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2010 Modularization of Korea's Development Experience: SME Financing

2011

MINISTRY OF STRATEGY AND FINANCE

KDI Korea Development Institute

2010 Modularization of Korea's Development Experience:
SME Financing

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Preface

In the 21st century, knowledge is one of the key determinants of a country's socio-economic development. In recognition of this fact, the Ministry of Strategy and Finance (MOSF) and the Korea Development Institute (KDI) launched Knowledge Sharing Program (KSP) in 2004. The KSP aims to share Korea's development experience and knowledge to assist socio-economic development of partner countries.

The KSP is comprised of three parts: 1) the systemization and modularization of Korea's development experiences into case studies, 2) policy consultation through knowledge sharing with partner countries, and 3) joint consulting with international organizations. The systemization and modularization of Korea's development experience researches and documents Korea's successful policy experiences, such as the 'Five-Year Economic Development Plan' and 'Saemaul Undong (New Village Movement).' The policy topics are 'systemized' in terms of the background, implementation and outcome, and then, presented as case studies in order to achieve a complete understanding of the actual policies. These systemized policy case studies are further 'modularized' by sector so they can be utilized as concrete examples by partner countries to meet their interests in specific institutions, organizations or projects. For example, Korea's 'Export Promotion Policy' has been prepared as a systemized case study while 'the Establishment of the Export-Import Bank' has been modularized to provide a specific example of Korea's export promotion experience in export financing. The modularization of Korea's development experience traces back to a policy's inception and recapitulates the rationale for its introduction; its main content; and its implementation mechanism. The case studies also evaluate a policy's outcome and draw insights with a global comparative perspective. These case studies include literature reviews, surveys and in-depth interviews with the policy practitioners and experts who participated in the implementation process.

The systemization of Korea's development experience was initiated in 2007 and finished in 2009. Under the new Modularization Project, launched in 2010, the plan has been set out to modularize 100 case studies by sectors and topics in three years.

I would like to take this opportunity to express my sincere gratitude to Project Manager, Dr. Wonhyuk Lim, and all the Korean experts for their immense efforts in successfully completing the '2010 Modularization of Korea's Development Experience.' I am also grateful to Managing Director, Dr. Kwang-Eon Sul, and Program Officer, Ms. Ja-Kyung Hong, the members of the Center for International Development, KDI, for their hard work and dedication to this Program.

I earnestly hope that the final research results will be fully utilized in assisting the development partner countries in the near future.

Oh-Seok Hyun
President
Korea Development Institute

Contents

Chapter 01
Establishment and Roles of Industrial Bank of Korea

Chapter 02

Establishment of Korea Credit Guarantee Fund and Its Operation

Contents | List of Tables

Contents | List of Figures

Chapter 01

Establishment and Roles of Industrial Bank of Korea

Chapter 01

Establishment and Roles of Industrial Bank of Korea

Jeong Yun Lee, Bokwang Kim (IBK Economic Research Institute)

<Summary>

This chapter examines the establishment and roles of Industrial Bank of Korea, the only government-owned bank specializing in small and medium sized enterprises (SMEs) in Korea. The review consists of four parts, covering the background of IBK, its establishment and growth over a half century, its roles and achievements, and comprehensive insights and implications.

Section 1 provides the historical background for the foundation of IBK by describing the economic situations in the 1950s. In the 50s, the aftermath of the Korean War stroke the economy and the government was struggling to restore the economy. In order to promote the all-around economic expansion, it was considered indispensable to support SMEs and resolve their financial difficulties as they comprised a large proportion of the national industry.

Section 2 discusses the process of establishment of IBK from the outset to the official promulgation in 1961, examines its development over time, and analyzes its structure. It was first designed in 1957 and, after going through formal procedures, launched its business in 1961. By continuously expanding deposits and strengthening the bank's competencies to support SMEs, it has supported and fostered SMEs for about fifty years. As the industry tended toward technology-required, knowledge-intensive, the roles and sizes of SMEs grew large, and so did the roles of IBK. Currently, the bank consists of 12 Business Divisions, 1 Research Institute, and 41 Departments.

Section 3 describes the roles and major achievements in detail. Established as a Korea's first-of-its-kind bank, exclusive for SMEs, it serves to stabilize the economy when in crisis,

rescue and foster SMEs, and build comprehensive support system. It makes credit loans for SMEs with growth potential, tighten up loan policies when necessary, promotes modernizing facilities with the supply of facility funds, explore high-performing businesses, conducts statistical research and provides information useful for business operators. The sound functioning of IBK was especially critical in the 1997 financial crisis and in 2008 world financial crisis.

The chapter is concluded with the discussion of insights and implications. The unparalleled economic growth of Korea transformed the nation from the ruins of the Korean War to an export rank 9th nation in the world as of 2009. Many say it would have been not possible without the contribution of IBK. The success story of IBK provides a good development model for many developing countries.

1. Background of Industrial Bank of Korea

1.1. National Economy upon the Foundation of Industrial Bank of Korea

1.1.1. Specific Features of the Korean Industrial Structure[1]

At the time of the establishment of Industrial Bank of Korea (IBK), Korea's industrial structure displayed typical characteristics of the developing economies. The major issue was the structural imbalance in three key areas: firstly, the primitive industries and modern ones, secondly, the capital goods and the consumer goods, and lastly, the export industries and the domestic ones.

The first aspect of primitive versus modern industries is evidenced by the 'industry structural development pattern' reported in 1961. The primary industry, mainly composed of the agriculture, forestry and fishery, accounted for 40.3%, while the secondary industry comprised of mining, manufacturing and construction contributed 20.6% and the remaining tertiary industry 39.1%. This weight distribution indicated the underdevelopment of Korean economy at the time.

1. Extracted from "The White Paper on the SME Banking" (1966, Ministry of Commerce and Industry, IBK), "Retrospect and Forecasts of the SME Banking" (IBK Research Department, August 1 1963) and modified.

Table 1-1 | Pattern of Korea's Industrial Structure (constant Price as of 1955)

(Unit: %)

	1948	1952	1956	1957	1958	1959	1960	1961
Primary Industry	52.0	41.1	39.7	39.7	39.9	38.5	38.0	40.3
Secondary Industry	8.9	9.9	17.0	18.3	18.7	20.0	20.5	20.6
Tertiary Industry	39.1	49.0	43.0	42.0	41.4	41.5	41.5	39.1
Gross National Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Ministry of Commerce, Bank of Korea.

The weight of the secondary industry in Korean economy increased more than twofold by 1961 to 20.6% from less than 10% in 1952. In other words, the output in the manufacturing sector, which was limited to 8.2% of the GDP in 1953, dramatically increased to 14% throughout the period at a 5.8% growth rate.

Table 1-2 | Trends in the Output from the Secondary Industry (constant Price as of 1955)

(Unit: %)

	1953	1956	1957	1958	1959	1960	1961
Mining and Quarrying	0.9	1.0	1.1	1.2	1.5	1.9	2.1
Manufacturing	8.2	12.9	13.3	13.4	13.8	14.4	14.0
Construction	3.6	3.1	3.9	4.1	4.7	4.2	4.5
Production Volume from the Secondary Industry	12.7	17.0	18.3	18.7	20.0	20.5	20.6

Source: Ministry of Commerce, Bank of Korea.

Yet, the Korean economic structure displayed characteristics more of an underdeveloped economy than that of the developed or the developing countries. In other words, the weight of the primary industry was as high as 38.5% in Korea in comparison to the advanced countries like the U.S., the UK and Germany with less than 10% and 17% in Japan. On the contrary, the secondary industry that contributed approximately 40 to 50% in advanced countries and 34% in Japan, recorded only 20% in Korea. Interestingly, however, the tertiary industry accounted for a comparably high figure of 41.5% in Korea.

Table 1-3 | Industrial Structure in Major Countries (1959)

(Unit: %)

	U.S.	U.K	Western Germany	Japan	Thailand	Korea
Primary Industry	4.1	4.2	7.2	16.5	41.2	38.5
Secondary Industry	37.2	45.2	54.0*	34.4	19.0	20.0
Tertiary Industry	58.7	50.6	38.8	49.1	39.8	41.5
Gross National Product	100.0	100.0	100.0	100.0	100.0	100.0

Note: * including all companies

Source: the 1960s' version of the UN National Account Statistics Yearbook.

Second issue on the list is the industrial imbalance found between the capital goods the consumer goods. As seen in the table below, the ratio of value-added in the retail industries took up a high portion of 65% to 90% in Asian countries other than Japan. On the other hand, the ratio of value-added in the capital goods recorded very low at 10% to 35%. Generally speaking, the difference in the value-added between the consumer goods like food and textile and the capital goods including machinery serves as an indicator of a country's industrial development. A country with a lower engineering competency tends to have a greater value-added in the food and textile industries. In the case of Korea at the time, the composition ratio of the industries was 67.6% to 32.4% with a higher contribution from the consumer goods. Specifically within the consumer goods, the contribution of the daily necessity, such as food & beverage and textile industries, was 50.5%. Although this recorded higher than that of Japan with 27.9%, it was lower than that of India, whose total weight of the consumer goods is lower than Korea, at 61.7% and was similar to that of the Philippines at 49.4%. This implies that Korea's retail industry achieved multifaceted and balanced development. The metal and machinery industries that are critical for the capital goods industries, however, contributed less in Korea than that in Japan and even in India at 14.0%. Clearly, Korea's industrialization, until the mid-1950s, was still in its infancy.

Table 1-4| Industrial Structure in Asian Countries

(Unit: %)

Category	Korea (1956)	Vietnam (1956)	Pakistan (1954)	Taiwan (1956)	Philippines (1956)	India (1954)	Japan (1955)
Consumer Goods	67.6	94.5	71.9	75.7	66.7	64.4	46.3
Food & Beverages	32.7	39.5	15.0	49.8	44.9	11.0	11.7
Textiles	17.8	41.2	46.7	17.0	4.5	50.7	16.2
Leather, Rubber, Wood, etc.	17.1	13.8	10.2	8.9	17.3	2.7	18.4
Capital Goods	32.4	5.4	18.5	22.5	22.9	35.6	53.7
Chemicals	18.4	4.1	11.8	12.7	14.6	12.5	19.0
Metals	4.3	-	4.1	4.7	4.5	13.3	15.7
Machinery	9.7	1.3	2.6	5.1	3.8	9.8	19.0
Others	-	-	9.6	1.8	10.3	-	-
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Practitioners' Discussions on the 4th Economic Development and Plans.

The third feature is the domestic-export industrial imbalance. The balance in international payments, in general, serves as an indicator of a country's economic independence, and continued adverse balance of payments could disrupt its economic independence. In 1962, Korea's total product export volume amounted for a mere USD 54.8 million that the total.

In 1962, total products exported by Korea amounted to merely USD 54.8 million, and addition the income from invisibles of USD 122.3 million, the total imports of products and services amounted to USD 177.1 million with the total product exports of USD 387.3 million. Add the invisible trade balance of USD 29.8 million, the total payments of products and services amounted to USD 417.1 million, a stark difference from the total product exports. As such, due to a lack of export industries in Korea, the net export volume was not only meager but was also undeveloped in terms of the export product composition.

Table 1-5| Exports by Product (as of 1962)

(Unit: USD million, %)

Category	Amount	Percentage
Food	21.8	39.8
Non-food Raw Materials	19.4	35.4
Mineral Fuel	2.8	5.1
Vegetable and Animal Oils and Fat	0.1	0.2
Chemical Products	1.0	1.8
Raw Materials Products	6.2	11.3
Machinery	1.5	2.7
Miscellaneous	2.0	3.7
Total	54.8	100.0

Source: Bank of Korea (1963).

1.1.2. Portion of SMEs and its Significance in the National Economy

As aforementioned, the national economy at the time of the establishment of IBK was mainly composed of the primary and the tertiary industries with a small input from the secondary industry. Therefore, both the quantitative and the qualitative significance of SMEs in the secondary industry had been immense.

According to the statistical survey on the mining industry in the 1960s, the number of SMEs in Korea amounted to 15,173 with 200,927 employees, covering 97.4% and 63.8% of the total mining businesses and employees, respectively. The output of SMEs was KRW 36.5 billion, 54.7% of the total mining output of KRW 64.9 billion. The value-added volume was KRW 13.4 billion, 52.2% of the total value-added output of KRW 25.7 billion.

Table 1-6 | SMEs Contribution in the Overall Mining Industry (1960)

(Unit: %)

	SMEs	Percentage (%)	Large Companies	Percentage (%)	Total	Total Percentage
No. of Businesses	15,173	97.4	399	2.6	15,572	100.0
No. of Employees	200,927	63.8	114,127	36.2	315,054	100.0
Output	35,495	54.7	29,370	45.3	64,865	100.0
Value-added Volume	13,388	52.2	12,274	47.8	25,662	100.0

Source: Mining Census of 1960.

The significance of SME clearly becomes evident in the national economy and the economic development processes. Furthermore, the role of SME is reflected in the contribution made in the industrial structure.

Firstly, SMEs played a role to balance the industries. While SMEs remained light industry- and consumer goods-oriented, the conglomerates concentrated in the heavy industries. The close correlation between the two demands for cooperation as no stable growth is possible in the absence of the inter-industry balances. .

Secondly, being in the labor intensive industries, SMEs have contributed highly in the rapid growth of national income and employment with short payback period and high employment.

Furthermore, SMEs were invited to play a pivotal role in the export industries due to the domestic economic structure and the industrial mechanism on the resources and technology. The growth of export industry had been the national agenda to enhance the international balance of payments and to accomplish self-sufficient economy. The promotion of SMEs, which is labor-intensive and thus cost competitive, had been the best strategy for the government to develop the export industry at the time. It was for Korea’s low-wage advantage.

As the majority of SMEs coincides with the local industries, a further development of SMEs promotes a balanced economic development across a nation via improving the regional economy. As the regional economic development attracts the conglomerates, it has been beneficial to foster the local SMEs. Likewise, SMEs played an important role in reducing the regional economic disparity by promoting the regional development and catalyzing the industrialization of the surrounding cities.

Fifth, SMEs play an intermediary stabilizing role during the economic reform period. For achieving economic development plan, since the payback period for production facilities is long, the production of output following the capital investment is slow, and the expansion of social capital is merely economically efficient over the gradual and long-term basis. As such, inflation often emerges due to excessive purchasing power with no output during a planning phase. Moreover, Korea always suffers inflationary periods resulting from excessive demand, and such economic instability could hurt economic planning. SMEs have absorbed such excessive purchasing power with their fast production output and, thus, have greatly contributed in the re-stabilization of the national economy.

Lastly but not the least, there are other significances of SMEs that sprang out from non-economic basis, instead more from the political and social reasons. The most critical advantage of having SMEs is their capability to stabilize a nation both economically and politically. It is because a healthy growth of SMEs that cover a significant portion of the secondary industry may establish an economic and political safe-zone that could reduce the social imbalance. True, the middle class do include small and medium-sized merchants, farmers and medium-level wage earners as well as SME employees, but since Korea requires the changes in the industrial structure and maximized employment, the expansion of the middle class is achieved by fostering SMEs and their quantitative growth. That is why other names for SMEs are living depiction of the democracy and economic liberty, and the shield of the middle class.

SMEs have the potentials to play an active and important role in economic development. In Korea's industrial structure, in particular, where a close linkage among the primary, secondary and tertiary industries or within the same industry is in absence, the SMEs was not ignorable for their capability to create such relativity and to realize an overall economic development.

1.2. SME Policies in the 1950s[2]

The Korean economy underwent unprecedented turmoil in the aftermath of the Korean War, which claimed many lives and destroyed economic and social facilities. The Korea's economic activities were constrained due to a shortage of goods, and monetary expansion was inevitable to fight the war.

