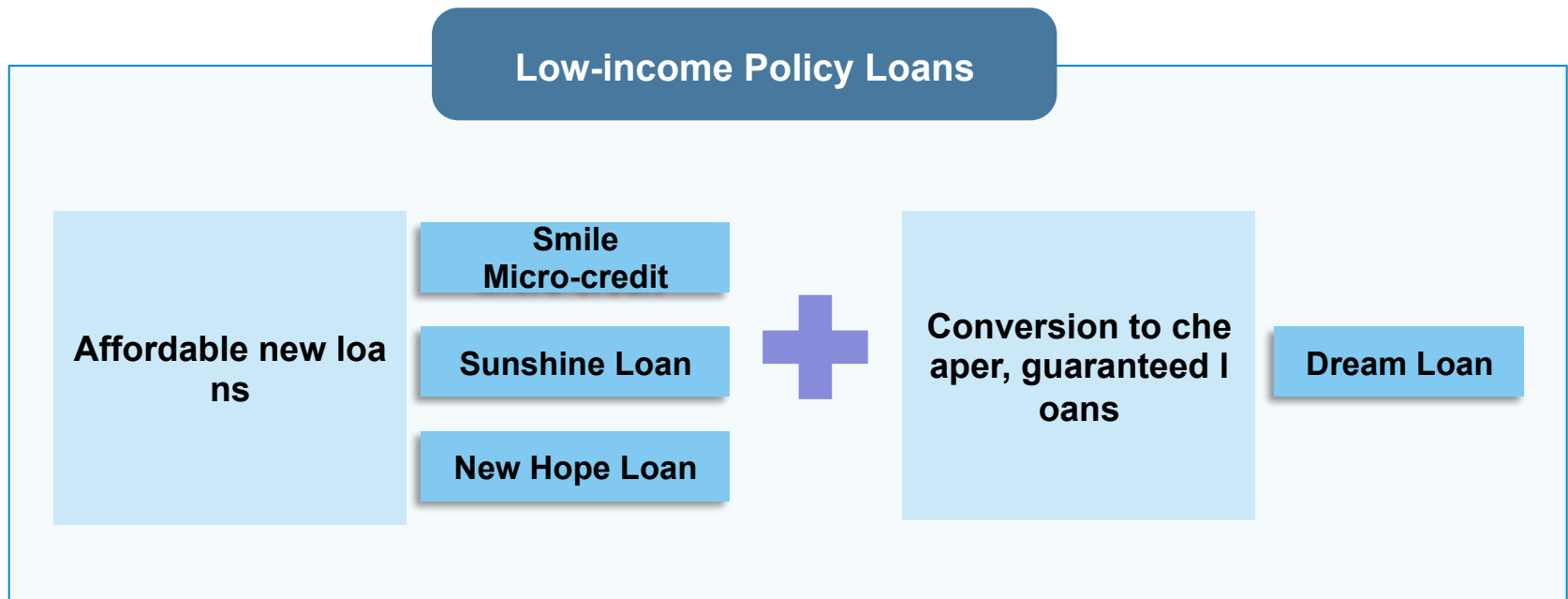
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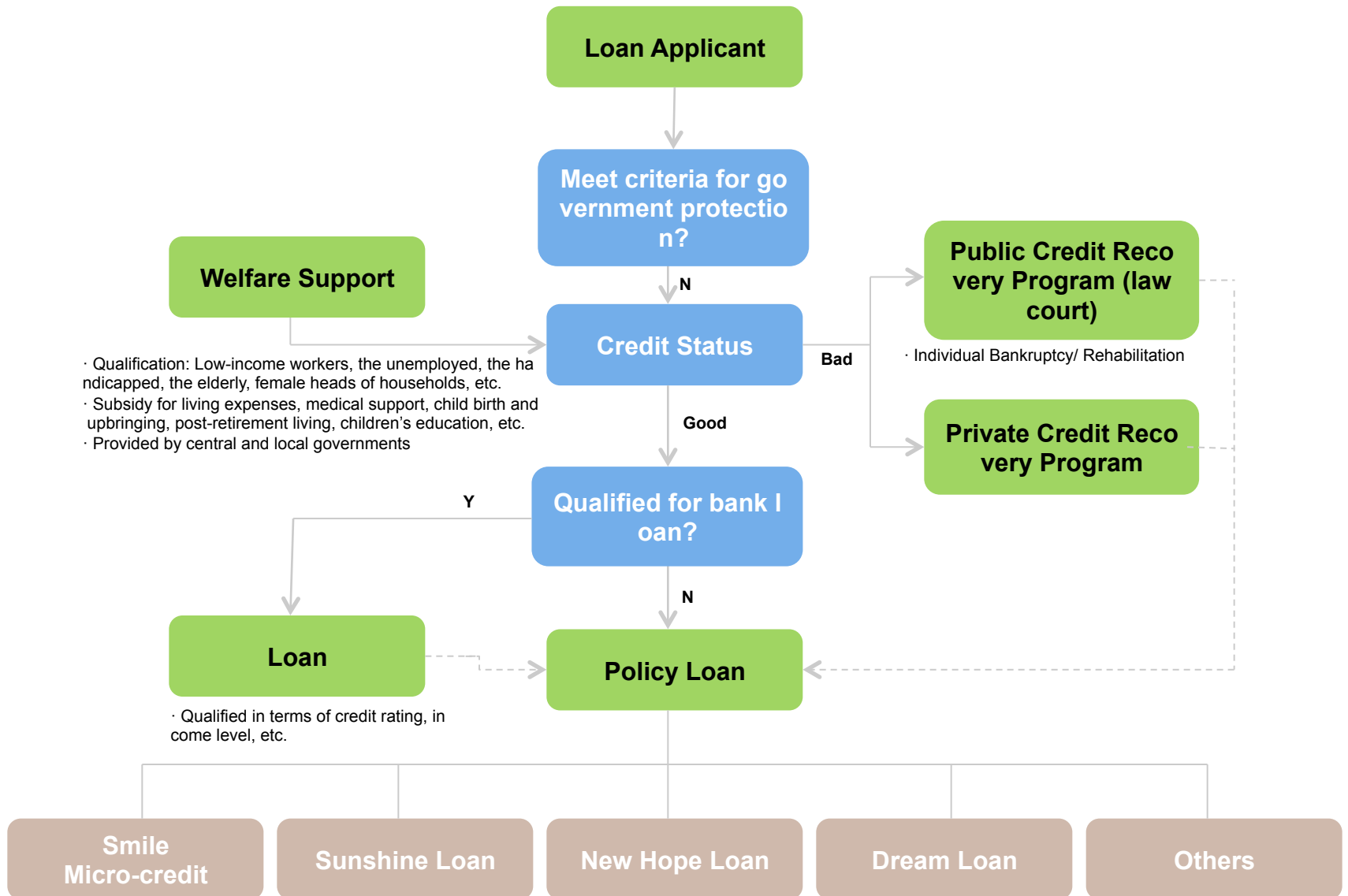
# Low-income Policy Loans in Korea