The government put all its efforts on recovering from the war with 'the war recovery budget' but without any tax revenues. Expenditures ended up being twice of the initial budget. Besides of the excessive war expenditures, Bank of Korea had to support the expenditures of the U.N. Forces in accordance with the Agreement on the Expenditures for the U.N. Forces (July 26, 1950). This led to a rapid monetary expansion along with the unavoidable accumulation of the inflationary pressures.

2. Extracted from the "Five-year History of IBK" (August 7, 1966), "60-Year History of the Korean Economy" (September 2010, Korea Development Institute), and corrected and complemented.

Economic activities stalled: the accrued capital was depleted and even the operation of the remaining industrial facilities in Busan was stopped due to lacking infrastructure. Towards the end of the wartime, Korean government concentrated in seeking for the egress and, more specifically, to promote the key industries. As a starting point, the government subsidized the key industries on the basis of the Rules (Financial Rules) on the 'Fund Management in Financial Institutions' written by the Monetary Policy Committee.

Although Korean government aimed for the promotion of the key industries under the principles of the 'restoration of industries amid the war,' the issues were not simple to tackle. Most companies were facing liquidity problems due to retrenchment policy, and the situation was worse for SMEs whom the general loan conditions were not applicable. In addition, the rampant financial inflation resulted in a rapid reduction of the private capital savings and normal investment activities. Consequently, the balance between industry and distribution channel was lost, and further caused overall production shrinkage as the demand for corporate funds increased with the false investment demand. Clearly, there were limitations in developing the major industries in the middle of war.

As the financial difficulties SMEs faced increased with the time, the government adopted the SME Financial Loan Ceiling in 1952 to support SMEs. This first financial measure for SMEs in Korea epitomizes the strictly retrenchment policies implemented by the Korean government at the time to control the inflation.

1.2.1. Establishment of the 'SME Fund Limit System'

In the post-war chaos, the government sought to implement stronger, emergency, measures to manage the situation. First of all, the government restored power generators, and focused on the production of basic materials such as cement, cotton yarn and wool fabric. However, it did not resolve the liquidity problems especially in the SMEs who failed to receive the financial benefits, which resulted from the stringent retrenchment policies.

Given the reality, a new policy was adopted in 1952: a certain amount of loans[3] were provided to the companies engaged in the agricultural machinery, textiles, printing, ceramics, paper and craft industries in every first two quarters of the year. Moreover, the temporal eligibility for the re-discount at the Bank of Korea was offered only to these six industries.

However, this policy did not last long: it was terminated in the third quarter due to the financial constraints. However, being the first financial package tailor-made for the SMEs signified the implementation of the policy, even for a short period.

3. Throughout the first and second quarters, the loan ceiling of KRW 2.5 million (i.e., 2.5 billion hwan back then) was extended.

Unfortunately, however, SMEs suffered more from the financial burden greatly owing to the monetary policies implemented in February 1953 and the large-scale account blockage. Only the key industries were the subject of the newly implemented 'the Guideline on the Emergency Financial Rescues for Industries' and neglected SMEs, leading to the greater financial burden. So as to resolve the situation, the government allocated additional budget exclusively for the SMEs.[4] With this, the budget for the SMEs revived only in a year without any specification of the industry field to address many issues insofar addressed. In this regard, SMEs became eligible to receive loans regardless of their industry once they complied with the financial plans and loan regulations under this measure.[5] This measure to open the loan opportunities to the SMEs in general without any restriction in the field of industry can be said to be a big step made towards the SME banking. Nevertheless, SME loan system was not actively managed for the ambiguity against other general funding sources, complicated procedures and long review periods. as the measure turned out to be ineffective in tackling the issues, the government retreated back to the former-financial institution direct Ceiling System ceiling system in June 1954. Since then, Korea's SMEs were left to develop unaided for a long period.

1.2.2. Loan Funds for SMEs in Manufacturing and Mining Industry in accordance with the United Nations Korean Reconstruction Agency (UNKRA)

In September 1953, the government signed the Agreement on SME Loan Fund Management with the United Nations Korean Reconstruction Agency (UNKRA) and the Bank of Korea as part of war reconstruction efforts following the Korean War in accordance with one of the UNKRA's economic reconstruction plans. It was the first 'special independent fund' prepared to provide financial support to the SMEs.

The government sought to realize two goals under this fund. One, it sought to rebuild small and medium-sized production plants, considering companies suffered weak productivity due to the shortage of capital.[6]

4. In the third quarter of 1953, approximately KRW 8 million out of KRW 170 million (back then 1.7 billion hwan) was allocated as SME funds.
5. In dealing with loan extensions, industries for SMEs subject to the loans were not designated as in 1952: funds complying with fund plans and loan regulations amounted to KRW 100,000 per case. It was ensured that the Bank of Korea's rediscount rate for the SME funds was set at KRW 5.5 million and its branch heads were to allocate the amount considering local specificities.
6. As a part of the UNKRA's plan in 1953, USD 1.5 million out of the UNKRA funds of USD 70 million, and the internal capital of KRW 25 million out of the UNKRA Counterpart Funds were set as loan funds. These funds were redeemed as revolving loan funds, and dollar-denominated loans as won-denominated ones, which were added to the existing ones of the same kind. Loan limits were set at USD 25,000 or KRW 450,000.

The other was that it sought to provide short and long-term loans to subsidize private small and medium-sized mining companies to assist them restore the mining facilities, secure modern and competent machinery and facilities and shore up facility funds.[7]

Along with the SME Fund Limit System, this fund that began in August 1954 was significant in that it was the first-of-its-kind policy aimed at supporting SMEs. The fund has also served as a milestone at which point the importance of SMEs became widely acknowledged.

1.2.3. Financial Policies from 1954 to 1956

Following the armistice agreement, the economic goals of Korea converged two points: one, to the revival of self-sufficient economy and the other, to break away from the stabilization-oriented policies. As the main strategy involved the foreign aid-induced post-war restoration and reconstruction projects, Korean economy became increasingly foreign-aid dependent after the armistice.

The government pursued economic policies based on market economy in accordance with the conditions of the offered foreign aids as stipulated in the agreements with other countries. The balance in fiscal and financial policies and the single foreign exchange principles were also enforced. With the 'principles on the privatization and liberalization,' the government's intervention in major products was lifted and large enterprises under the government's management started to assume their own responsibilities. These indicated an active shift towards a market-based economy that became evident during the elimination process of the wartime controls.

Meanwhile, as foreign goods started to be imported in full swing, resources such as 'Counterpart Funds' were secured for industrial financing. However, the government's decision to strengthen the policy for "Treasury investment and Loans" using the 'Treasury Bonds for Industrial Revival' and 'Industrial Financial Bonds,' the inflated funding sources, resulted in worsened inflation. Nevertheless, amid increased foreign aid, Korea's processing industries started to recover along with commercial capital from importers and the like. This, in turn, brought about abnormal expansion of the tertiary industries due to the inflation. Therefore, the industrial sector, except for backbone ones, became disproportionately full of retailing

7. USD 200,000 out of the UNKRA's funds planned for 1953, and KRW 2.5 million out of the UNKRA Counterpart Funds were set as such. Under these funds, exportable mining goods were produced in dollar-denominated loans, and dollar-denominated funds were extended for loans necessary for importing materials and facilities for mining companies capable of repaying loans in the currency they acquired through export. For loans were limited to mining companies whose fixed assets do not exceed KRW 1 million. Loan limits were at USD 50,000 or KRW 625,000.

industries mostly dependent on imported raw materials. New plants that processed raw cotton, raw sugar and raw wheat were constructed under the initiatives to restore production of large plants destroyed during the war.

Besides, the completed products and the smuggled goods imported as the aids and relief supplies resulted in the domestic market decline. And growth of SMEs faced many difficulties. Besides these side effects, such supplies facilitated securing of raw materials and catered to the needs of the war-stricken public for daily necessities.

Under such circumstances, the post-1954 financial policies broke away from the temporal stability-oriented policies of the wartime, enabling the government to concentrate on the long-term industries. Accordingly, the Treasury Investment and Loans were reinforced utilizing the 'Financial Institution Loan Priority List' that has existed to ensure the maximum allocations of the resources in the long-term industries.

On the other hand, SMEs that did not qualify for loans suffered further from the financial difficulties. Their financial burden worsened. As the government's economic policies focused on the 'principles of privatization and liberalization,' the SMEs were exposed to the management challenges. Thus, financial assistances for the SMEs that dominated the production of daily necessities were urgently required.

As a result, changes were made to the former "funds for the SMEs" executed in the format of the re-discount approval by the Head of branches of the Bank of Korea. In June 1954, a new system, 'Direct Ceiling System for Financial Institutions,' was implemented for a smoother management and a more aggressive fund allocation.[8] This change allocated KRW 25 million out of total loan amounting KRW 150 million to cover both the public and private sectors for the SMEs. Such an unprecedented high portion of funds helped to ease the financial struggle SMEs faced. Unfortunately, however, these actions failed to eliminate the practical liquidity problems in SME as these funds belonged to the 'fund for the private business sector' and lacked discrete set of financial measures.

In the third quarter of 1954, the Korean government sold foreign reserves in dollars and cash held by the Korea stationed U.S. military forces in dollars to counter domestic inflation. As this had possibility of worsening the liquidity problems industries as a whole faced by absorbing too much currency, the government wrote another special loan act, 'Guideline to Deal with Funds to

8. According to the Guideline on Dealing with SME Funds, KRW 25 million for private business out of the ceiling in the increases of total loans worth KRW 150 million is allocated as SME funds. Those eligible for loans are companies whose paid-capital is less than KRW 500,000 and number of employees is 50 or lower, and the loan ceiling was set at KRW 100,000 per case with the repayment period of six months and lower.

Produce Daily Necessities.' With this special loan act, the Korean government tried to reduce the liquidity problem that companies producing daily necessities experienced. Loan extensions accordingly started to be implemented from October 1954 as emergency funds, but their significance lied in the fact that they were the first-of-its-kind financial assistance to SMEs. Meanwhile, UNKRA's SME Loan Funds for the Manufacturing and Mining Industries expanded in scale. Under the 1954 plan, USD 600,000 for small-and medium-sized manufacturing companies, USD 200,000 for the small-and-medium sized mines and extra KRW 3.6 million were added to the funds,[9] fulfilling their roles as SME production funds.

On top of these successes, further demands to strengthen the SME financial measures from the late 1955. The Monetary Policy Committee initiated the 'Guideline to Deal with Production Funds in the Key Industries' in December, and replaced the previous 'Guideline to Deal with Production Funds for Daily Necessities' with the 'Guideline to Deal with Production Funds for SMEs'.[10]

The setbacks in establishing credit funds for SMEs was the limited resources. Despite of the qualitative or quantitative improvement, the amount of fund available remained the same, making it difficult to extend financial benefits to companies in local regions due to continued anti-inflationary policies and the new foreign exchange rate implemented in August 1955 as part of stronger financial controls. Financial constraints for SME funds were unavoidable, and the situation was worse for companies in local regions. As a policy response, the Monetary Policy Committee devised the 'Guideline to Deal with Promotion Funds for SMEs' in November 1965, allocating the fund ceilings of KRW 100 million. The funds were extended as loans for SMEs ineligible for loans under the 'Guideline to Deal with Production Funds for SMEs.'

SME policies till then were limited to easing the liquidity issues revolving around the financial policies. Moreover, except for the UNKRA funds, mostly were the short-term operating funds. Such financial support policies acted as short-term economic measures and to reduce risk of bankruptcy.

Among the two sections of the policy support for SMEs, classified as the SME funds and the SME fostering funds, the latter was terminated in 1958.

9. Those eligible for loan extensions shall have fixed assets of KRW 1 million or lower, and operate in the textiles, chemicals and machinery industries. The interest rate for loans is as low as 7% per year, that is one third of that of general loans, while the loan ceiling per case is higher (KRW 450,000 or USD 25,000) and the repayment period is six months and higher.
10. The Guideline induced the expansion of loan targets and conditions through repeated revisions of the rules, and the loan ceiling was raised from 10) KRW 130 million to KRW 280 million (during the second quarter of 1956).

1.2.4. Establishment of Comprehensive Measures to Foster SMEs

SME policies, up until 1956, were effective in fostering SMEs despite of some specific measures in the financial sector. Among them, there was the autonomous organization of SMEs. 'The Small and Medium Enterprise Cooperative Act' was legislated in this period. Then, in August 1956, initiatives to develop SMEs were introduced as one of the economic policies at the presidential inauguration ceremony. Since then, the government devised comprehensive policies aimed for the SME development. At the end of that year, the Promotion Committee and the Asset Committee passed the 'Guideline on SME Fostering Measures.' This was Korea's first comprehensive plan to foster SMEs.[11]

The guidelines under the plan sought to foster SMEs in a comprehensive and multifaceted manner. Parts of the guidelines were put into action, and had major significances: it provided an opportunity for the long-neglected SME issues to be addressed and served as a basic principles upon which the SMEs fostering policies were designed.

1.3. A Need to Establish Financial Institution for SMEs[12]

A financial institution for SMEs was established out of socio-economic need. It was because their development was crucial for the national economic revitalization accounting the large contribution the SMEs makes in the national economy. Despite of the significance of SMEs, the existing financial support was not effectively organized and was not efficiently implemented, hence, a financial institution for SMEs was not needed. In this respect, an efficient financial support was essential to an effective development of the SMEs, as the required capital for the SMEs often was small in scale.

11. The main points of the guideline are: 1) to devise the Cooperative Act as a measure to strengthen the Korea Federation of Small and Medium Business; 2) to secure loan resources of KRW 2 billion as fund measures and secure partially from assets held worth KRW 600 million, fertilizer funds worth KRW 100 million and Urban Financing Cooperative Funds worth KRW 410 million, and the remaining amounts are to be secured by counterpart funds; 3) to abolish the existing estimated taxation on SMEs, and replace it with the self-assessment system, for which to promptly devise the asset re-assessment method; 4) to amend the commodity tax, expanding the reliefs for the direct tax, and consider tax exemption for inner reserves for re-investment of corporations; and 5) to expand military supplies to find more channels for business, second to legislate the Product Sales Market Act to set up an open market, third to enhance the product quality and consistency in regulations, fourth to expand the scope of operation of commercial notes, and fifth to control the import of foreign goods as well as domestic ones and to strengthen exemplary plants and promote excellent domestic products.
12. Extracted from the "5-Year History of IBK" (August 7, 1966), "40-Year History of IBK" (July 30, 2001) and modified and complemented.

In the early 1950s, retrenchment policies were actively pursued due to persistent inflation, which led to a more severe liquidity problems that affected SMEs. In addition, the government's special financial policies were mostly oriented towards large enterprises, excluding SMEs from the policy programs. The lacking human resources and asset credibility further prevented the commercial banks from including SMEs in the loan clients. This is why Korea, for the first time in its history, implemented financial policies for SMEs in 1952.

However, SME finances were limited to creating an environment to encourage the commercial banks to extend loans to the SMEs. Although the Bank of Korea encouraged banks to lend to SMEs by adjusting and managing the 'ceiling' system, banks were still reluctant due to a high NPL ratio, which explained the lack of credit to SMEs.

To improve this, the Loan Funds for the Small and Medium-sized Manufacturers and Loan Funds for the Small and Medium-sized Mines were established in 1953 using the UNKRA funds. Since then, passive measures have been implemented e.g. devising the Guideline to Deal with SME Production Funds in the financial sector. As seen from above, SME supporting policies in the early 1950s were mostly designed as rescue packages amid difficult circumstances. In addition, the ceiling for the SME sector was merely separated from the loan ceiling in the financial sector.

After this initial period, financial SMEs entered a new phase in 1957 with support being driven by financial funds. SME financing somewhat gained momentum driven by the supply of financial funds, but the support system was not organized and there was a lack of skilled expertise and know-how in financial institutions. This made the provision of financial support inefficient. For instance, the loan supply path was divided into two main categories: firstly, the short-term funds were through either the Agricultural Bank of Korea (currently, Nonghyup Bank) or the Bank of Korea to each commercial bank, and secondly, the middle and long-term funds were administered by the Korea Development Bank.

As such, loan conditions were different at each bank for the same fund, and at times, the government's support was left unused due to regulatory limits on lending under the Bank Act. In other words, the funds allocated to support SMEs could not be deployed effectively due to constraints in available resources, lack of transparency in policies and weak administrative capabilities. Thus, SME policies failed to provide comprehensive services. This is why SME policies and means to implement the policies were not in line. A uniform system was needed to efficiently deploy SME financial support which meant the establishment of a financial institution for SMEs. This was urgently needed especially for the modernization of the facilities and the establishment of a stable fund supply channel.

At the same time, the public awareness about fostering and supporting SMEs started to heighten, raising two issues: First, the policy goal was not clear between the 'protection' and the 'promotion' of SMEs. The word 'fostering' was sometimes interpreted as a quantitative increase of SMEs. It was understood that the policy sought to increase SMEs to an appropriate scale or build facilities. This blurring of policy goals brought about poor results in achieving any goals.

Second, past SME policies focused on economic recovery, neglecting the structural improvement aspect. SME policies were focused on short-term economic targets without any long-term structural improvement measures in place.

Discussions were underway to establish a special entity to institutionalize the financial support of SMEs as a consensus had been reached on the urgency to address this problem. Moreover, overall conditions and infrastructure matured enough to establish a financial institution for SMEs, e.g., expansion of financial resources and expansion of funds for the non-agricultural sector in urban branches of the Agricultural Bank.

2. Establishment and Growth of Industrial Bank of Korea

2.1. Background to Its Establishment[13]

2.1.1. Circumstances that Led to Its Establishment

2.1.1.1. Designing of an SME-exclusive Financial Institution

The plan to launch a financial institution specifically for the SMEs goes back to 1957. It began with the enactment of the Agricultural Bank Act aimed for the reorganization of the Agricultural Bank of Korea into a special bank by stating that "The financial tasks of the Agricultural Bank in the urban cities are to be separated to launch an independent financial institute responsible for the SMEs and the general public." Discussions on its establishment continued on through August 1960 when three establishment measures were proposed.

The first proposal to establish a commercial financial institution in accordance with the Commercial Law to be transformed into a Bank for SMEs Ltd. under the Bank Act came on the

13. Extracted from the "30-Year History of IBK" (August 1, 1991), "40-Year History of IBK" (July 30, 2001) and modified and complemented.

top of the list. Yet it was not realized for the financial reasons. After that, the government decided to establish an exclusive financial institution through government investment under the special law, and enacted the Small Business Finance Act. This, too, faced difficulties under the given circumstances: the idea was that even with full funding from the government, the new financial institution would be unable to meet the enormous capital demand from the SMEs.

Finally, the third proposal was made to resolve the issues on the Small Business Finance Act. The main ideas was to eliminate the unrealism on funding mechanism by establishing the financial institution for SMEs as a bank, instead of fund, to secure income stream from the deposits and loans. Accordingly, the Standing Finance and Economic Committee of the National Assembly formulated the Industrial Bank of Korea Act by combining the Small Business Finance Act proposed by the government and three Industrial Bank of Korea Acts from the National Assembly.

2.1.1.2. Formulation of the Industrial Bank of Korea Act

Under the Standing Finance and Economic Committee of the National Assembly, the Sub-committee of the Small Business Finance Act was tasked to combine the Small Business Finance Act proposed by the government and the Industrial Bank of Korea Act into a single Industrial Bank of Korea Act. The integrated act stipulated that the banks are to open the offices by taking the existing branch offices of the Agricultural Bank under the co-investment between the government and SME. The investment capital was prepared by clearing the shares of the non-farming members of the financial unions. As for the tasks, the banks were to concentrate on the loans while dealing with the SME and the working class finances. To this end, it was stipulated that the limitless income from the deposits besides the borrowing from the government was permitted.

This Act was passed by the Secretariat Supreme Council for National Reconstruction[14] on June 23, 1961, and promulgated as Act No. 641 on July 1 of the same year. And on July 12 of the same year, the Matter on Establishment of Industrial Bank of Korea and the Ordinance Decree of the Industrial Bank of Korea Act were promulgated as Decree No. 37 and No. 38, respectively. On July 13, the Rule on Registration of Industrial Bank of Korea was promulgated as the Supreme Court Rule No. 82 to handle the registration of the bank. As such, legal framework was established for the Industrial Bank of Korea.

14. Korea's then highest region in power established under an emergency measure for the reforming power to complete its reform initiative immediately after the May 16 military coup detat.

2.1.1.3. Major Contents of the Industrial Bank of Korea Act

The Industrial Bank of Korea Act consists of seven chapters and 56 articles and four appendixes.

First, the General Provisions in Chapter I stipulated that the Industrial Bank of Korea was a special corporation established with goal of establishing an efficient SME banking system, and further defined the term SME entrepreneurs and the composition of the capital stock. It identified Industrial Bank of Korea as a policy lending institution that was established "to facilitate the economic activities of SMEs and to enhance their financial soundness by establishing an efficient credit system for SMEs." For the specificities of SME banking, the Industrial Bank of Korea was recognized as a special corporation subject to the regulations and the articles of Industrial Bank of Korea Act. The Federation of Financial Associations and liquidators of financial associations were to provide the capital stock of KRW 100 million each, totaling KRW 200 million. The increase in the capital stock was subject to the approval from the Minister in charge. Furthermore, this Act had defined the term, SME, for the first time in Korea.

Chapters II and III prescribed the issues related to the bank's corporate governance and management. It stated that a steering committee should be established as a decision-making body to set the basic guidelines for the operation and management of the Bank and to monitor its compliance. It was also mandated that there should be one governor, four executive directors and one auditor in the management broad of the Bank. The governor was to hold the management authority and the voting right while the executive director assists the governor and a permanent auditor monitors the management.

Chapter IV described the operational size and the scope of the Industrial Bank of Korea. First of all, that the credit in principle was to discount the loans and notes provided to SMEs. Loans provided to local governments or non-profit corporations were permitted to the extent it did not harm the financial ability to support SMEs. The Bank was to be in charge of funds for ordinary citizens until a banking regulator was established. Although income from various types of deposits and installment savings were allowed, only the lending institutions were permitted for the current accounts.

Chapter V defined the budgetary and the account settlement.. The main and the supplementary budget were to be approved by the Steering Committee and then approved by the minister. It regulated to save 25/100 of the closing earnings and to expend the remaining earnings as decided by the Steering Committee. Furthermore, the net losses were arranged to be first settled by the reserve and, should there be, any excess were to be carried over to the following year. Chapter VI contained regulations on supervision. It allowed the Minister of

Finance to place a required order for the operational supervision, to request for management reports, or to appoint personnel to audit the tasks. Supplementary Provisions in Chapter VII defined the process of the succession of the bonds on SME loans and capital investments on SMEs. The procedure of succession of the business and property of the Agricultural Bank was also included in this last section.

2.1.2. Establishment of the Industrial Bank of Korea

2.1.2.1. Composition of the Establishment Committee

On July 1, 1961, both the Industrial Bank of Korea Act and the Special Treatment Act on the Liquidated Property Handling of the Korea Federation of Financial Associations and Financial Associations were promulgated. With these, the legal bases for the establishment of IBK and for the capital investment using the un-liquidated stocks held by the non-farming members of the former finance unions were prepared.

The government formed the seven-member Establishment Committee of the Industrial Bank of Korea on the July 4, the same year. This Committee was chaired by the Vice Minister of Finance in accordance with Article 2.1 of the Appendix of the Industrial Bank of Korea Act.

The committee began by deliberating on the Articles of Association of Industrial Bank of Korea, and by formulating a draft on the articles of associations consisting of seven chapters and 70 articles on July 12. The committee confirmed the Article having had obtained approval from the Minister of Finance on July 13.

As the Articles of Association were confirmed, the committee requested the government, the Federation of Financial Associations and liquidators of financial associations to make the promised investments to the bank in accordance with Article 2.3 of the Appendix of the Industrial Bank of Korea Act; subsequently, the payment of KRW 2 million (2 billion Hwan in the currency of the time) was realized on July 14. Simultaneously, the Committee processed the preparation of various regulations required for the tasks, office buildings and the procedures of the businesses and the asset transfers after the launch of IBK. As the establishment of the bank progressed smoothly, the government named Mr. Park Dong-gyu as the first governor of the Bank on July 14, and further appointed four executive directors and one auditor on July 18 and 20, respectively. On July 19, the government established a steering committee with members from the private sector by appointing three SME representatives and one private investor. Accordingly, the Steering Committee approved the bank's business plan and budget for 1961 including the organization of the Bank, initial expenses, the location of the head office, the title and branch locations on July 24.

As the paperwork related to the establishment of the Bank was completed on July 25, the Establishment Committee transferred the remaining tasks to the Governor on July 29 and was dissolved on their final report to the Minister of Finance. On August 1, the main office and 30 branches were opened, heralding a historic day for the bank and SME industry.

2.1.2.2. Business and Property Succession

The Industrial Bank of Korea Act stipulated IBK to succeed the bonds involved in the SME loans and corresponding rights and duties from the commercial banks and the Agricultural Bank. In addition, the Act wrote the Bank to succeed certain urban branches' operational tasks and assets of the Agricultural Bank. In other words, the Bank took over the operational tasks and the assets of the branches of the Agricultural Bank and commercial banks in accordance with the regulations of the Industrial Act of Korea Act.

The operations and loans of the Agricultural Bank involving SMEs were transferred including the rights and obligations. Additionally every non-agricultural businesses held in the certain 31 urban branches were also transferred to the Bank. The acquisition of the Agricultural Bank' assets was carried out based on a ratio that was computed on July 31 of the same year under the contract between the Bank and the Agricultural Bank made on August 1, 1961. The total assets taken over from the Agricultural Bank amounted to total equity of KRW 1,984 million and total liabilities of KRW 2,560 million.

Meanwhile, the bank also took over SME loans provided through government support from the commercial banks including the related rights and obligations. Among them, the Office of Bank Supervision determined bad loans were excluded from the list. Since the SME loans provided by the commercial banks were funded by the counterpart fund[15] held at the Bank of Korea, the Bank directly took over the SME loans from the Bank of Korea.[16]

The transfer of loans from commercial banks and the Bank of Korea was completed on August 7, based on the computation of August 5 and were processed according to the individual loan acquisition agreements signed with each corresponding commercial bank. In details, the assets amounted to KRW 552 million including the loans of worth KRW 547 million, while liabilities totaled KRW 712 million, KRW 424 million from commercial banks and KRW 288 million from the Bank of Korea.

15. The loans the government extended to financial institutions to extend to the private sector for economic development and improvement in international balance of payments.
16. In the process of the aid supply from the U.S., the right to import products worth the amount from abroad was distributed by the government to private importers, who, in turn, deposited the allocated amount in the Korean currency in the Bank of Korea and obtained the import permit in exchange. The proceeds deposited then were expended as the Korean government funds under the supervision of the U.S. government, which are referred to as the "counterpart funds."

2.2. Changes in the Industrial Bank of Korea Act [17]

Table 1-7 | Changes in the Industrial Bank of Korea Act

Amendment	Date of Amendment	Details
2nd Amendment	December 31, 1964	• The government's over a half of the capital investment made mandatory • To permit the issuance of SME financial bond
3rd Amendment	March 7, 1968	• To abolish the restrictions on the income from current accounts
4th Amendment	March 5, 1973	• To form the Board of Directors
5th Amendment	December 22, 1975	• To losses to be replenished by the government
6th Amendment	December 28, 1979	• To form special provisions for SME transactions
7th Amendment	December 31, 1980	• To make legally mandatory to conduct researches and corporate guidance for SMEs • To differentiate the reserves ratio from other financial institutions
8th Amendment	December 31, 1991	• To abolish investor restrictions (confined to the government and SME entrepreneurs) • To form the shareholders' meetings
10th Amendment	August 28, 1997	• To abolish the government's obligation of mandatory capital investment • To expand the issuance limit of the SME financial bonds
13th Amendment	May 24, 1999	• To set the rationale for supervising soundness of the Financial Supervisory Commission
14th Amendment	December 11, 2003	• To deregulate including abolishment of the permit & approval of the guardian minister
15th Amendment	December 14, 2005	• To prohibit other intuitions from the brand, Industrial Bank of Korea
16th Amendment	December 14, 2008	• To change the competent Minister from Ministry of Strategy & Finance to Financial Supervisory Commission
17th Amendment	February 6, 2009	• To increase paid-in capital from 4 trillion to 10 trillion won

The Government's Capital Investment Made Mandatory and Permit to Issue SME Financial Bonds (Second Amendment)

The capital investment source is to be limited to the government and SME entrepreneurs among which the government contributes more than one half of the total. Yet, the capital

17. Extracted from the "30-Year History of IBK" (August 1, 1991), "40-Year History of IBK" (July 30, 2001) and modified, added and complemented with the internal sources.

investment made by the non-SME entrepreneurs under the exception regulation that had been enacted at the time of establishment were to be undertaken by the government only upon the request of the investor. SME financial bonds can be issued, and the total amount of issuance shall not exceed ten times the bank's capital stock and total reserves. Meanwhile, the government guarantees the repayment of principal and interest on the bonds, and the methods of issuance shall include public offering, public sale and the acquisition of the total amount.

Due to the government's investment, the bank could establish stable corporate governance, while facilitating financing and strengthening competitiveness through the issuance of SME financial bonds.

Abolishing Restrictions on the Income from Current Accounts (Third Amendment)

Restrictions on current transactions with non-SME customers until December 31, 1967, which were implemented to expand SME loans, were lifted to liberalize the income from current accounts. This would increase the legal capital and the bank's loan limit.

Formation of the Board of Directors System (Fourth Amendment)

To ensure efficient operation and responsible management of the bank, the size and the scope of the Steering Committee were reduced while newly forming a Board of Directors. The number of members in the Steering Committee was reduced from nine to seven by excluding the two representatives from the private investors. The member qualifications were also changed: from the original version of 'Minister of Finance, Minister of Commerce and the Governor of the Bank of Korea' to 'the public official designated by each Minister and the Executive Member appointed by the Governor of the Bank of Korea'.

The functions of the Steering Committee were also changed. The task was limited to the 'principle formulation' from the 'formulation, supervision and monitoring of the principles.'

It was also decided that the Bank were to form a Board of Directors to act as a decision-making body regarding the Bank's operation and management. The Board of Directors consisted of the governor, senior executive directors and executive directors, and auditors, and had to attend the Board of Directors' meetings and express their views.

Expansion of the Fund Borrowers and Losses to be Replenished by the Government (Fifth Amendment)

In fact, the Bank was only able to borrow funds from the government and the Bank of

Korea, but it was allowed to borrow funds from other financial institutions, thus fulfilling the increasing demand to support SMEs.

In addition, the net losses that was to be first cleared with the reserves and carry over the excess, if any, to the following year, became the responsibility of the government. This was to enforce the Bank to actively provide policy support to SMEs.

Formation of Special Provisions for SME Transactions (Sixth Amendment)

A Special Provisions for the Grown-out SME was newly prepared. A systematical supplement to eliminate the difficulties companies that grew bigger than the defined range of SME during their business relation with IBK faced at the transaction termination was reinforced. In cases where SMEs are found out to be those not trading with the Bank, the repayment period will be three years from the date the SME became ineligible. However, payments on residual loans could be paid beyond this period if the repayment period is longer.

Differentiation of Researches, Corporate Guidance and Reserves Ratio (Seventh Amendment)

This stated about the researches and the corporate guidance on SMEs. It was classified the deposit reserves of the Industrial Bank of Korea separately from those of other financial institutions by the Monetary Policy Committee.