- The scheme was introduced in 2008 to facilitate funding to **low-income borrowers**
  - Funding resources were mostly mobilized in the **private sector**, partly supplemented by fiscal budget





# Low-Income Policy Loan Flow Chart



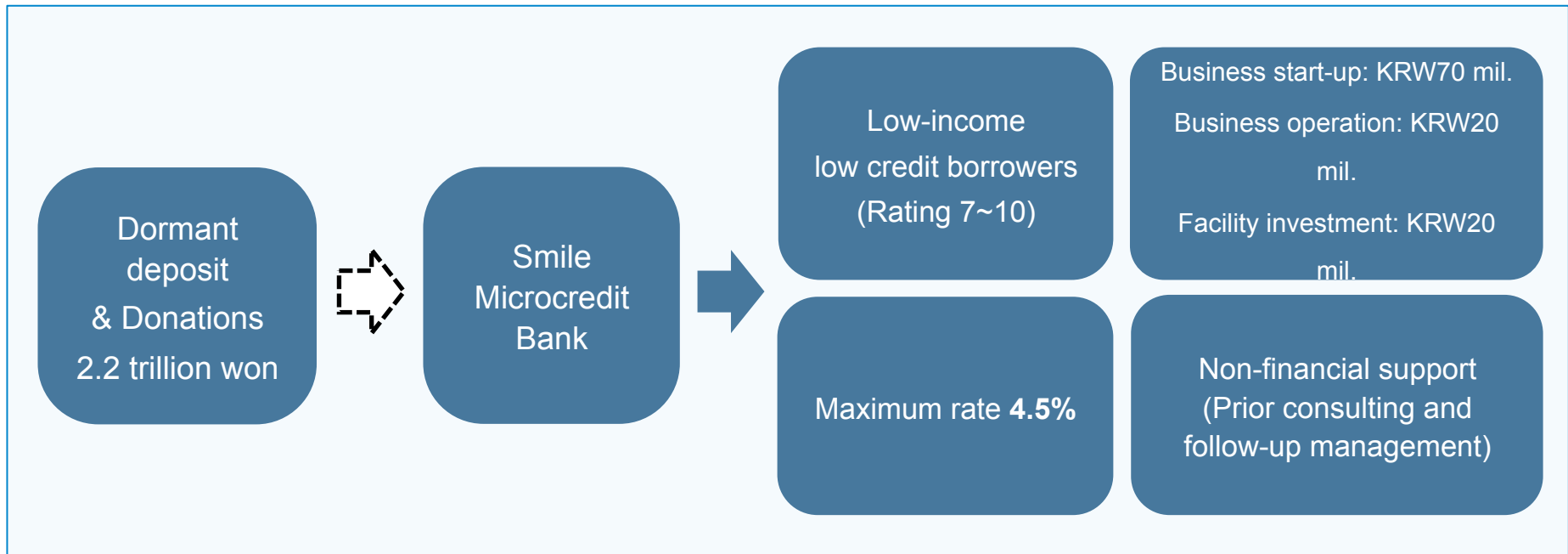
# Korea's Low-income Policy Loans at a Glance

	Smile Micro-credit	Sunshine Loan	New Hope Loan	Dream Loan
Lender	Smile Microcredit Fund	Mutual Credits Savings Banks	Banks	Banks (guaranteed by People's Happiness Fund)
Potential Borrower	· Low-credit-low-income borrowers (credit rating 7~10)	· Annual income of KRW40 mil. or less (credit rating 6~10) · Annual income of KRW30 mil. or less (others)	· <u>Same as left</u>	· <u>Same as left</u>
Maximum Loan Size (won)	Start-up (70 mil.) Business operation (20 mil.) Facility investment (20 mil.)	Start-up (50 mil.) Business operation (20 mil.) Living subsidy (10 mil.)	Living subsidy & business operation (20 mil.)	30 mil. (max amount of conversion)
Maximum Rate	4.5%	12%	12%	12%
Funding Target	2.2 trillion won for 10 years	10 trillion won for 5 years	10% of banks' operating profits for 5 years	-
Track Record (~2013)	1.02 trillion won	4.45 trillion won	5.52 trillion won	2.08 trillion won

# Low-Income Policy Loan (1) : Smile Micro-credit

## ■ Introduced in July 2008

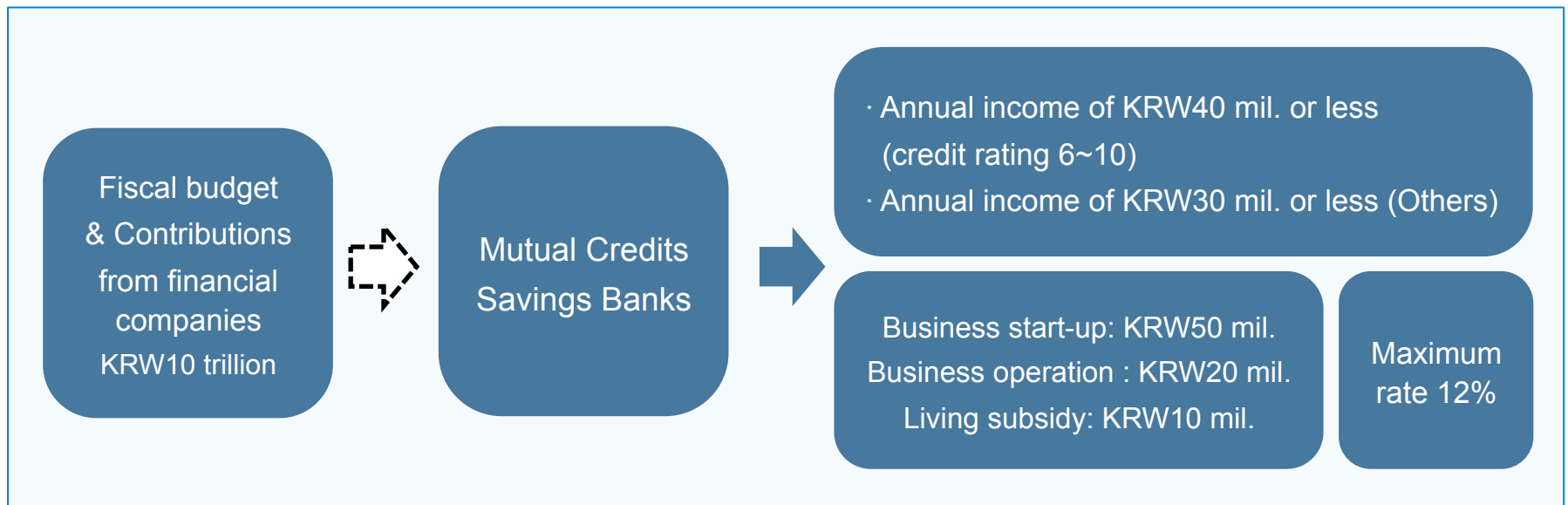
- **Micro loans without guarantee or collateral** for people without official funding access to launch and manage business
- Facilitates financial independence of low-income, low-credit workers and **mitigates financial exclusion**