Abolishment of Investor Restrictions and Formation of the Shareholders' Meetings (Eighth Amendment)

As the financial industry became more globalized, opened and liberalized, the competition among financial institutions has intensified. Accordingly, the need to amend the Industrial Bank of Korea Act to continuously increase the financial support for SMEs was recognized. In specific, there was calling to modify the Act to provide an autonomous and flexible management basis to enhance the competitiveness of the Bank.

Likewise, the means to constantly expand the assistant for the SMEs while proactively responding to the changed financial environment, such as the opening of the financial market, were sought. In other words, it became inevitable to amplify the capital size by allowing the inflow of private fund via simultaneous elimination of the restrictions on investors and the stock market.

Through the 18th amendment, the Bank abolished the restrictions on investors that limited its investors to the government and the SMEs shareholders. Tthe Shareholders' Meetings to protect the rights of shareholders were also introduced as the shares of the bank became publically available.

Abolishment of the Government's Mandatory Capital Investment and Expansion of the Issuance Limit of the SME Financial Bonds (Tenth Amendment)

The Korean government declared in 1993 in its "New Five-year Economic Plan" and "Measures to Privatize and Functional Coordination of Public Corporations" that it would foster the Bank as an exclusive bank for SME policy loans while expanding the private sector participation, thus privatizing it over the long haul. In its "Measures to Raise the Management Efficiency of and Privatize Public Corporations," it announced that it would convert it into a government-invested enterprise throughout 1997.

According to such privatization plans, it was ensured that the bank would be converted into a government-invested enterprise from a government-funded institution, thus, strengthening the autonomy of management while providing financial support for SMEs by expanding the regulatory capital and borrowing limits.

At the time, the average authorized capital of the top six commercial banks was KRW 2 trillion, at the same time, the government's share of capital had to be over half, which hampered the securing of the capital stock. Therefore, the increasing of the regulatory capital and lifting of the government's mandatory capital share led to greater participation of the private capital.

Moreover, the bank's limit on bond issuances was increased from 10-fold to 20-fold of the paid-in capital and total reserves. The expansion of the issuance limit sought to strengthen SME supporting policies such as the SME restructuring funds and discounts for commercial notes. At the time, the limit on bond issuances for other special banks such as Korea Development Bank (30-fold) and Korea Long Term Credit Bank (20-fold) were greater.[18]

Rationale for Supervising Soundness of the Financial Supervisory Commission (Thirteenth Amendment)

18. It is a long-term financial institution established under the Long Term Credit Bank Act legislated in 1979. It is distinguished from a commercial bank that is a short-term banking institution. Korea Long Term Credit Bank shall issue long-term credit bonds depending on the income from deposits, whose main business is to extend loans for facility funds and long-term funds (according to Article 2 of the Long Term Credit Bank Act). The institution was designed to ease the burden of long-term financing of a commercial bank and to adjust the short and long-term financing sectors. It is unique in that it is capable of issuing bonds with the limit that is 20 times larger than the equity. It no longer exists as the Long Term Credit Bank Act was abolished in 2007.

The main objective was to make financial supervision more efficient by enabling the Financial Supervisory Commission to supervise and to conduct inspections on special banks subject to the supervision and inspection of the Ministry of Finance and Economic (currently, Ministry of Strategy and Finance) to ensure financial soundness.

In addition, supervision of the Bank was transferred from the Ministry of Strategy and Finance to the Financial Supervisory Commission, which was charged with the bank's oversight to secure management soundness and enforce regulations in accordance with the Enforcement Decrees of the Industrial Bank of Korea Act. The supervisory commission provided regulatory oversight of the bank's operations, bookkeeping, documentation and other regulatory issues. Accordingly, the Financial Supervisory Commission prescribed the necessary scope of supervision and standards for conducting the supervision on soundness of the Bank.

Deregulations Including Abolishment of the Permit & Approval of the Guardian Minister (Fourteenth Amendment)

As competition has intensified in the financial sector among banks that support SMEs, regulations on Industrial Bank of Korea's asset management, etc. have been eased to strengthen autonomous management.

As a result of some of the deregulations, the minister's approval is no longer required on shares issued to SME investors, the issuance of corporate bonds or borrowing of foreign capital, etc.

Initiation of Penalties on the Usage of IBK's Name (Fifteenth Amendment)

Using the name IBK or a similar one is not prescribed, nor were there any penalties against using it. A penalty of imprisonment of less than one year or a fine of KRW 10 million was newly imposed on December 14, 2005 for using the name IBK or a similar one, except for IBK.

Integration of Financial Policy and Supervisory Functions (Sixteenth Amendment)

The government established the Financial Services Commission by integrating the financial policy functions of the Ministry of Strategy and Finance and the supervisory functions of the Financial Supervisory Commission. The idea was to actively respond to rapid changes in the financial environment such as business expansion, dual businesses and globalization. Then, the institution in charge was changed to the Financial Services Commission as reflected in the 16^{th} revision of the Enforcement Decree on December 14, 2008.

Stronger SME Support through the Expansion of Legal Reserves (Seventeenth Amendment)

On February 6, 2009 in the middle of the global financial crisis, the 17th amendment was passed in order to strengthen the bank's competencies to support SMEs and flexibly respond to market changes. First, the amount of legal reserves was increased from KRW 4 trillion to KRW 10 trillion. Necessary capital was promptly secured upon the adoption of Basel II and higher regulatory capital requirements - a measure to maintain a stable BIS ratio. Second, procedures on requiring the prior approval of the Financial Services Commission were eased with ex-ante reporting. Third, the penalties for violating regulations that prohibit the use of IBK's name were changed.

2.3. Changes in the Government-Bank-SME Relationship[19]

2.3.1. Prior to 1980 (1961~1979)

Under the five-year economic development plan, a framework for SME financial support was formed and there was a greater amount of funds made available to support SME facility expansion and modernization.

From 1961 to 1970 at a time when the large enterprise-oriented growth policies were in full swing, the government adopted diverse financial support systems targeted at SMEs being stratified and clustered. Special banks such as the Industrial Bank of Korea were established to provide policy support while local banks were established for local SME financing. As such, various types of financial support were implemented to foster the export-led light industries. While interest rate support policies and differential reserves policies were implemented, the trade finance system and the mandatory ratio scheme for lending to SMEs were adopted.

Under the government's heavy chemical industry policies from 1971 to 1979, policy funds and facility investment funds such as the National Investment Fund were actively supported to increase loans. Moreover, contract-based business between SME and large companies were expanded by facilitating the SME integration. Special funds such as SME Rationalization Fund and SME Special Long-term Loan were given support while SME special funds such as SME Promotion Fund were in place. The existing mandatory lending ratio for SMEs was revised upwards for local banks while loans for small and medium-sized facilities backed by financial loans and foreign funds were expanded. Furthermore, SME support was broadened by establishing the Credit Guarantee Fund.

19. Extracted from "IBK's Mid-to Long-term Development Measures" (October 2005) and corrected and complemented.

The government continued to expand its active policy support of SMEs by shifting the SME loans to commercial banks, and then complemented them in the late 1970s through local banks. SME loans from commercial bank were expanded thanks to the adoption of the mandatory lending ratio for SMEs in the 1960s. However, due to sluggish production activities amid the first oil shock after 1973, the portion of SME loans dropped until 1976 and then rose again afterwards.

Commercial bank's ratio of SME loans to total loans gradually dropped towards the late 1970s from 52% in 1964, 48.5% in 1966, 56.7% in 1982 and 50.2% in 1979. By contrast, the ratio in local banks increased from 30% to 40% in 1976 where the portion of SME loans gradually increased.

2.3.2. From 1980 to the 1997 Financial Crisis

In order to address the structural imbalance that occurred during the high growth phase prior to 1980 and to raise economic efficiency, the government's focus was on upgrading the structure of SMEs and capital intensiveness. Despite the government's efforts, the growth base of SMEs gradually weakened.

In 1980 to 1987, the functions and roles of SMEs were intensified to promote the economic efficiency while mandatory provisions on protecting and fostering SMEs were formulated. Accordingly, micro businesses and small and medium-sized start-ups that had been neglected were intensively explored and fostered through funds. In 1980, mandatory provisions on protecting and fostering SMEs were ratified in the Constitution, and the government established the Long-term SME Promotion Plans in 1982. As such, the government unfolded long-term and diversified SME fostering plans whereby it intensively fostered companies that produced parts and components, technology development companies, business start-ups and small enterprises. Moreover, SMEs underwent structural reforms by shifting from the labor-intensive light industries to capital-intensive high technology industries and entering new markets overseas.

According to the "New Five-Year Economic Plan"[20] in pursuit of globalization from 1988 to 1997, SME funds were expanded to pursue structural reforms. However, the portion of SME loans in commercial banks gradually dropped while the growth basis for SMEs weakened.

The mandatory lending ratio for SMEs of local banks was excessively high compared to other financial institutions, which according to some, constrained the autonomy in fund

20. It was thought that the Korean economy turning stagnant in the 1990s would not develop further under the existing economic development scheme amid the changes at home and abroad. The economic plan different from the previous ones was established immediately after the launch of the Kim Young-sam government in 1992.

management and business promotion. As a result, the ratio for local banks was reduced from 80% to 60% on a gradual basis while that of the Industrial Bank of Korea also fell from 90% to 80%.

SME loans by commercial bank quantitatively rose, but due to increases in household loans, the portion of SME loans out of total loans was reducing more. To complement such setbacks, the government upgraded the SME mandatory lending ratio to 35% for commercial banks (1980) and 80% for local banks (1986).

The portion of SME loans by commercial banks dropped over time, but the portion of SME loans by local banks gradually increased, as local banks were mandated to increase lending to SMEs in 1986. As the ratio in commercial banks was revised upwards to 45% from 1989 to 1997, the scale of SME loans steadily increased until the financial crisis hit. However, post to 1996, the increasing trend in the ratio greatly slowed down as commercial banks and local banks reduced lending to SMEs and limits to SMEs were scaled down. Throughout 1980 and 1997, the SME loan ratio in commercial and local banks increased until 1995, but has dropped since then.

2.3.3. After the 1997 Financial Crisis

As the industrial structure moved toward one that was more knowledge-based after the 1997 financial crisis, the roles of SMEs further intensified as the driver of new technologies and job creation. The roles of SMEs strengthened as they advanced into new industries and new jobs were created in new business fields such as parts and materials development, Information Technology (IT), Nanotechnology (NT) and Biotechnology (BT) in the age of the economic globalization and knowledge information. However, the ripple effects from the bankruptcy of large companies led t massive bankruptcies of SMEs, which put the industrial basis on the verge of collapse. The number of SME bankruptcies was 11,589 in 1996 and skyrocketed to 22,828 in 1998. In addition, banks strengthened risk management to comply with BIS capital adequacy ratio without making effort to lend to new, innovative companies. Commercial banks, meanwhile, tightened credit by collecting SME loans, while lending less to SMEs. Moreover, amid the financial distress following the withdrawal of local banks, the portion of total loans and SME loans gradually dropped from 46.0% in 1997 to 41.7% in 2004.

The net volume of SME loans dropped from the post-financial crisis until 1998, and then steadily increased. In particular, loans to individuals with strong collateral and high-yielding SMEs increased. However, the portion of loans towards companies (large companies and SMEs) taking up in total loans steadily dropped from the mid-1990s. As for the portion of loans to large companies, the ratio dropped from 34.6% in 1998 to 13.3% in 2004 for commercial banks while the ratio decreased from 13.7% to 4.9% for local banks. As for the portion of SME loans, the ratio dropped from 51.7% in 1995 to 35.9% in 2004 for commercial banks, and it declined from 74.8% to 62.5% for local banks. The portion of household loans out of total loans, meanwhile, dramatically increased after the 1997 financial crisis. This is because individuals with strong real estate collateral were considered lower credit risk compared to companies with high credit risks.

* The ratio of corporate loans to household loans was reversed from 59.9% to 19.7% in 1998 to 43.8% to 54.8% in 2002.

Table 1-8 | Increases of IBK in the Net Volume of SME Loans

	2002	2003	2004	2005	2006	2007	2008	2009
SME Loan (KRW: trillion)	33.9	38.8	42.4	49.3	60	68.6	78.5	83.8
SME Loan Market Share	16.2%	15.9%	16.7%	18.5%	19.1%	18.0%	17.8%	19.5%

Sources: Bank of Korea, IBK Economic Research Institute.

2.4. Structuring of IBK[21]

2.4.1. IBK Organization Chart

In accordance with the IBK Act, Enforcement Decrees of the Act and Articles of Association, IBK was comprised of 12 Business Divisions, one Research Institute and 41 Departments.

Table 1-9 | Major Tasks in Each Business Division

(as of the end of July 2010)

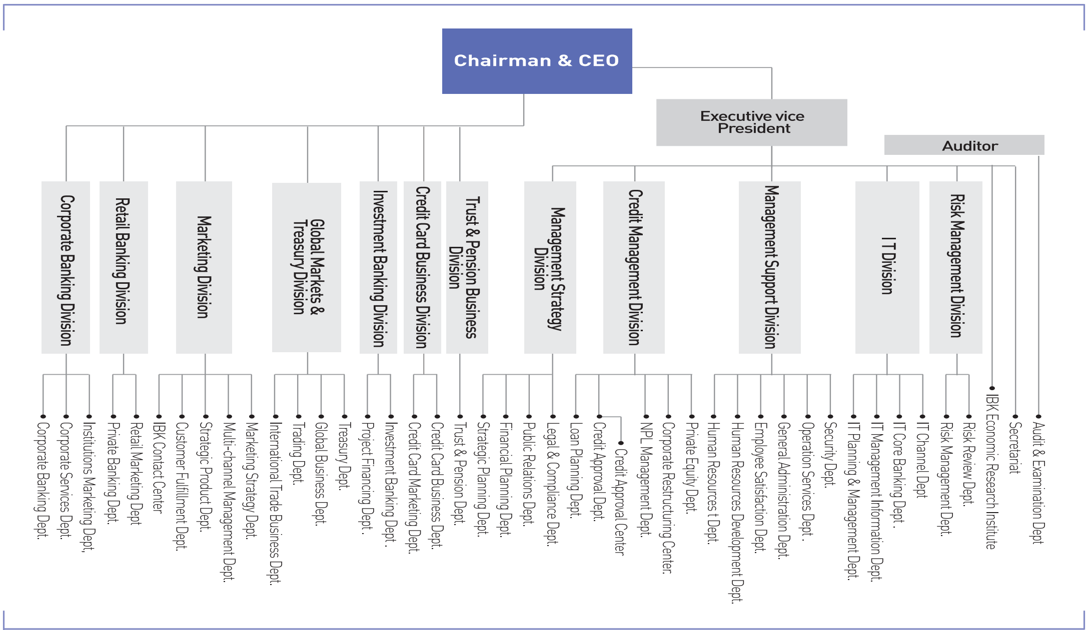
Corporate Banking Division	To maximize risk-reflected profits by efficiently/effectively conveying products and services by designating goals for branches, initiating tasks and managing customers, regarding corporate clients (including institutional ones)
Retail Banking Division	To maximize risk-reflected profits by efficiently/effectively conveying products and services by designating goals for branches regarding retail customers, initiating tasks and managing customers
Marketing Division	To maximize risk-reflected profits through collection and analysis of data, produce development and marketing strategy setup for corporate/retail customers

21. Extracted from the "40-Year History of IBK" (July 30, 2001), Sources from the Ministry of Strategy and Finance and the IBK Act and modified and complemented.

Global Markets & Treasury Division	To manage liquidity, low-cost financing and efficient management through the bank-wide adjustment of fund supply/demand, organize and cover international tasks and manage overseas branches
Investment Banking Division	To dominate the market by doing business in investment, M&A, SOC and real estate and raise profits
Credit Card Business Division	To raise risk-based profits by providing credit card services and financial services and efficiently managing bonds
Trust & Pension Business Division	To raise profits by providing trust financing services, efficiently manage trust assets and cover retirement pensions
Management Strategy Division	To contribute to the bank-wide profits by organizing and managing the Bank's strategies and efficiently distributing resources of the Bank
Credit Management Division	To contribute to generating stable profits for the Bank by organizing and covering the loan business, supporting to secure asset soundness and conducting the PEF-related business
Management Support Division	To maximize the bank-wide work efficiency and raise the satisfaction level of internal (external) customers by effectively supporting the bank-wide HR business
IT Division	To maximize the bank-wide business efficiency by organizing/developing and managing/supporting the bank-wide IT system
Risk Management Division	To support to secure the Bank's soundness and efficiently distribute resources in the management level by measuring and managing credit risks and diverse financial risks, and providing the related information

Note: To conduct the management information analysis and provision, and suggest management strategy directions through investigation and researches on the economic and financial markets at home and abroad.

Figure 1-1 | Organization



2.4.1.1. Shareholders' Meeting

The 8th amendment of the IBK Act and the changes in the Articles of Association were carried out on May 1, 1992. The Operational Committee which was the top decision-making was dismantled and the system of shareholders' meeting was adopted instead. The regular Shareholders' Meeting (32^{nd}) that was confirmed on 1992, was held for the first time on March 17, 1993, and has been going till today.

2.4.1.2. Shareholders' Meeting and Call

The Shareholders' Meetings was divided into regular meetings held within two months from the closing of each settlement period, and ad-hoc meetings.

2.4.1.3. Methods of Decision-making

Shareholders have one decision right for one share held. Decisions at the meetings are based on a majority vote by the shareholders present and one fourth of all shares, except for cases prescribed differently per the Enforcement Decree.

2.4.1.4. The Board of Directors' Meeting

The Board of Directors is the top decision-making body in charge of major decisions on all matters related to the bank's operation and management except for the shareholders. IBK's Board of Directors was first formed on March 5, 1973 pursuant to the 4^{th} amendment of the IBK Act. The Board of Directors consists of the chief director, governor and non-standing executive directors, and was formed pursuant to the Framework Act on the Management of Government-Invested Institutions after December 31, 1981, and has been sustained for 14 years. The Committee was constituted with the executive members of IBK mainly the Executive Directors, Managing Directors and Standing Directors, since November 29, 1997, when the Bank was converted into a government-owned financial institute.

2.4.1.5. Management Council

IBK's Management Council was effected on April 7, 2000. Major management matters not on the agenda of the Board of the Directors are deliberated and decided in accordance with the regulations of the Board of Directors. The Management Council consists of the governor, executive directors, standing directors, department directors and unit directors. The Council's chief director shall be the governor, and when he is unable to conduct tasks due to unavoidable reasons, standing directors shall take the seat according to the order previously set by the governor. Auditors may state opinions by attending the meetings.

2.4.1.6. Executives

IBK's executives include top executive directors consisting of the Board of Directors including the governor, executive managing directors, executive directors and auditors. Upon the foundation of the Bank, the executives were one governor, four directors and one auditor. But now it consists of one governor, one executive managing director, one auditor, one or no standing director and four or less outside directors.

2.4.2. IBK's HR Management

IBK focuses on the HR management to fulfill its management goals. HR management's ultimate goal is the allocation of human resources in an effective and in a timely manner. Based on this principle, the qualifications to become a HR staff are based on employees' attributes, capabilities and performance.

The basic rationale in IBK's HR management has evolved to reflect changing times. The main goal is to advance the HR management through fair and rational HR management techniques and adoption of such a HR system. The existing seniority-based system has significantly changed into a merit-based one.

Specifically speaking, IBK's HR reported to the General Administration Department. In February 1962, the HR Department and General Affairs Department were integrated into one HR Department during reorganization. After several integration and restructuring of the HR Department, some new departments were formed in July 2001. The Employee Compensation and Benefits Team and the Employee Training Center were independently operated by the Welfare Benefits Division and the HR Development Division, respectively. In April 2004, under another restructuring, the HR Department was incorporated into the HR Development Department. In January 2007, the two departments were separated again, reflecting the changes in the financial environment and HR development and recruitment trends. Currently, IBK's HR management is focused on strategic talent development.

Table 1-10 | No. of Employees per Year

(Unit: No. of Employees)

Year	Executives	Employees	Bankers	Secretaries	Non-regular Workers	Total
Upon its Foundation	6	200	575	123	31	935
1970	8	625	1,454	546	9	2,642
1980	8	1,179	3,514	639	30	5,370
1990	2	2,476	6,711	752	260	10,201
2000	9	3,293	3,015	112	570	6,999
2009	5	4,587	2,471	-	2,652	9,715

Source: IBK Human Resources Dept.

2.4.3. IBK's Resources Composition

2.4.3.1. Financial Management

Accounting System

The fiscal year of IBK is same- as that of the government. IBK being subject to Accounting Regulations for Government-owned Institutions used to conduct settlement in accordance with the guidelines issued by the Ministry of Finance and Economy. With the amendment of the Enforcement Decree of the IBK Act in 2000, IBK's accounting was made subject to the Accounting Rules and Standards of the Banking sector as prescribed by the Securities and Futures Commission and Financial Services Commission. Matters not prescribed in these standards were subject to Corporate Accounting Standards.

Meanwhile, all listed companies, starting from 2011, were subject to the International Financial Reporting Standards (IFRS) in accordance with the 'Rules on the External Auditing for Joint Stock Companies.' From January 5, 2010, IBK has been subject to the accounting standards prescribed by the IFRS and the accounting standards for banks prescribed by the Financial Services Commission.

Fluctuation of the Capital Stock

IBK was established with a capital stock of KRW 200 million in 1961. Since then, the government's investment in the bank has been steady. Its capital stock was KRW 1.7 billion at the end of 1970, and increased to KRW 5.7 billion and KRW 217 billion at the end of 1990. The Bank's capital continued to grow driven by the government's capital supply expansion and efforts to upgrade its external image.

The government has provided a total of KRW 1.3 trillion (capital injection of KRW 500 billion in December 2008, KRW 500 billion in January 2009 and KRW 300 billion in May 2009) in capital to expand financial support to SMEs amid the financial crisis in 2008 and 2009. To do so, the regulatory capital was revised upwards from KRW 4 trillion to 10 trillion with the amendment of the IBK Act in February 2009. The capital surplus amounted to KRW 3.2 trillion at the end of 2010 with the government's share of equity of 65.1% thereof.

Management of BIS Capital

In the mid-1980s, supervisory authorities in advanced countries were actively engaged in strengthening bank's capital adequacy to address uncertainties in the financial market and encourage sound competition among banks. In July 1998, the Basel Committee on Banking Supervision (BCBS) under the Bank for International Settlements drafted the 'International Agreement on the Capital Measurement and Standards.' The Basel Committee's BIS capital regulations are, in principle, applied to its member countries (that is, 12 countries including G-10 and Luxemburg), but the authorities in non-member countries are recommended to adopt the standards.

Korea as a non-member of the Basel Committee, is not obliged to adopt the BIS capital regulations, but Financial Supervisory Service adopted the BIS capital ratio in July 1992, setting it at the minimum ratio of 8%. IBK was not subject to the mandatory BIS capital ratio, but has been subject to it since 1998 upon the recommendations of the IMF.

Meanwhile, the BIS also included its calculation, market risk due to the growth of F/X, securities and derivatives in January 1996. Korea's Financial Supervisory Service accepted them in 2002, modifying the BIS settlement standards, which IBK applied in 2007.

The BIS adopted Basel II in 2004, which also included operational risk to the BIS ratio besides credit and market risks to comprehensively manage all risks in banks. The Financial Supervisory Service decided to calculate the BIS ratio under Basel II, starting from January 2008, and IBK currently applies the standards.

Table 1-11 | BIS Capital Ratio

(Unit: %)

1998	2000	2004	2006	2008	2009
8.33	11.01	10.43	11.17	11.70	11.91

Source: IBK Financial Planning Dept.

Assets and Debts

At the end of 1961, immediately after its foundation, IBK's assets were only KRW 4 billion. However, thanks to the growth of deposits and loans, its total assets have increased to KRW 84.1 billion.

In the 1970s, funding from the government directly decreased while its capital grew from deposits, loans and borrowings from the Bank of Korea. As a result, the Bank's total assets were KRW 1.4 trillion at the end of 1980, growing 16.9 times from that of 1970.

In the 1980s, financing sources were diversified by developing new products such as mutual installments, CDs, and Small and Medium Industry Finance Debentures. With improved customer services, household deposits and commercial deposits continued to expand. By significantly increasing the capital supply to SMEs as such, its total assets soared at the end of 1990, hitting as high as KRW 10.7 trillion, up KRW 9.2 trillion from 1980.

In the 1990s, financial institutions were engaged in fierce competition amid the interest rate liberalization policies, while newly founded banks strived to expand their branch network. Against this backdrop, IBK sought to secure more branches through a strategy of setting a large number of small branches. As a result, deposits and loans increased, which enabled the Bank to grow its total assets of KRW 35.5 trillion at the end of 1997, the year when the financial crisis occurred.

Since then, IBK has strived to increase its deposit base from 1998 throughout 2000 with the following: to raise funds to revive SMEs; to secure low costs; to specially increase total deposits; and the IBK Jump 2000 campaign. As a result, the Bank's deposits as of the end of 2000 amounted to KRW 25.6 trillion, up KRW 15.0 trillion from KRW 12.2 trillion at the end of 1997. Not only that, backed by capital stock worth KRW 1.7 trillion injected by the government, IBK focused on extending funds to SMEs struggling in the wake of the 1997 financial crisis. The Bank's loan extensions amounted to KRW 31.2 trillion with its assets of KRW 49.6 trillion at the end of the 2000s.

In the 2000s, IBK adopted a performance system to strengthen its management system by promoting accountability, while strategically expanding its branch network to attract core and high-yielding customers. Moreover, the Bank strongly carried out mid-and long-term management plans, aiming to become a leading bank in Korea. As a consequence of continued growth of assets, improved asset portfolio, dramatic improvement in financing capabilities and increased focus on retail banking, its total assets amounted to KRW 103.4 trillion at the end of 2006, achieving its goal of becoming a large-scale financial institution whose total assets are worth over KRW 100 trillion.

IBK's total loans at the end of 2009 amounted to KRW 116.3 while its total assets stood at KRW 150.9, up KRW 47.5 from the end of 2006. The Bank's household loans increased to KRW 26 trillion at the end of 2010 when the goal was to achieve balance between retail and corporate banking performances. Its total assets soared to KRW 171 trillion, solidifying its fourth rank in Korea.

IBK, since then, has privatized itself through total asset expansion, and as a comprehensive financial group, has strived to pave the way to establishing itself as a holding company.

Table 1-12 | Changes in Asset Accounts by Year

(Unit: KRW 100 million)

Year	Cash and Deposits	Securities	Loans	Fixed Assets	Others	Total
1961	10	-	28	2	2	40
1970	204	-	528	20	90	841
1980	2,331	921	10,009	132	932	14,325
1990	12,029	3,514	69,701	2,306	18961	106,511
1997	13,029	47,349	206,060	6,803	81508	354,749
1998	23,734	87,344	202,684	10,648	80276	404,687
1999	27,201	93,543	251,949	8,043	23135	403,871
2000	26,258	121,674	311,534	7,966	28140	495,572
2007	35,636	211,292	892,682	11,630	41,802	1,193,042
2008	31,640	232,960	1,050,944	11,978	90,286	1,417,808
2009	38,661	240,197	1,162,794	11,935	55,583	1,509,170

Note: For figures for 1999 and onwards, in accordance with the classification of the revised accounting regulations.
Source : IBK Annual Report.

Table 1-13 | Changes in Debts and Capital Accounts by Year

(Unit: KRW 100 million)

Year	Deposits	Borrowed Debts	Other Debts	Capital	Total
1961	22	15	1	2	40
1970	572	201	41	27	841
1980	8,893	3,324	1,309	700	14,225
1990	54,185	20,877	28,173	3,275	106,511
1997	114,948	72,381	161,263	6,411	354,749
1998	147,708	81,342	161,609	14,028	404,687
1999	174,678	104,032	105,608	19,533	403,871
2000	255,945	109,676	106,965	23,903	495,572
2007	368,636	695,095	62,469	66,843	1,193,042
2008	402,588	815,626	124,368	75,891	1,417,808
2009	507,115	837,271	72,628	92,156	1,509,170

Note: 1.Deposits in a foreign currency are to be included in deposits.
2. Loan funds belong to borrowings in foreign currencies after 1999.
3. Small and Medium Industry Finance Debentures and other private bonds are to belong to other debts.
4. In accordance with the classification of accounting regulations revised after 1999.
Source: IBK Annual Report.

Table 1-14 | Disposition of Retained Earnings

(Unit: KRW million)

Year	Un-Appropriated Retained Earnings	Legal Reserves	Discretionary Appropriated Retained Earnings	Dividends	Total
1961	16	4	0	0	16
1970	262	80	55	124	262
1980	8,861	2,629	3,947	2,284	8,861
1990	22,272	5,568	15,618	1,086	22,272
1997	△57,025	397	△57,422	0	△57,025
1998	△1,353,648	3	△897,400	0	△1,353,648
1999	△300,592	0	0	0	△300,592
2000	30,832	7,710	3,108	16,285	30,832
2007	1,167,918	292,436	612,019	263,463	1,167,918
2008	767,023	192,507	573,046	1,470	767,023
2009	710,476	180,327	376,187	153,962	710,476

Note: For figures for 1999 and onwards, in accordance with the classification of the revised accounting regulations.
Source: IBK Annual Report.

2.4.3.2. Income Management

In 1961, immediately after its foundation, IBK achieved net income of KRW 16 million for five months. Since then, the scale has increased, but due to greater expenditures such as expansion of the branch network and expenditures, the net income dropped temporarily. However, driven by expanded revenues and management streamlining, the bank has maintained a high income growth rate since 1968. In 1981, in particular, the bank achieved revenues of KRW 14.2 billion. After lowering interest rates six time for six months from November 1981, its net interest margin ratio dramatically dropped. As a result, the bank recorded a net loss of KRW 15.5 billion for the first time in 1982, covering it with its reserves and retained earnings. The bank's net income did not grow amid the real estate downturn after 1984, but since 1988, income from fees and F/X increased, and with a turnaround in the real estate market, its net income rose again to KRW 61.8 billion in 1995.

Such net income increases were wiped out after the 1997 financial crisis. The Bank realized a net loss of KRW 57 billion due to a series of bankruptcies by SMEs as large enterprises went into bankruptcy due to credit crunch. In 1998, upon the recommendation of the IMF, the same standards were applied by commercial banks on loan loss reserve was adopted by the bank. This resulted in a deficit of KRW 1.4 trillion, the largest ever since its foundation. The bank recorded a net loss even after accounting for its capital reserves and retained earnings. The loses of KRW 456.3 billion could not written off, leaving KRW 300 billion to be carried over.

In 2006, the bank's current net income soared, recording KRW 1.5 trillion, going over KRW 1 trillion for the first time since its establishment due to increase in high-performing assets, improved soundness, increased non-interest income and thorough management of net interest margins. Their impact was huge. The bank overcame the 1997 financial crisis, and for the first time, it recorded a net income of over KRW 1 trillion without expansion through a merger. In 2008 and 2009, the bank's balance sheet worsened due to increased delinquencies and bankruptcies in the aftermath of the financial crisis, resulting in a net income of KRW 797 billion and 710.5 billion, respectively, which were lower than those of 2007. However, these were outstanding achievements given the reality of massive insolvencies and bankruptcies triggered by the crisis. The bank's achievements as such were attributable to sound management.