# Low-Income Policy Loan (2) : Sunshine Loan

## ■ Launched in July 2010 and will last until the fund is depleted

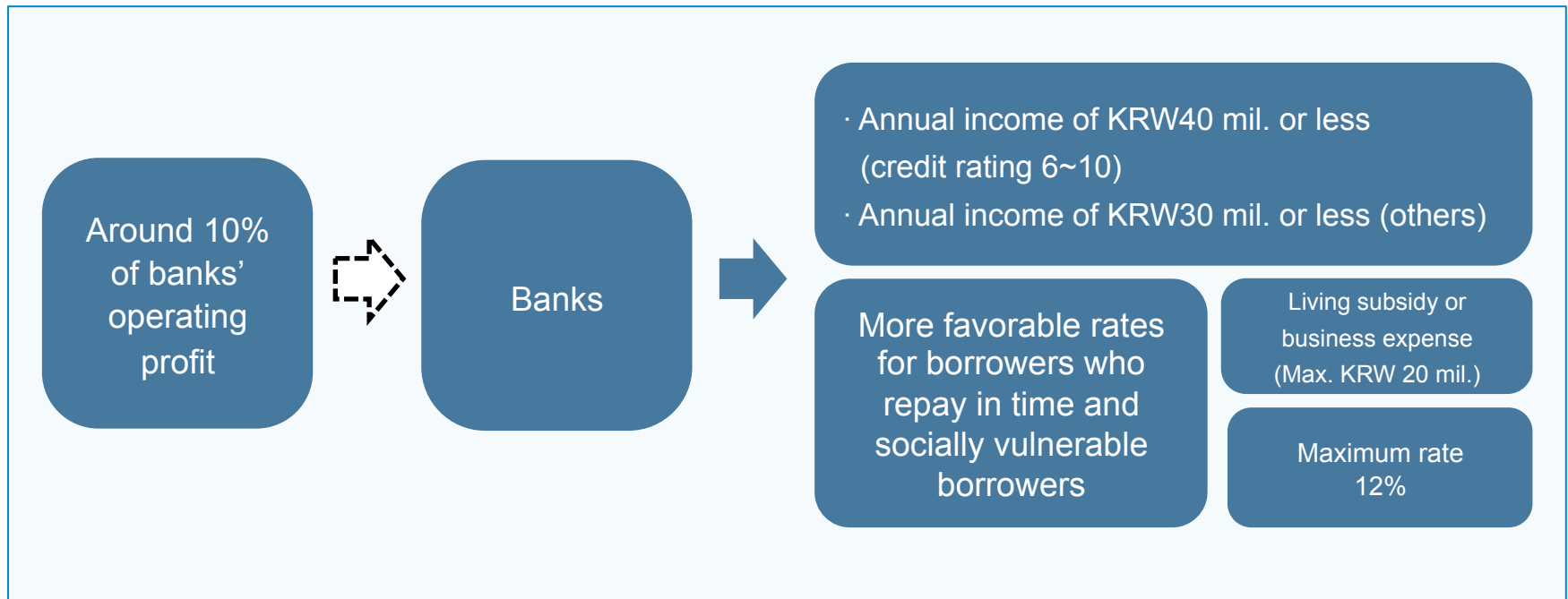
- **Affordable loans for** borrowers who would **otherwise pay 30% or higher interest rate**; **guaranteed** by Korea Federation of Credit Guarantee Foundations



# Low-Income Policy Loan (3) : New Hope Loan

## ■ Introduced in November 2010; effective for 5 years

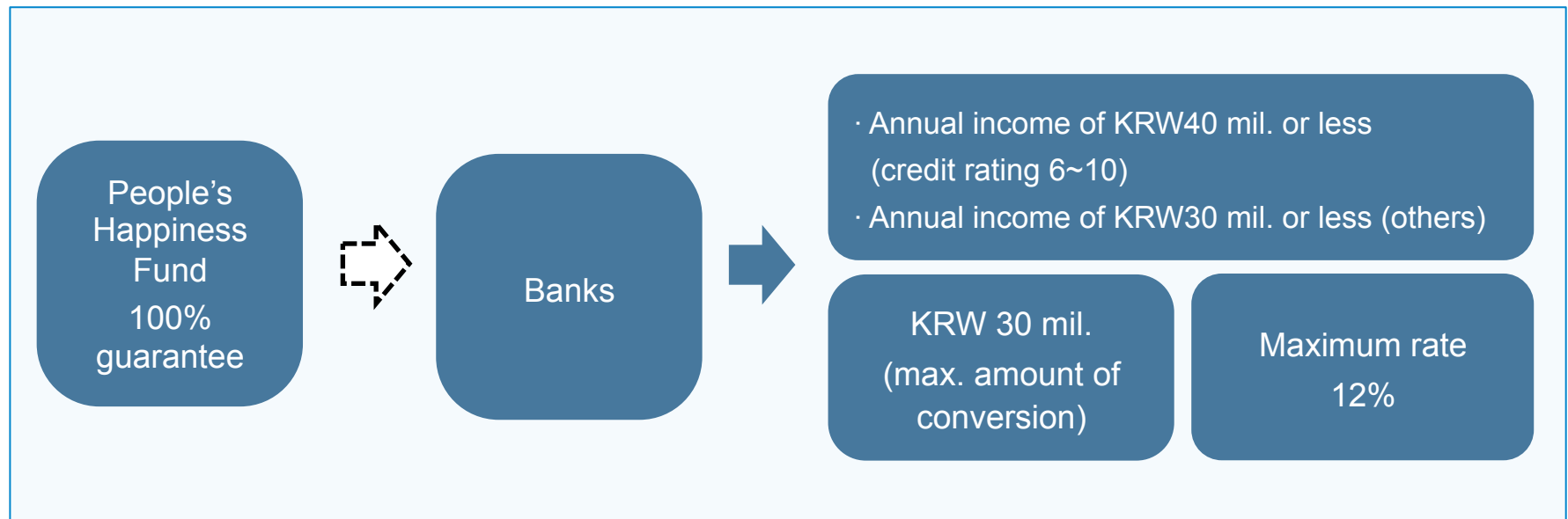
- **Banks' customized loans** for **low-income borrowers** that apply **different lending criteria**;  
Funds are pooled from banks



# Low-Income Policy Loan (4) : Dream Loan

## ■ Introduced in April 2011

- The scheme allows **low-income-low-credit borrowers** who took out expensive loans from private lenders or capital companies (at 20% or higher rate) to **convert to cheaper loans** with the **guarantees** from the **People's Happiness Fund**