Korea overcame the global financial crisis in 2010, and economic recovery rebounded. The government's emergency measures on SMEs were over, and the financial sector recovered rapidly. However, the bank suffered from delinquencies and non-performing loans of SMEs with weak management conditions. Amid such challenges, IBK maximized its profits with sound management, and driven by dramatic increases in non-interest income, increases in core deposits in the fund management market and better marketing as a result of synergies with its subsidiaries.[22]

As such, within only two years, IBK recorded a net income of over KRW 1 trillion, overcoming the global financial crisis by mobilizing all competencies.

Table 1-15 | Balances per Year

(Unit: KRW million)

	Total Revenues	Total Costs	Corporate Tax, etc.	Current Net Income
1961	148	132	0	16
1970	10,385	10,125	0	260
1980	203,730	193,216	1,654	8,860
1990	871,628	832,206	17,214	22,208
1997	3,207,424	3,261,881	2,573	△57,029
1998	4,636,981	5,990,392	237	△1,353,648
1999	4,552,859	4,409,854	△45,577	188,582
2000	4,562,005	4,181,357	△23,597	404,245
2007	10,454,832	8,846,763	440,151	1,167,918
2008	22,811,240	21,713,405	330,812	767,023
2009	20,863,981	19,962,809	190,696	710,476

Source: IBK Annual Report.

22. IBK Financial Planning Dept.

3. Roles and Major Achievements of Industrial Bank of Korea[23]

Stabilizing the SME Banking Market in Overcoming the Crisis

- To pursue strong tightening policies amid the economic crisis and assist the recovery of SMEs
- To restore management stability in SMEs backed by the government's massive capital investment and acquisition of non-performing loans
- To provide policy loans for the setup and growth/development of SMEs, joint venture companies with growth potentials and promising SMEs that have a strong business plan but lack financing capabilities
- To implement the "System to Support Household Stability Funds" for employees of SMEs, thus bringing about employment and management stability

Assisting SMEs through Expansion of Financial Support

- To expand deposits and secure foreign capital
- To modernize the facilities of SMEs through the expansion of supply of long-term facility funds
- To raise the efficiency of the government's SME policies through the qualitative and quantitative expansion of SME financial support

Fostering SME through Selective Financing

- To optimize and prioritize the allocation of funds by sector considering the economic situation and the government's SME promotion policy
- To extend financial support for job creation, and for expansion of small enterprises and local SMEs
- To secure growth drivers, and explore and foster high-performing SMEs
- To support restructuring efforts by SMEs
- To induce credit covering and management stability for SMEs

Establishing a Comprehensive Support System

- To strengthened structural weaknesses that are difficult to address with policy support alone by means of management and technical guidance for SMEs
- To represent the SMEs and make multifaceted efforts to support SMEs by establishing various information and service systems

23. Extracted from the "Five-year History of IBK" (August 1, 1966), "30-Year History of IBK" (August 1, 1991) and "40-Year History of IBK" (July 30, 2001) and corrected and complemented.

The bank established as Korea's first-of-its-kind bank for SMEs has played a leading role in promoting the growth of SME industry, the backbone of the national economy.

The bank's lending has grown steadily driven by expansion in deposits and the introduction of foreign capital, which has been expanded and provided in the form of long-term facility funds to sectors that are most need of support. This has supported the modernization of SME's facilities and driving the growth of the SME sector. In other words, the bank has fulfilled its leading role in support SME promotion policy.

The bank, since its establishment, has actively responded to the demand for supporting the SME sector, which has grown dramatically with Korea's economic development. Moreover, its new financial tools for managing interest rates and credit risks, and its introduction of the lending system has also positively impacted the SME activities of commercial financial institutions. As such, active fund support for SME policies drove the efficient management of the government's SME policies.

Moreover, in allocation of the fund support let along its quantitative expansion, the Bank controlled unnecessary loans in tandem with the government's SME fostering policies and intensively supported the priority sectors that would have huge implications following the national economic support. The bank's provision of financing to SMEs was critical in driving the growth of SMEs as it led the endeavors to foster SMEs through selective financing.

The bank's SME support activities were unique in that it was in line with SME promotion policies. One classic example is the management of the SME special funds support system. The bank designed and implemented the allocation plan for each sector in tandem with the government's SME promotion policies every year in order to efficiently allocate funds to SMEs based on its functions and features. This was definitely significant in that the bank not only suggested selective financing means but also set directions for the provision of SME loans.

Meanwhile, the bank established a comprehensive support system in response to diverse credit demands of SMEs. The bank was able to increase efficiency in providing support while effectively responding to the stronger demand in the non-financial service sector. Besides the direct provision of funds, the bank contributed in addressing structural weaknesses that are difficult to resolve with financial support alone by providing management and technological guidance to SMEs. Also, the bank acted as a representative of the SME industry by proposing policy recommendations to the government based on SME management research, feasibility studies and statistics, etc. In addition, the Bank established various information and service provision systems for SMEs.

The Industrial Bank of Korea began to receive more attention when the Korean economy was in turmoil. The 1997 financial crisis proved to be extremely difficult for SMEs and the global financial crisis that swept the world in 2008 put Korea in a severe downturn. Upon each crisis, the bank strived for strong, sound management and sought to support the recovery of SMEs, bringing financial stability in the in the SME industry.

3.1. Stabilizing the SME Banking Market in Overcoming the Crisis

Amid the financial crisis that caused a severe economic downturn, the bank implemented stringent management policies and sought to support the recovery of SMEs. As a result, the bank was able to come out stronger in overcoming the crisis during which its survival was not even certain.

The 1997 financial crisis was a severe blow to SMEs. The crisis endangered the bank's future, which led to a shakeup of its management base. However, the bank was able to implement various support measures to assist the struggling SMEs, which helped to restore their economic vitality. At the same time, it further solidified their management base.

One of the major policy initiatives implemented at the onset of the crisis was to revive the struggling SMEs to be the future economic growth engines. In implementing such a critical policy initiative, the bank's roles was put into focus, which helped bring a measure of management stability in the SME industry driven by the government's massive investment and acquisition of non-performing loans. Meanwhile, the bank made every effort to reconstruct the national economic base by expanding its lending for supporting the growth of SMEs that were deemed strong but were unable to secure liquidity. Some of these promising SMEs included small and medium-sized venture companies and technology-driven companies.

3.1.1. Full Support for Management Stability and Restructuring of SMEs

In order to assist financially struggling SMEs, the bank initiated the "Special Support Program for SMEs" in 1998 to provide fund support and expansion.

First of all, the bank sought to secure policy loans for SMEs by going on a "campaign to collect funds to revive SMEs", which unfolded for two months from June to July, 1998, generating new funds worth KRW 893.8 billion and attracting capital worth KRW 1.7 trillion. The bank used this to lending capacity to SMES.

The bank established a support unit at the main branch and local offices to assist promising SMEs undergoing financial trouble, albeit temporarily, from going bankrupt. Moreover, the bank extended loans for companies lacking operating funds due to the default of their commercial notes. To facilitate this, the branch manager was given permission under special measures to roll over secured loans worth less than KRW 300 million per the same person (notwithstanding the delegated discretion). The amount of loans rolled over under the Special Fund for Bankruptcy Prevention during this period amounted to KRW 448.2 billion in 1997, KRW 581.7 billion in 1998 and KRW 409.8 billion in 1999.

Moreover, under the "Special Support Program for SMEs" implemented from June 1998, a "special support unit for SMEs" was formed in the main branch, local offices and branches where all the employees of the team focused on assisting SMEs. The bank extended funds worth KRW 2.1 trillion for seven months by monitoring the results and giving encouragement every 10 days. In particular, on June 29, 1998, Dae-Dong Bank and Dong-Nam Bank, two local banks specializing in SMEs and Chungchong Bank and Kyungki Bank, two local banks, were closed down on June 29, 1998. In response the bank's program for financially struggling local SMEs intensively extended funds worth KRW 1.4 trillion, significantly stabilizing the local economy.

Meanwhile, in 1998 when the crisis had peaked for SMEs, the bank actively developed and extended loan systems, which somewhat provide relief for SMEs from the crisis. The bank's effort was highly commended, thus winning the presidential award organized by the Small and Medium Business Administration as an excellent SME banking institution, the Grand Prize in the institution sector, in November 1998.

Along with such endeavors, the bank carried out restructuring of SMEs to improve the corporate financial structure and strengthen their competitiveness after the 1997 financial crisis. This was conducted by the bank as the creditor based on negotiations with struggling companies that could recover. 18 companies were subject to workout, that is, 6 companies in 1998 and 12 in 1999. The Bank extended the financial support using new funds worth KRW 29.2 billion, and participating in debt restructuring worth KRW 51.5 billion and investment conversion worth KRW 500 million and interest rate reduction, as of the end of 2000. Three companies that recovered with strong management were graduated from the workout program earlier than expected, while the workout of five poorly performing companies was suspended, for whom composition proceedings and auctions was carried out. As of the end of 2000, 10 companies implemented turnaround plans by 92%, showing that the workout was well underway.

3.1.2. Strengthening the Support for Small Enterprises

The Bank strived to stabilize the management of SMEs while seeking to expand the fund support and the active support of start-up companies. With resources of KRW 1 trillion in 1999, the bank aligned with the Korea Credit Guarantee Fund and Technology Credit Guarantee Fund, to implement the “Discount Bank” system, primarily for small companies that were neglected by the financial sector. Funds were provided at the low interest rate of the prime rate (9.95% back then) to reduce the financial costs for small enterprises, total funds provided amounted to KRW 1.4 trillion for 11,603 companies at the end of 2000.

Besides, the bank facilitated an atmosphere in which starting up a business for self-employed in retailing and food related businesses was made easier to bring in stability and create jobs as well as foster the middle class in July 1999. The bank developed and extended loan systems to make it easier to start up an SME through “Livelihood Start-up Fund and Franchise Business Incubation Fund.”

3.1.3. Actively Fostering SMEs and Venture Companies

The government formulated and implemented the Special Act on Fostering Venture Companies in October 1997, as a new growth driver in the knowledge-based economy for the 21st century.

Prior to the 1997 financial crisis, the bank focused on boosting the competitiveness of existing SMEs. However, after the financial crisis, the bank attempted to change policies to focus on the incubation and support of SME venture companies to set in place a framework for job creation and economic recovery and for upgrading of industrial structure. The bank launched the “Business Start-up and Venture Company Support Team” under the Loan Planning Division in April 1998 in tandem, and established the “SME and Venture Company Incubation Information Center” in the main branch in May 1999.

The center was expanded afterwards, and in April 2000, the bank additionally launched the “Venture Company Support Center” in Tehran Valley where venture companies are clustered. It also set up the “SME and Venture Company Incubation Information Center” in the Busan Branch in August of the same year. Moreover, the bank established the “Venture Financing Team” integrating the “Venture Company Support Center” in Tehran Valley under the Inspection Division for investment fund operation and management and inspection of investment companies in October of the same year.

As a result, support for SME venture companies amounted to KRW 1.2 trillion as of 1998 based on KRW 1.1 in 1999 and to KRW 1.4 trillion in 2000. The investment portfolio of stocks and converted bonds was KRW 53.3 billion for 94 companies as of the end of 2000. As such, the bank plays a leading role in fostering SME venture companies by establishing a financial support system for each growth stage and consistently accumulating and exerting the business capacity as an investment bank.

3.1.4. Expansion of SME Banking through Financing in Foreign Currencies

The bank signed an agreement to secure yen-denominated foreign funds worth USD 1.3 billion from JEXIM in January 1999, which the bank used to allocate USD 572 million in 1999 and USD 470 million in 2000 of funds to SMEs. Moreover, the bank provided USD 217 million in 1999 and USD 59 million in 2000 in SME support through five commercial banks. This entire amount has been repaid as of now.

3.1.5. Contributing to the Management Stability in SMEs

After the 1997 financial crisis, the credit crunch worsened and household income fell, leading to increases in household delinquencies. Accordingly, a majority of financial institutions cut off credit loan limits for households, and suspended the extension of credit to household such as apartment-secured mortgage loans. Nevertheless, the bank put in place the "system to extend household stability funds" for employees of SMEs in February 1999, inducing employment and providing management stability of SMEs.

The bank extended support to 5,628 employees with credit worth KRW 48.7 billion by the end of 2000 so that they could concentrate on their operation and management of their businesses. From April 2000, the bank installed the "household stability funds for the jobless" in conjunction with the Korea Labor Welfare Corporation, to secure nationwide social welfare.

3.1.6. Overcoming the Global Financial Crisis[24]

The global financial crisis that started in 2008, originated from the U.S. financial sector due to the sub-prime mortgage collapse that led to the failure of investment banks. The crisis that started with the bursting of the real estate bubble spread to the banking sector, the effects of which rippled through the global economy like a domino effect.

Banks in Korea had provided loans to SMEs that amounted to a monthly average of KRW

24. Extracted from "IBK's Responses to the Financial Crisis(2010)" and modified and complemented.

5.2 trillion prior to the Lehman-crisis (from January through July, 2008), except for that of IBK, but after the crisis, the amount of loans provided to SMEs dramatically dropped to KRW 1.9 trillion (from August through November 2008). As a result, SMEs were suffered great financial difficulties, leading to an increase in bankruptcies. The rate of SMEs in financial difficulty was gradually increasing since 2008 but dramatically rose after the Lehman-crisis in September, reaching its peak in November. The number of bankruptcies per month stayed at 199 prior to the Lehman crisis (From January through July, 2008) but dramatically increased to 269 after that (August through December, 2008).

The government sought to lessen the financial burden of SMEs, actively initiating policies for liquidity support to provide financial relief and prevent bankruptcies. As a result, the scale of SME policy funds (according to Small and Medium Business Administration) dramatically soared from KRW 3.2 trillion in 2008 to KRW 5.9 trillion in 2009. Efforts followed to enhance the accessibility of SMEs to financial institutions. While the scale of guarantee soared, the guarantee ratio was revised upwards. The government signed MOUs with banks to increase credit to SMEs by increasing loans and extending loan maturities, striving to minimize the unwillingness of banks to extend loans to SMEs.

Nevertheless, net increase in loans to SMEs was sharply reduced by most commercial banks with some of them even redeeming funds. Since private commercial banks tend to turn conservative when credit tightens, it also squeezes the credit market for SMEs. However, IBK was different. IBK actively sought to relieve the SMEs' financial burdens, while complying with government policies. During the global financial crisis (from August 2008 to December 2009), IBK took up over half of the net increase in SME loans. During the crisis, IBK's net increase in SME loans reached KRW 13.3 trillion, 50.8%, or over half of the net increase in total loans of KRW 26.3 trillion.

Table 1-16 | Net Increases in SME Loans by Bank and the Ratio (Aug. 2008 ~ Dec. 2009)

(Unit: KRW trillion, %)

	July's end, 2008		August 2008 ~ December 2009	
	Balance	Ratio	Net Increases in Loans	Ratio
IBK	70.5	17.4	13.3	50.8
Kookmin Bank	59.6	14.7	2.9	11.1
Woori Bank	56.3	13.9	5.0	18.9
Shinhan Bank	51.9	12.8	1.1	4.2
Hana Bank	30.3	7.5	0.8	2.9
Banking Sector	404.4	100	26.3	100

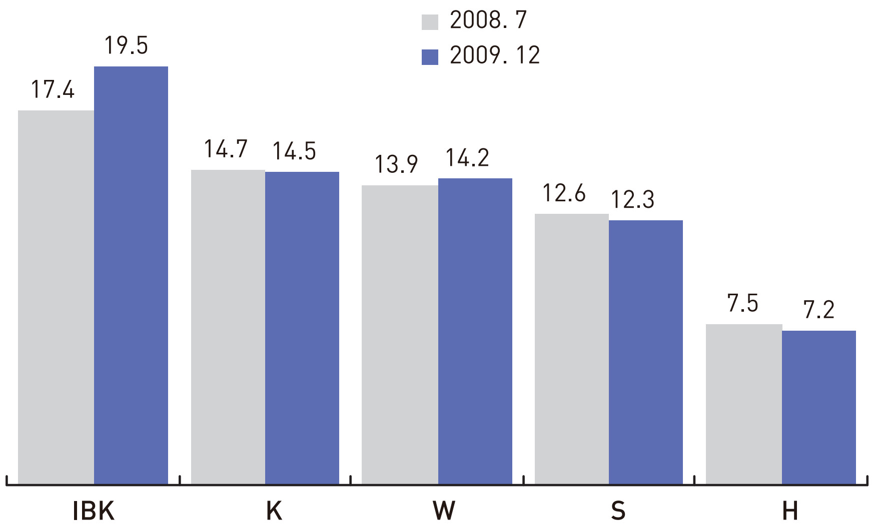
Note: Based on the Bank of Korea's report (loans in won in banking accounts + trust loans - loans in the financial sector).