# Track Records of Low-income Policy Loan

## Track Record of Policy Loans

(Unit : 100 mil. won)

(Launching Period)	~2009	2010	2011	2012	2013	Total
<b>Smile Micro-credit</b> (08.7)	612	1,144	3,107	2,746	2,624	<b>10,233</b>
<b>Sunshine Loan</b> (10.7)	-	13,859	4,835	6,109	19,728	<b>44,531</b>
<b>New Hope Loan</b> (10.11)	-	2,677	13,655	19,874	18,983	<b>55,189</b>
<b>Dream Loan</b> (08.12)	1,431	1,685	4,752	6,132	6,821	<b>20,821</b>
<b>Total</b>	<b>2,043</b>	<b>19,365</b>	<b>26,349</b>	<b>34,861</b>	<b>48,156</b>	<b>130,774</b>

## Delinquency Rate of Policy Loans

(Unit : %, year-end)

	Delinquency Rate			
	2010	2011	2012	2013
<b>Smile Micro-credit</b>	1.6	3.1	5.7	8.6
<b>Sunshine Loan</b>	0.03	4.8	9.9	9.3
<b>New Hope Loan</b>	-	1.7	2.4	3.6
<b>Dream Loan</b>	5.1	4.9	9.1	15.7

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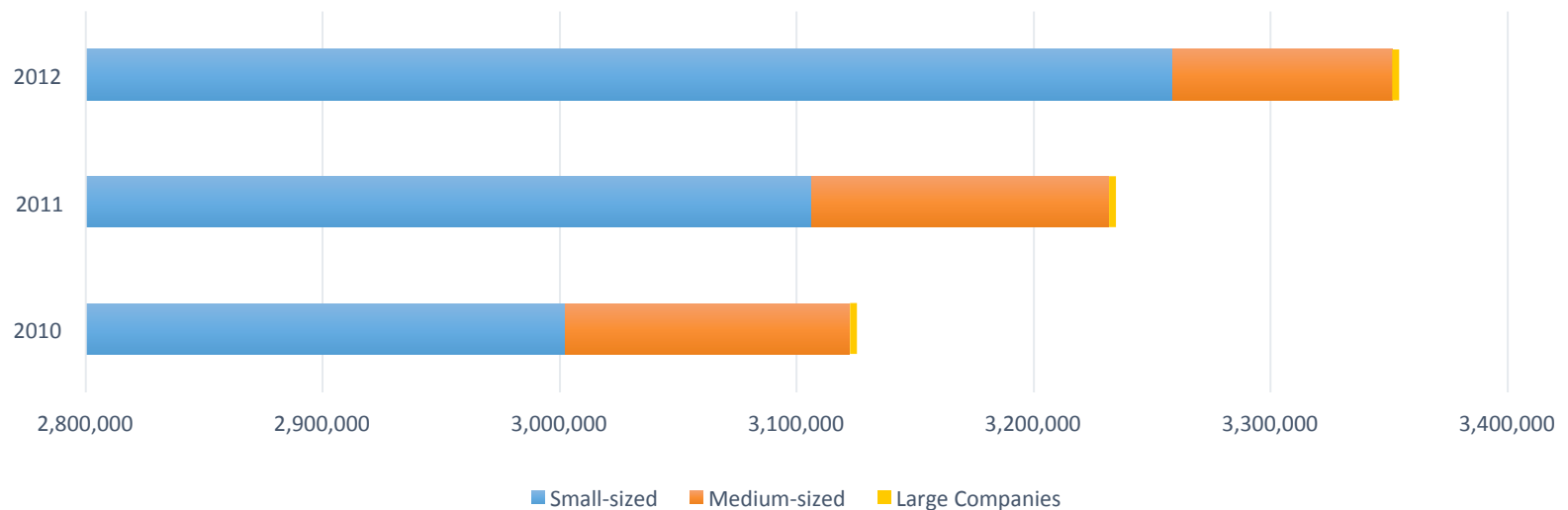
# Small & Medium-sized Business in Korea

## No. of Korean Companies by Size

(Unit : 1,000 Companies)

Category	2000	2005	2010	2011	2012
<b>SMEs</b>	2,854 (99.6)	3,002 (99.9)	3,122 (99.9)	3,232 (99.9)	3,351 (99.9)
<b>Small-sized</b>	2,777 (97.0)	2,910 (96.8)	3,002 (96.1)	3,106 (96.0)	3,259 (97.1)
<b>Medium-sized</b>	77 (2.7)	92 (3.0)	120 (3.8)	125 (3.9)	93 (2.8)
<b>Large</b>	10 (0.4)	4 (0.1)	3 (0.1)	3 (0.1)	3 (0.1)
<b>Total</b>	2,864 (100)	3,006 (100)	3,125 (100)	3,235 (100)	3,354 (100)

Note : ( ) denotes market share.



# Fact Sheet: Korean SMEs

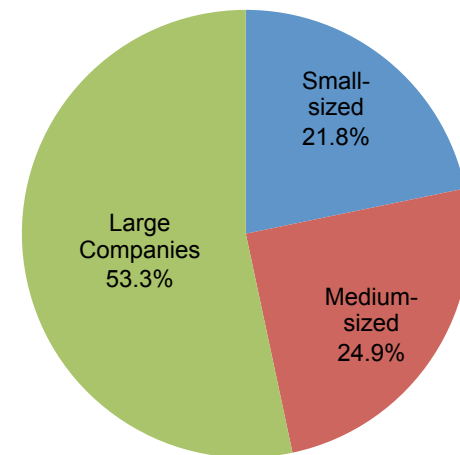
## Production Volume by Company Size

(Unit : trillion won)

<b>Large Companies</b>	833.8 (53.3)
<b>SMEs</b>	729.2 (46.7)
<b>Small-sized</b>	340.1 (21.8)
<b>Medium-sized</b>	389.1 (24.9)
<b>Total</b>	1,562.9 (100)

Note 1) ( ) denotes market share.

2) As of 2011



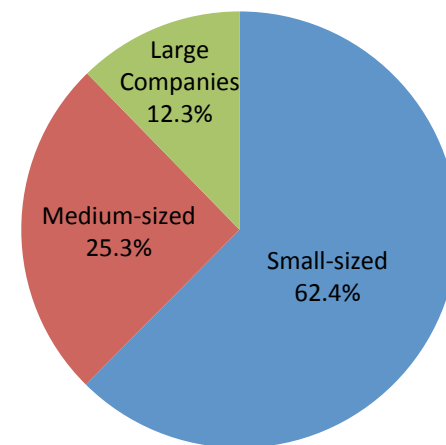
## No. of Employees by Company Size

(Unit: 1,000 people, %)

<b>Large Companies</b>	1,832 (12.3)
<b>SMEs</b>	13,060 (87.7)
<b>Small-sized</b>	9,296 (62.4)
<b>Medium-sized</b>	3,764 (25.3)
<b>Total</b>	14,891 (100)

Note 1) ( ) denotes market share.