What is noteworthy is the ratio of SME loans in 2008. At the end of July, 2008, IBK's ratio of SME loans was 17.4%, which implied that its net increase ratio of 50.8% was unprecedentedly high. In other words, IBK in fact expanded the monthly ratio above pre-financial crisis levels, a stark contrast with commercial banks that dramatically cut the monthly net increase after the crisis.

In December 2009, the Bank's ratio of SME loans significantly rose vis-a-vis the pre-financial crisis, even up by 2.1% to 19.5% at the end of December in 2009 from 17.5% at the end of July in 2008. The ratio slightly increased for Woori Bank among major ones while most of them had a steady drop in the ratio.

Figure 1-2 | Changes in the SME Loan Ratio by Bank

(Unit: %)



As the financial crisis continued, IBK's extension of SME loans increased, unlike commercial banks. Even concerns of the bank's decision rose in the market, but it steadily maintained excellent asset soundness vis-a-vis the market average. Even with the financial crisis, IBK's SME loan delinquency ratio was lower than the market average by 0.3 to 0.4%. This was a remarkable achievement despite the increased loan extensions.

This is attributable to IBK's know-how and expertise in supporting SMEs in terms of: credit reviews for SME loans, consistent upgrades in risk management systems and development of specialized reviewers, something it has done for the past 50 years. IBK's know-how was evidenced by the Risk Adjusted Performance Measurement (RAPM) in 2003 and the 'watch-list check' introduced during the financial crisis at the end of the 2000s. In particular, the 'watch-list check' system was set up to monitor fluctuations in credit risks of vulnerable companies in terms of insolvency, which is a classic example of proactive management of assets.

Such achievements by IBK were highly recognized in the market, being awarded the 'Bell Risk Manager Award' by the president of Financial Supervisory Service, an acknowledgement of its advanced know-how. The bank's 50 years of know-how continues to bear fruit.[25]

Table 1-17 | Delinquency Ratio in SME Loans

(Unit: KRW trillion, %)

Classification	2007's end	2008's end	2009's end	February's end, 2010
All the Banking Sector(A)	1.00	1.70	1.09	1.63
IBK(B)	0.61	1.34	0.79	1.26
B-A	-0.39	-0.36	-0.30	-0.37

Note: Nominal delinquency rate for SME loans in won.
Source: Financial Supervisory Service, IBK.

3.1.6.1. Actively Complying with the Government's Fast Track Program for Emergency Liquidity Injection[26]

In order to promptly provide SMEs with urgent temporary liquidity, IBK set up an exclusive unit, the SME Support Center. Guaranteed loans with a ratio of over 40% of liquidity can be provided at the discretion of a branch head.

3.1.6.2. Specially Discounted Interest Rates for SME Loans

IBK lowered the interest rates for SME loans for the first time as a bank in a bid to ease the burden of financially struck SMEs with the resources from wage returns. The Bank also lowered interest rates on guarantee-backed loans by setting a ceiling of KRW 4 trillion for

25. Extracted from the "The Financial Crisis and Roles of IBK (2010)" and modified and complemented
26. The Fast Track program is a government measure to overcome the global financial crisis where companies classified as Grade A or Grade B as a result of banks' evaluation of corporate credit risks, lending banks are to extend benefits such as new fund extension and lower interest rates. This aims to contribute to normalizing companies in transaction by promptly supporting liquidity for SMEs suffering from the liquidity crisis.
    * The process is as follows: application for liquidity support at the SME Support Center (application for liquidity support) ⟶ Evaluation and grade classification at the Center or upon the application of transacting companies ⟶ Notification of bond repayment postponement to other lending banks (application for liquidity support) ⟶ Liquidity support for A/B Grade in credit evaluation, and reviews on work-out for Grade C (devising support measures) ⟶ Guarantee application and implementation of support for each lending bank (implementation of support).

guarantee-backed loans and KRW 2 trillion for discounted notes.[27] Moreover, default loan interest rates were lowered by 3.0% from a maximum of 21% to 18%.

3.1.6.3. Expansion of Credit Guarantee Loans

IBK formed a credit guarantee task force to directly administer guaranteed loans and to strengthen cooperation with guarantee providers. To expand guarantee-backed loans and share the burden, the bank extended a total of KRW 21 million to the Korea Credit Guarantee Fund and Korea Technology Guarantee Fund, totaling KRW 1.9 trillion as of the end of December 2009.

3.1.6.4. Support for Cooperation between Large Enterprises and SMEs

IBK has sought to strengthen cooperation between large enterprises and SMEs by extending low-interest funds to companies that participate. This program is backed by deposits of large enterprises or contributions of credit guarantee institutions, so as to not create additional burden that could lower the BIS ratio.

Table 1-18 | Loan Extensions for Cross-Enterprise Cooperation

Classification	Loan Extensions for Cross-Enterprise Cooperation
Process	To extend support in conjunction with guarantee institutions by forming loan funds backed by deposits of large enterprises
Participating Institutions	Korea Racing Association, Hyundai Motor, Korea International Trade Association, SK Group, LG Telecom, Hyundai Heavy Industries and Mando Corporation
Extension Records	KRW 319.4 billion (2009), KRW 25.9 billion (2008)

Source: IBK Corporate Services Dept.

Table 1-19 | Support for Cross-Enterprise Guarantee Loans

Classification	Cross-Enterprise Guarantee Loans
Process	Guarantee-backed loans after banks and institutions in conjunction jointly extend special contributions to guarantee funds
Participating Institutions	10 companies including POSCO, Hyundai Motor, Hynix, Samsung Electronics and GM Daewoo
Extension Records	KRW 323.6 billion (2009)

Source: IBK Corporate Services Dept.

27. Key facts in support: 1.0%p for guarantee-backed loans (guarantee rate of 100%); for guarantee rate of 85% to 100%, automatic write-offs by 0.5%p; for lower rate discounts for discounted notes, automatic write-offs by 1.0%p.

3.1.6.5. Support for the Job Creation for Youth Project

The Job Creation for Youth Project started in 2008 is one of several support projects to ease the labor shortage faced by SMEs. The bank's goal has been to act as a bridge between SMEs and universities to provide youth employment opportunities to improve the job market for both. Accordingly, the 'ICC Industry-Academia Alliance Project'[28] was implemented for the first time based on credible recruitment information resulting from SME job fairs. Based on such ideas and experiences, IBK has launched diverse opportunities for job seekers and employers. This has contributed to easing the youth unemployment and labor shortage by connecting SMEs and young job seekers.

The bank organized a 'launching ceremony for a project to create 10,000 jobs for youths' and the 'Job World (February 3, 2009)' following the formation of a task force for a youth employment project (August 28, 2008). After that, the bank implemented a special fund for companies that participated in the job creation program and the Job World Youth Internship (February 17, 2009). The Bank conducted road shows for region-specific Job World nine times (from March 9 to September 29, 2009), opening the Job Creation Center (April 6, 2009). IBK's efforts turned into outstanding achievements: since the launch of the project to create jobs for 10,000 youths, the number of job seekers amounted to 10,000 in nine months (October 29, 2009), and the number of the employed amounted to 20,000 as of July 22, 2010.

Table 1-20 | No. of Jobs and Job Seekers

Classification		Oct. 29, 2009	Dec. 31, 2009	Jun. 30, 2010	Vis-a-vis the last year's end
Recruiting Companies	No. of Members	34,076	34,783	52,049	17,266
	No. of Recruiting Companies	6,688	7,329	12,065	4,736
	No. of Jobs Available	19,415	22,244	35,859	13,615
Job Seekers	No. of Members	83,638	102,366	150,325	47,959
	Applications for Jobs	47,552	55,346	80,757	25,411
	No. of Job Seekers	10,028	12,193	19,155	6,962

Source: IBK Corporate Services Dept.

28. It is a public good project jointly organized by IBK and the Korean Council for College Education so that companies and universities forge sisterhood relationships and achieve mutual goals through industry-campus connections.

3.2. Leading the SME Banking through Expansion of Financial Support

For the last 40 years, the bank has made every effort to expand financial support for SMEs so that a greater amount of funds could be supplied to the SME sector. It has also sought to secure financial resources to fund its support for SMEs.

The financial support of SMEs began with the implementation of the loan limit system in a bid to systematically provide financial funds to SMEs in 1952. Following UNKRA's allocation of funds in 1953, the government funds generated from the special account reserves that consisted of proceeds from the divestiture of vested property funds and counterpart funds started to be supplied from 1957, which vitalized the support for SMEs. However, the measures were not that effective due to a lack of necessary institutions and the fund supply system. Worse, in the 1950s, support funds were allocated largely to large companies that were producers of consumer goods. At the same time, the government implemented retrenchment policy to stabilize prices during the economic reconstruction period of the 1950s. As a result, SMEs were facing hard times and suffered from the budgetary turmoil, triggering the socio-economic issue involving SMEs.

Against this backdrop, the bank was established on August 1, 1961, and took its first ambitious step as a financial institution specialized for SMEs by integrating and systematizing the financial support of SMEs which used to be administered by various commercial banks, the Agricultural Bank and the Korea Development Bank, etc. The bank also provided the contingency fund of KRW 297 million to ease the financial difficulties of SMEs in the latter half of its founding year.

Up until 1964, when the bank was in its infancy, it had depended on the financial counterpart loans from the government. However, amid the growth of the SME sector as well as the government's SME policies that were in full swing from the mid-1960s, the bank had difficulty with meeting the financial demand of SMEs with its limited resources. As a result, the bank's loan resources were urgently raised by increasing the deposits. The bank strengthened its ability to secure funding by focusing on growing deposits.

The bank depended on government funds mostly for loans in the initial period. However, the scale of the government's support was far too small to meet the financial the demand of SMEs - one of the major initiatives of the bank. Moreover, the bank strived to expand and diversify financing sources by increasing its capital stock, actively securing foreign financing, and issuing SME financial bonds, etc.

This served as a momentum for the bank to greatly secure adequate funding capacity every year. In the 1980s, the policy support was oriented towards large companies, while the social consensus to foster SMEs spread out. Against this backdrop, the bank handled SME special funds on its own to further facilitate promotion of SMEs, while strengthening the lending functions with various funds as resources, playing a leading role in the promotion of SMEs.

Deposit Growth (1967~1974) - 4th and 5th IBK Chairman & CEO, Chung Woo-chang (December 29, 1967 ~ January 29, 1974)[29]

Back then, Korea urgently needed to mobilize domestic capital to drive economic development, and a savings campaign was inevitable to stabilize the national economy. Given the status of the Industrial Bank of Korea, its ability to finance loans with deposits was much weaker compared to commercial banks. This was at a time when government funds to IBK dropped in scale, so it had to focus on absorbing deposits to survive.

The bank sought to grow dramatically by doubling the net intake of deposits in early 1968. To this end, the campaign, "A Hit in Mushin, Doubling the Savings", was conducted on a large-scale to increase deposit for the first time since the bank's foundation.

The bank established a planning system to secure more deposits by expanding the Savings Department under the Fund Division in February 1968, and subsequently, began the campaign to increase deposits. The bank separately managed its Seoul Branch and local branches, and allocated the deposit targets on a weekly and monthly basis, holding meetings with the branch heads occasionally and encouraging them to achieve the targets. I believe that the branch chiefs back then must have been under enormous stress. It is unimaginable how hard they worked to increase deposits from KRW 15.3 billion upon my appointment at the end of 1967, a net increase of KRW 10 billion for 1968.

Meanwhile, the bank initiated efforts on product development, institutional improvement, expansion of the branch network and improvement in the window response, etc. so that all its employees could focus on strengthening the system for deposits. Accordingly, the bank opened, for the first time back then, night-time services and deposit handling offices. It also founded an education and training center at the Seoul Girls Commercial High School. It also provided banks services on large buses. At the same time, the bank amended the Industrial Bank of Korea Act to further expand the opportunities for securing financial funds by abolishing any restrictions on income earned from current accounts, which used to hinder the bank's efforts to increase deposits.

Furthermore, as demand for long-term funds skyrocketed amid the quantitative expansion of the real economy under the economic development plans, the bank actively sought to increase

29. Extracted from the "Ark of Blessings (August 1, 1991)" and modified.

its capital stock and securing of foreign capital to expand the supply of facility funds necessary to expand and refurbish the facilities of SMEs.

In the 1970s, government's financial support was intensively focused on the heavy and chemical industry to upgrade Korea's industrial structure. As a result, matching funds from the government either decreased or stopped since 1974. However, the bank converted the financial funds it had procured into government funds, first extending them as policy-related funds, and then being covered by the government for the differences with the general financial funds, thus continuously increasing the fund supply capacity towards SMEs.

In the 1980s, meanwhile, the direction of the economic policies shifted from being government-led to being private-led. In addition, as the portion of funds towards SMEs increased amid the shrinkage in policy financing, financial support for SMEs skyrocketed quantitatively. In supplying the SME special funds which used to be allocated by various financial institutions, the bank has administered the special funds on its own with funds it secured since 1982. Since then, the bank has dramatically expanded its deposit base. Moreover, the bank has provided loans through various funding resources such as the recently expanding Small and Medium Enterprise Promotion Fund and Industrial Development Fund in the 1980s.

In the 1990s, the business environment for SMEs has rapidly changed brought on by changes in the global economic order, global movements towards market opening and accelerated industrial restructuring following the launch of the WTO regime. Accordingly, the bank sought to strengthen the competitiveness of SMEs amid the economic situations at home and abroad.

As such, financial support for SMEs has radically expanded driven by the establishment of Industrial Bank of Korea. The scale of SME loans in all deposit banks skyrocketed from KRW 5.9 billion in 1961 to KRW 117.6 trillion at the end of 2000. Accordingly, the portion of SME loans among total loans in deposit banks increased from 11.1% in 1961 to 44.6% in 2000. Moreover, the portion of SME loans provided by IBK compared to total SME loans provided by deposit banks was 21.7% in 1970, 21.1% in 1990 and 15.4% in 2000, continuing to maintain a high percentage. The total number of SME depositors at the bank was 160,300 at 2000, among which the number of manufacturing companies was approximately 75,000.

The balance of SME loans in deposit banks was KRW 430.7 trillion at the end of 2009, and 87.1% in 2008, while the Bank's MS was 19.5% and the balance of SME loans amounts to KRW 83.7 trillion.

Table 1-21 | The Portion of SME Loans in Each Bank (as of the end of 2009)

Bank	IBK	S Bank	K Bank	W Bank	H Bank	Others
Percentage (%)	19.5	12.3	14.5	14.2	7.2	32.3

Source: IBK Loan Planning Dept.

3.3. Fostering SMEs through Targeted Financing

3.3.1. In Alignment with the Government's SME Fostering Policies

The business environment for SMEs has rapidly transformed brought on by the economic integration that has been accelerated amid the opening and liberalization of the global economy, and rapid technological innovation amid the combination of science and technologies. This has led knowledge and technologies to be at the core of stronger competitiveness and value creation. Amid the changes in the environment, the bank sought to establish a sound basis for SMEs and to raise their competitiveness, greatly contributing to the growth and development of the SME sector.