2) As of 2012



# Banks' Mandatory SME Lending

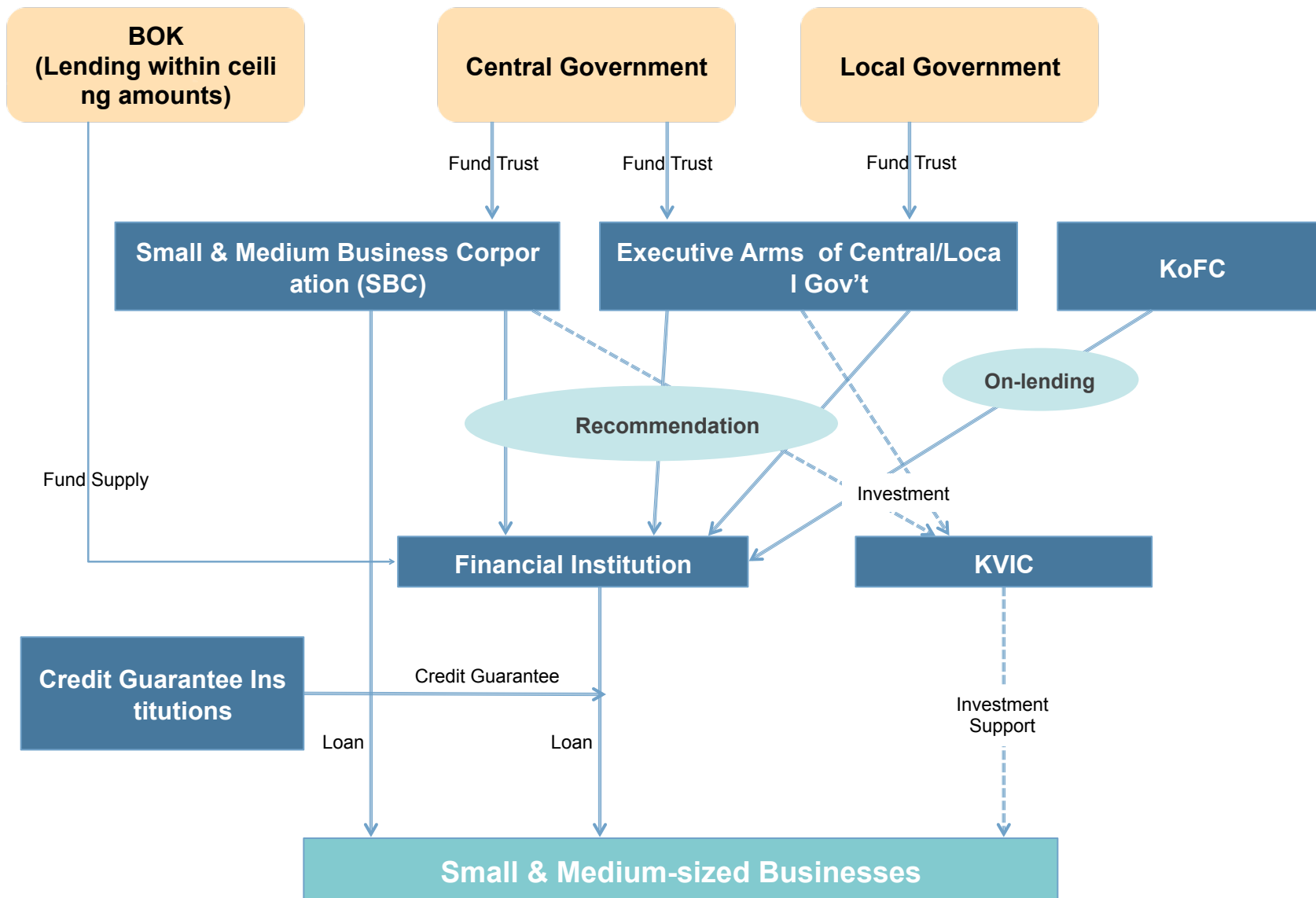
- Banks are required to earmark a certain ratio of their lending for SMEs

	Mandatory Lending Ratio
Commercial Banks	At least 45% of increased amount in local currency lending
Provincial Banks	At least 60% of the same amount
Foreign Bank Branches	At least 35% of the same amount (25% if without BOK's indirect lending support)

- However, banks' SME lending is **heavily biased** toward well-established SMEs or SMEs with solid collaterals;

➤ The need for policy loans arose to support small start-ups and SMEs with innovative technologies

# Basic Framework of SME Policy Loans



# SME Policy Loan (1) : BOK lending within ceiling amount

- For banks' SME lending, the BOK lends cheap money to banks within a ceiling amount
  - Banks have incentive to make profits from the borrowed money
  - The ceiling amount is **regularly adjusted** by the Monetary Policy Committee reflecting financial market conditions

	Launching Period	Max. Loan Amount (tril. won)	Total Ceiling Amount & Lending Rate	Goal
Trade Financing	1994.3	1.5	<b>12 trillion won at rate of 0.5~1.0%</b>	Exporter financing
Credit-backed Lending	2012.4	2		To mitigate collateral dependence in lending
Financing for Small Business Owners	2012.1	0.5		Relieves interest rate burden for small business owners
Financing for Tech Start-ups	2013.4	3		Funding for start-up businesses with innovative technology
Financing for Provincial SMEs	1994.3	4.9		Funding for SMEs in local provinces

Note : As of Feb. 2014  
Source : BOK

# SME Policy Loan (2) : Small & Medium Business Administration (SMBA)

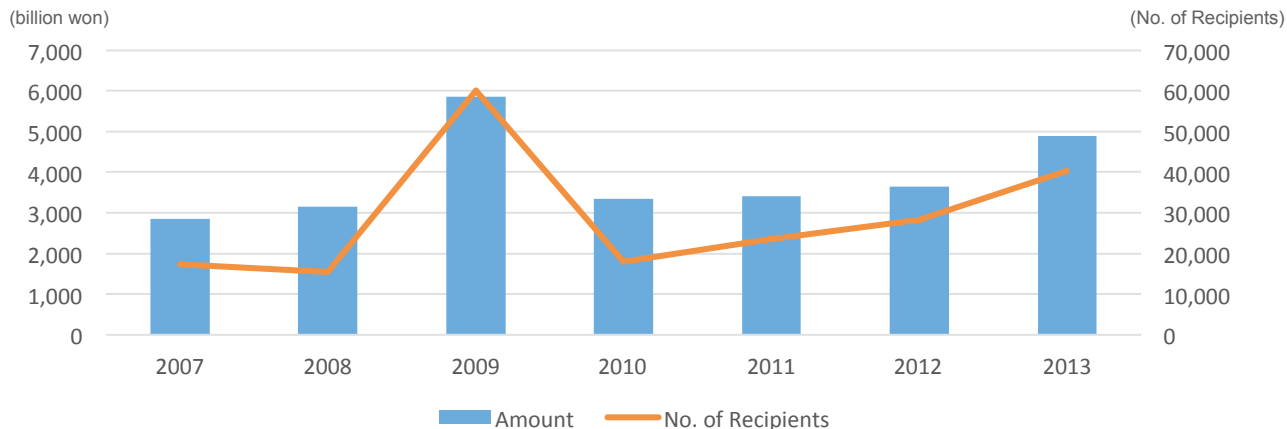
## ■ Each year, SMBA extends loans to SEMs

- With innovative technology, venture start-ups and to support commercialization of new technologies

### SMBA's Policy Loans

(Unit : billion won, No. of People)

	2007	2008	2009	2010	2011	2012	2013
<b>Amount</b>	2,843	3,153	5,856	3,336	3,402	3,651	4,893
<b>No. of Recipients</b>	17,443	15,441	59,968	18,094	23,580	28,334	40,244



# SME Policy Loan (3) : On-lending of Korea Finance Corporation (KoFC)

## ■ KoFC extends affordable, long-term loans

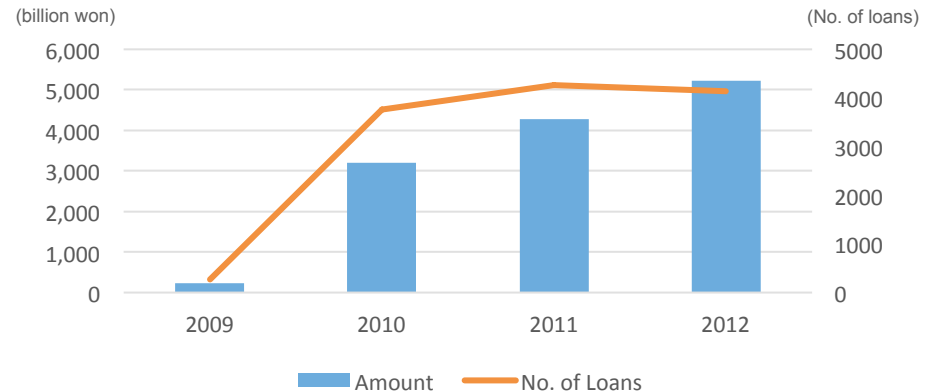
- via banks to foster **strategic industries** of the future



### KoFC's On-lending

(Unit : billion won, No. of Loans)

	2009	2010	2011	2012
<b>Amount</b>	231	3,201	4,271	5,219
<b>No. of Loans</b>	269	3,757	4,269	4,130



# SME Policy Loan (4) : Credit Guarantee

## ■ Korea Credit Guarantee Fund (KODIT)

- KODIT provides credit guarantees for businesses with high growth potential and weak collaterals

Guarantee Type	Description
General	Guarantees for various business loans against financial institutions
Special Purpose Company (SPC)	Guarantees for asset-backed securities that have corporate bonds of SMEs as underlying assets
Accounts Receivable	Insurance for losses of SMEs to prevent a chain of defaults and to facilitate stable management

## ■ Korea Technology Finance Corporation (KIBO)

- The KIBO **assesses companies' technologies** and **provides guarantees** to support high-tech businesses and commercialization of new technologies
- It also offers services for start-ups such as **management guidance** and **technical assistance**



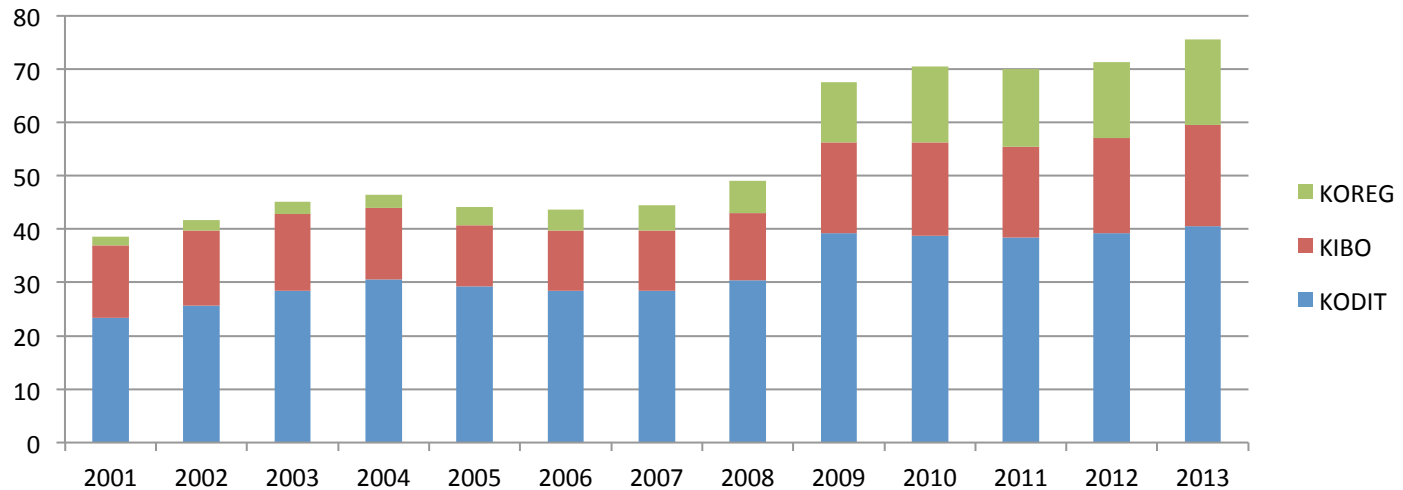
# SME Policy Loan (4) : Credit Guarantee

## SME Credit Guarantees

(Unit : trillion won)

	2001	2005	2010	2011	2012	2013
<b>KODIT</b>	23.3	29.2	38.8	38.4	39.3	40.6
<b>KIBO</b>	13.7	11.5	17.4	17	17.7	18.9
<b>Korea Federation of Credit Guarantee Foundations (KOREG)</b>	1.5	3.4	14.3	14.5	14.3	16

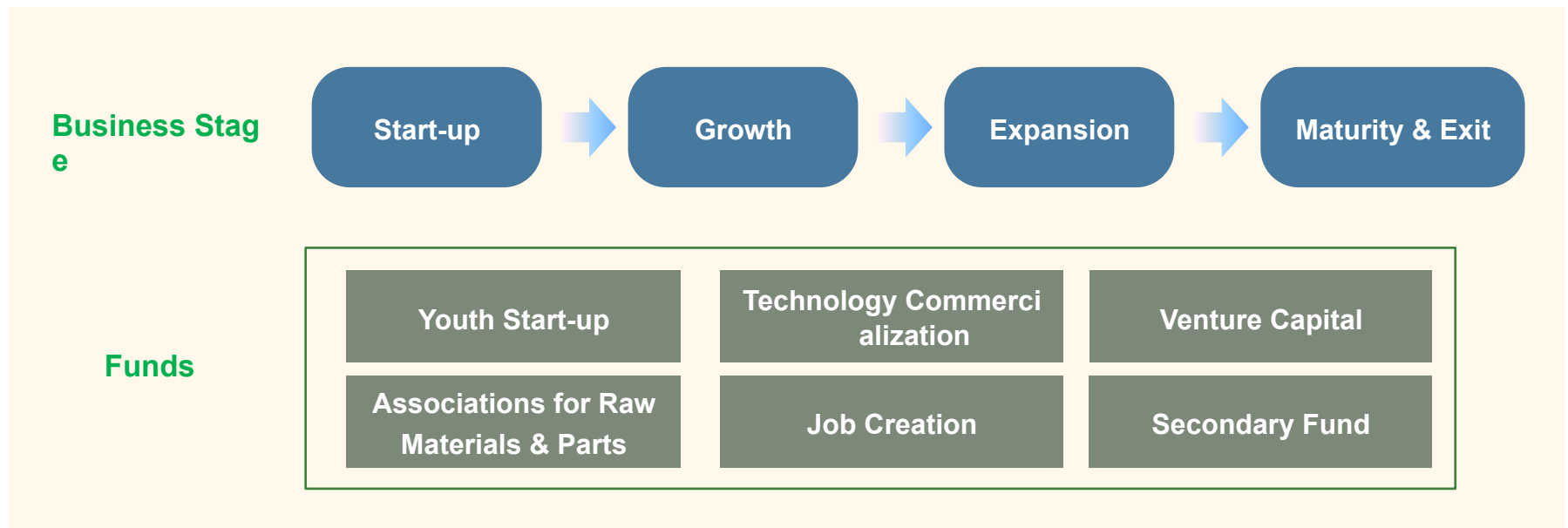
(trillion won)



# SME Policy Loan (5) : Indirect investment

## ■ Indirect investment (SME · venture businesses)

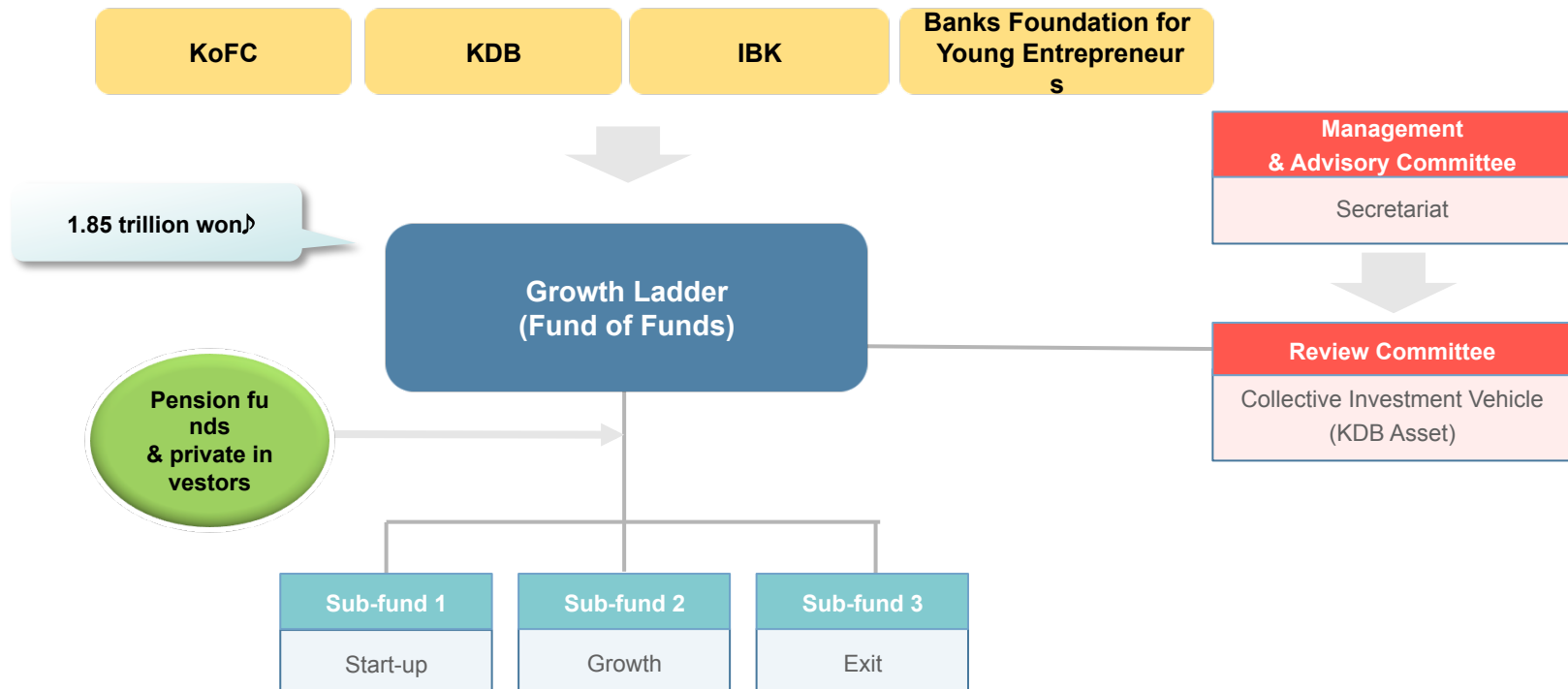
- KoFC **supplies funds** to financial companies, which in turn, review feasibility of SMEs (loan applicants) and make lending decisions
- The scheme **relies on the expertise of financial companies** for more efficient investment and management



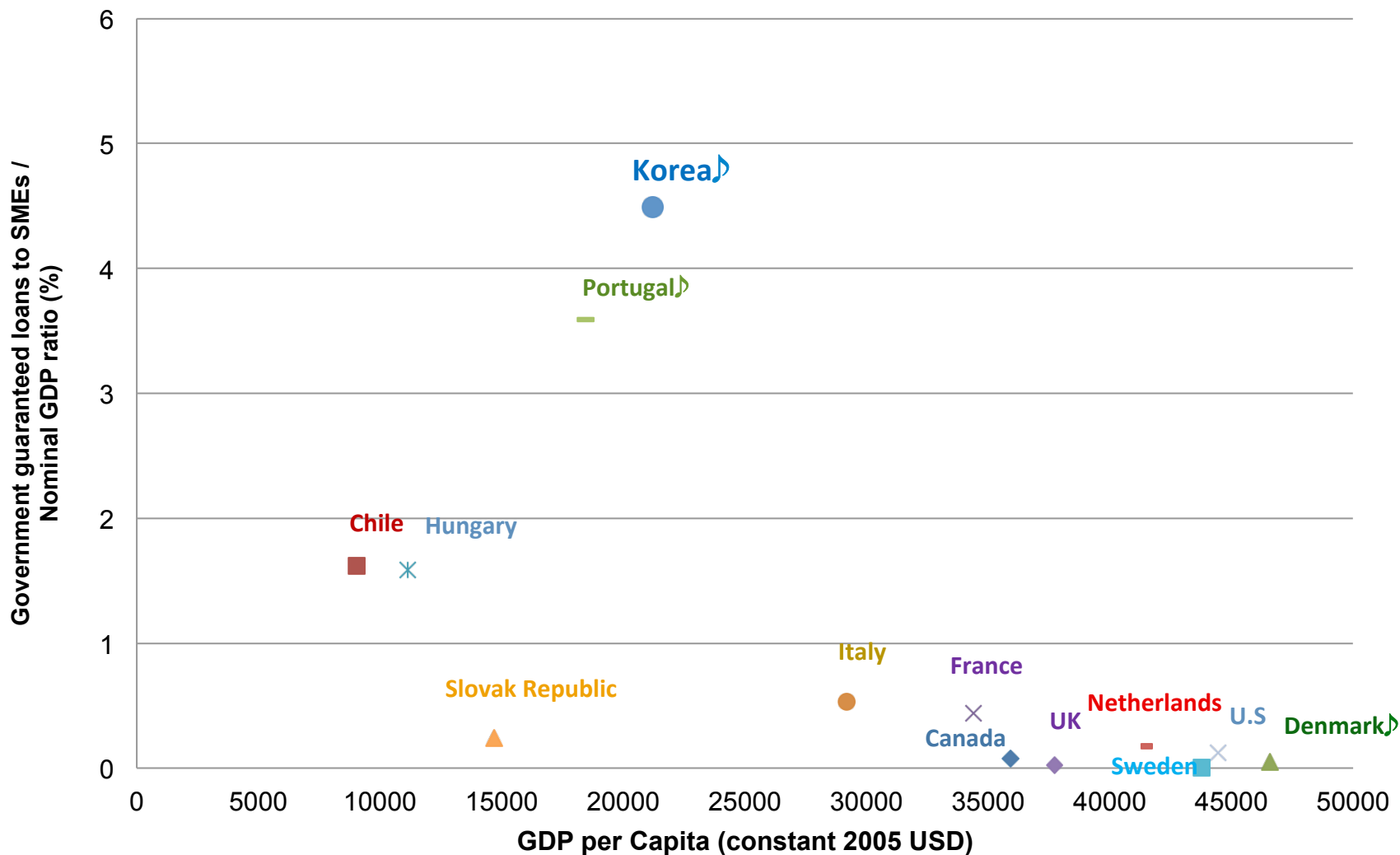
# SME Policy Loan (6) : Growth Ladder Fund

## ■ Growth Ladder Fund

- Aims to create a **virtuous cycle** of business **launch – growth – exit** or **re-establishment**
- **Meet funding needs** of business by their development stages
- Aims to foster venture and SMEs with excellent growth potential in the early stage



# Cross-country Comparison of Policy Loans-to-GDP Ratio



Source : OECD, "Financing SMEs and Entrepreneurs 2013", 2013

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# Contribution of Korea's Policy Loans So Far

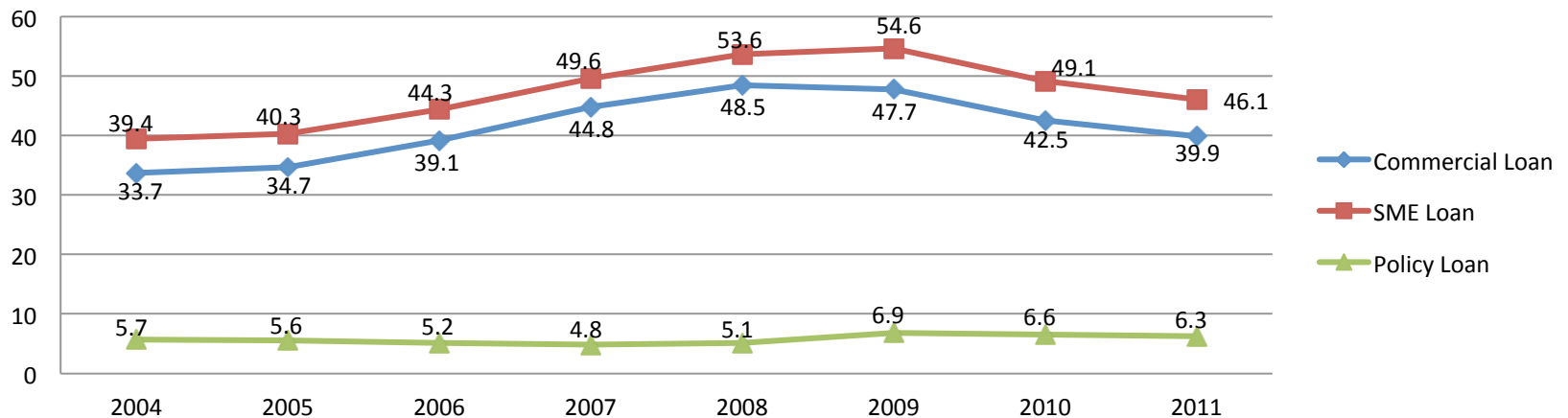
## ■ Promotion of financial inclusion

- The number of credit defaults has **steadily fallen**

No. of Credit Defaults (10,000)	2002	2004	2006	2008	2010	2012	2013.6
		263.6	361.5	279.6	227.1	151.4	124.3

## ■ Growing share of policy loans to SMEs

- In the post-crisis period, **policy loans** partly made up for **declining SME financing**



## ■ Weakening market functions

- Policy loans play more than a supplementary role, and **partly replace market functions**

## ■ The lack of powerful control tower

- **Inefficiency** from poor coordination among institutions involved in policy loans

## ■ Concerns for moral hazard

- Cheap, guaranteed loans might spawn borrowers' **moral hazard**
- **Uncertainty** over a long-term **sustainability** of the scheme lingers

## ■ The lack of credible evaluation of SMEs' technology and business feasibility

- The market continues to **cut SME lending**

# How To Tackle These Issues

- **Consistent criteria in lending to low-income borrowers**
  - **Lending criteria** of Sunshine Loan, New Hope Loan, Dream Loan needs to be **better aligned**
- **An integrated entity in charge of low-income finance**
  - Provides **integrated services** for low-income borrowers ranging from **employment to welfare and funding**
  - Works as 'Private Bank' to strengthen capacity of low-income borrowers
- **Enhancing technical evaluation of SMEs**
  - An **independent entity** may be established that is **capable of conducting technical evaluation** of SMEs effectively



# Thank You!