The bank has strengthened the fund support, focusing on the small and medium-sized manufacturing sector that has high income effects and productivity, driving the advancement of the industrial structure. The bank has flexibly adjusted its financial support of SMEs considering the economic conditions and the government's SME promotion policies. As such, its priority was to maximize the efficiency in the allocation of financial support by modifying the eligibility criteria for policy support.

In 1965, as the government pursued SME promotion policies, it started to strive for the support in alignment with SME policies as a means to induce the policies. The government established a SME special fund support system after the developmental stages. Specifically, in 1965, SMEs were divided into three groups under the SME promotion policy: Category A to be fostered as SMEs; Category B to be fostered as large companies; and Category C companies requiring new business plan. The bank, then, classified each group into the high, middle and low according to the level of importance to the national economy, and sought to improve the structure of SMEs by differentiating various categories of financial support based on the prioritization.

Table 1-22 | Business Categories

Business Categories	
Category A	- Not requiring large-scale facilities - Parts or components business - Belonging to the processing stage of raw materials - Labor-intensive
Category B	- Production of raw materials - Assembly work required - Where large companies are more advantageous in terms of the production cost - Requiring large-scale facilities
Category C	- With the oversupply of facilities - Where facilities are obsolete and technologies are backward - Where export is impossible - In competition with large companies and is hard to maintain for SMEs
High	- Items under specialized industries - Major items among those from growth industries - Items with the high foreign currency acquisition rate and clear export prospects among export items and military supply items - Import-substitutive items - Other categories that require major intermediate materials and devices
Middle	- Mass-produced items among daily necessities and semi-daily necessities - Items that are supplementary for the secondary products and belong to the processing industry
Low	- Items whose importance is low as semi-daily necessities - Categories similar to the service industry - Simple processing industry

From 1969, the bank specified the business categories to comply with the government's SME fostering policies putting priority on export industries, integrated industries, machinery industries and regional development industries.

This business category-specific classification was converted into one that was business type-specific in tandem with the implementation of the 3rd Five-year Economic Development Plan in 1972 and with the changes in the SME fostering policies. The goal was to intensively foster all SME business types into the SME-exclusive type, specialized/integrated type and large company type to induce the appropriate scale for each. At the same time, the bank emphasized targeted financing, while avoiding excessive lending to certain companies and trying to identify new SMEs. Moreover, the bank ensured that SMEs could evenly enjoy the benefits of financial support by prioritizing on microcredit.

In 1974, the bank provided financial support to SMEs together with commercial banks in a bid to induce smooth economic activities of SMEs. From 1976, this was divided into SME special low-interest funds, which provided preferential financing in terms of interest rates and payment period, etc, policy funds and general SME special funds. In 1980, SME special low-interest funds and policy funds were integrated, and from June 1982, SME special low-interest funds and general SME special funds were integrated and taken over by the bank.

Meanwhile, under the New Five-year Economic Plan of the new Korean government launched in 1993, major economic initiatives targeting the SME sector were put in place. Accordingly, various reforms were carried out including upgrading of SME industry to be sustainable; establishing an autonomous cooperative basis in the private sector; and realigning the SME support system. In February 1996, the Small and Medium Business Administration was formed, while the bank integrated and aligned SME-related laws.

The bank strengthened its support in line with the government's SME fostering policies by significantly expanding the supply of special funds to assist SMEs in financial difficulty in the aftermath of the 1997 financial crisis. Since 1982, when the bank started to solely support SMEs by financing loans with its own deposit, the scale further went up. Moreover, the bank successfully induced the efficient facility investment of SMEs, which carried out efforts on restructuring, production of parts and components, raising productivity and competitiveness. In the late 1990s, the bank's supported sound and competitive technology-intensive SMEs and venture companies and micro-scale companies.

3.3.2. Expansion of the Horizons of SMES

SMEs have significantly contributed to the stable growth of the national economy in regards to employment stability and balanced income distribution. As the government initiated its high growth policies oriented towards quantitative expansion after the 1960s, the growth of the SME sector has been weak as the financial resources were tilted towards certain sectors. Furthermore, in the SME categories stood the differences of development for each scale and region.

The underdeveloped SME sector and large structural imbalances weakened Korea's industrial base and external competitiveness. As a result, the Korean economy had difficulty overcoming the recession following the global economic downturn at the end of the 1970s and securing continued growth.

Accordingly, the government sought to strengthen the industrial base and pursue cross-industrial and regional balanced development in the 1980s. To this end, the government established the institutional basis for SME startups and fostering small enterprises, while intensifying the support for local SMEs. The bank actively provided support for business startups, the small enterprise sector and local SMEs, etc. by catering to changes in the environment, seeking for the expanded basis for SMEs and balanced national economic development.

The bank focused all its efforts to resolve the severe management turmoil facing SMEs that were on the verge of mass bankruptcy following the 1997 financial crisis. The bank continued to provide SME fund support, especially expanding the credit loans to small enterprises, business start-ups and venture companies with growth potential, and companies involved in technological development.

Meanwhile, the bank bolstered its SME support system by operating the “SME Special Support Unit” and focused on establishing a sound base for SMEs by expanding the SME financial support through the development of new financial products and loan schemes.

3.3.2.1. Fostering Small Enterprises and Facilitating the Business Startup

The bank strived to strengthen its allocation of financing support and to identify new SMEs to have a wider and more even impact on SMEs after the mid-1970s. The bank’s functions have been expanded and strengthened in tandem with the government’s SME fostering policy from the 1980s to the 2000s.

As a result, in 1980, the bank sought to intensively target small enterprises with 5 to 19 full-time employees that were under the radar of financial institutions in 1980. This would expand their opportunities to receive financing, thus reducing their financial burdens and bringing about stability in management. At the same time, the bank also fully utilized the credit loans or credit-guaranteed loans since small companies lack sufficient collateral as security. The bank, in particular, formulated the “Guideline on Supporting to Explore Small and Medium Enterprises” in 1989 and further pushed to identify and support small-scale manufacturing enterprises with growth potentials but have been neglected by financial institutions. In 1990, the bank downgraded the number of full-time employees from below 50 to below 30 to further specifically target these SMEs.

Meanwhile, small enterprises located in administrative units of eop and myeon were actively explored, while non-fund support was also pursued through the “Small and Medium Enterprise Council” formed for each region. In 1999, in particular, the bank established the Discount Bank, a discount note-exclusive fund for financially weak small enterprises in 1999.

The bank also formulated provisions on supporting small enterprises, which confined support to small enterprises pursuant to the Small and Medium Enterprise Basic Act, with the goal of fostering small enterprises with growth potentials into medium-scale enterprises. Moreover, the bank actively explored and supported small enterprises with less than five employees to identify promising startups in advance. As a result, the small enterprises explored by the bank in 2000 amounted to 11,312 to which funds worth KRW 1.2 trillion was extended.

Implementing such measures was not easy. Generally speaking, financially weak small enterprises are often times unstable and require micro loans that are risky with high debt coverage costs. As a result, SMEs have found it difficult to secure financing from profit-oriented commercial financial institutions. Despite such restraints, the bank has continuously strived to improve the financial condition of small enterprises to fulfill its roles as a bank that promotes the development of SMEs.

With the amendment of the Small and Medium Enterprise Basic Act in 1982, support of SME start-ups was one of the major SME policy directions. Accordingly, the bank has actively provided start-up capital from the SME Promotion Fund since 1984. Moreover, the bank has included companies that have been in operation for less than one year as a condition of eligibility in certain sectors, thus it has facilitated business start-ups in agricultural and fishing as well as technology-intensive areas.

The bank also formulated the “Guideline to Support SME Technology Incubation Funds” in 1987 to supply necessary funds to cover initial start-up costs, focusing on technology-intensive SMEs and those involved in machinery, materials and parts production.

Meanwhile, the government extended SME support. In 1998, the government established comprehensive support plans for small enterprises by setting up the “Small Entrepreneurs Support Center” in major cities throughout the nation to create favorable business conditions for small enterprises. In the same context, the bank bolstered its small enterprise support system by hosting courses on starting up businesses throughout the year, besides providing small enterprise with financial support and encouragement.

As such, the bank has actively supported small enterprises with great growth potentials and actively promoted business start-ups that are technologically strong. As a result, the bank has contributed in promoting the entrance of new SMEs, greatly contributing to the growth of SMEs and the national economy.

3.3.2.2. Stronger Support for Local SMEs

In 1965, in a bid to foster specialized local industries that could hugely contribute to the local economic development, the bank started to extend joint business funds in conjunction with cooperatives in eight specialized fields including craft and the Korean traditional paper, etc. The bank also was in line with the government's local industry fostering policies so that the local economy could be revitalized and bring about balanced economic development by fostering local SMEs.

After the mid-1960s, the government's SME policies sought to devolve industrial development down to local regions and to foster locally grown industries. Accordingly, the bank provided financial support mostly with government funds, focusing on fostering specialized local industries, operating the cottage industrial centers and forming local industrial complexes. From 1973, construction of Saemaeul (New Village) factories began, which were efforts to build factories in rural areas in a more active and systematic manner. The bank signed a basic agreement on relending funds from the Industry Rationalization Fund with the Korea Development Bank.

The bank's support for companies producing local crafts and residing in local complexes increased in the 1980s, which contributed to expanding the export base of local industries, devolving industries to local regions and increasing the income of farmers through greater job creation.

As the Act on Balanced Regional Development and Fostering of Local SMEs was formulated in January 1994, a cooperative network among local governments to support local SMEs was established. Accordingly, the central government and local governments formed funds to foster local SMEs in the form of matching, and promoted structural improvement and management stability by supplying funds through the bank.

In particular, autonomy at the local level was established by June 1995, so SME policy funds started be locally allocated based on regional specialties. As such, the bank supported local governments' policies to foster SMEs that are in line with regional conditions, while raising competitiveness among regions. The bank sought to raise competitiveness by improving facilities for local SMEs, addressing regional imbalances and fostering locally specialized industries. To this end, the bank continued to supply funds to SMEs recommended by the municipal and provincial branches of the Small & Medium Business Corporation that signed work consignment agreements with each local government as the eligible.

3.3.3. Securing the Growth Base and Securing High-growth SMEs

3.3.3.1. Inducing Facility Investment

One of the factors for the sustainable growth of SMEs amid the economic development in the industrialization phase through the 1960s was as a result of inducing significant facility investment in the SME sector and securing of the production base. Facility investment in SMEs has been greatly expanded through existing facilities and replacement of the obsolete facilities when economic development and facility investment was peaking.

Until the mid-1960s, in particular, export demand expanded amid the SMEs' successful efforts to produce export goods, which brought about rapid increases in the production of SMEs. This is attributed to facility investments and improved productivity base in the SME industry.

The bank has provided loans since 1962 for facility expansion and renovation of SMEs and construction of new facilities. As the second amendment of the Industrial Bank of Korea Act in 1964 made it possible to secure foreign sources of the funding, the bank has provided loans for facility investments to modernize the facilities of SMEs.

Foreign Capital Business - Former Auditor Park Ju-hee (August 1, 1961 ~ July 1, 1980)[30]

Companies engaged in the secondary industry in Korea in the 1960s were mostly SMEs in scale, and could not modernize their facilities due to the shortage in foreign exchange reserves. During the period, Korea received reparations from Japan in 1966 for its 36-year colonial rule of Korea. The Korean government earmarked and distributed USD 30 million from reparations as long-term facility funds to foster SMEs.

Industrial Bank of Korea ended up as the sole manager of the funds, a major decision made by the Economic Planning Board after endless efforts of then Governor Suh Jin-soo. As the bank announced that it would extend loans from the reparation funds within the limit of USD 200,000 at long-term low interests, SMEs that sought to replace their obsolete facilities by adopting new machinery from Japan sought to apply for the loans.

At the time, I (auditor Park Ju-hee) was serving as both the deputy general manager of the Foreign Capital Division and the deputy manager for analysis, and was then appointed as the head of a task force team that selected the eligible companies for loans -there was much reluctance on the part of all back then to take the job. I was grateful for the trust given to me by the senior management, but it

30. Extracted from the "Ark of Blessings (August 1, 1991)" and modified.

was definitely burdensome for me to fulfill a challenging job of having to set priorities among the applicant companies.

Facility Modernization for SMEs (1960s) - Former Executive Director Choi Heung-sik (August 1, 1961~ February 22, 1980)

I believe that the efforts to modernize the SME facilities were attributable to the first OECF foreign funds from the reparations; that is, USD 15 million in the first phase and USD 74 million in the second phase. Here, Korea Development Bank and Industrial Bank of Korea ended up competing against each other to be selected as main institution in charge of allocating the funds in accordance with the 1965 Agreement between Korea and Japan; in that, controversies arose on whether to extend the funds to large companies or SMEs, while conflicts of interests arose among policy makers and scholars to deliberate on the foreign capital adoption. After much debate, it was decided to allocate the funds to SMEs, so the Industrial Bank of Korea won the argument. Accordingly, the bank signed an agreement with the Economic Development Cooperation Fund in Japan in July and August, 1967. As such, SMEs wound up adopting modernized equipment from Japan. Back then, Kim Yeong-jun serving as the assistant minister of the Economic Planning Board and the late advisor Won Yong-seop played a decisive role in securing the funds for the Bank, for whose achievements, I would like to extend my gratitude. Accordingly, 10 dignitaries from Japan including Governor Watanabe of the Economic Development Cooperation Fund visited Korea and held meetings with the bank's management on numerous occasions.

Since then, the bank's ability to secure foreign financing has continued to grow further, broadening its creditors to IBRD, ADB, KFWM and EXIM, etc., totaling over USD 500 million. The bank's funding sources have become diversified and increased in scale. As this fund was adopted, it significantly contributed to fulfilling the funding gap for providing financial support to SMEs.

The government implemented policies to control the total demand to guard against strong inflation following the global oil shock in the 1970s. Accordingly, the bank extended loans to continuous projects and others where the existing facilities that were being replaced or restored to facilitate targeted financing, starting from 1974.

In 1977, the bank sought to secure additional funding from foreign sources i.e. foreign currency loans, to support facility investments. Accordingly, the facility fund loans financed by foreign funds skyrocketed in the 1970s, and mostly took up the facility fund loans up until the early 1980s.

In the 1980s, facility financing backed by various funds expanded, covering not only the Small and Medium Enterprise Promotion Fund established in 1979 and the Industrial

Development Fund and the Petroleum Enterprise Fund. In addition, the volume of the facility funds grew after all financial support to SMEs was administered by the bank. Moreover, the bank strengthened its extension policies in conjunction with the government's policies to foster SMEs to efficiently allocate the facility funds. As a result, the bank played a pivotal role in securing the growth basis for SMEs in the 1990s.

In the past, the bank provide policy support without distinguishing loans based on each policy for facility loans from SME special funds. However, policy loans from the Energy Saving Facility Funds were distinguished from the general facility funds from 1984. In 1985, the bank established a fund for support facility financing for exporting SMEs, thus, it actively sought to provide policy support for exporting SMEs. From 1986, the bank provided long-term low-interest rate loans via the Industrial Technology Improvement Fund and Industrial Restructuring Fund to facilitate investment in technological development and streamline facilities. The financial resources were allocated from the Petroleum Enterprise Fund, which was formed amid plummeting international oil prices.

In the late 1980s, in particular, labor-management disputes were widespread, the Won appreciated and the income level rapidly rose amid the wave of democratization that sweep through Korea's politics, economy and society. Under such circumstances, investment demand of SMEs significantly shrunk amid the environment of weaker profitability and slow exports. Accordingly, the government decided to secure and supply facility funds in a bid to strengthen exports and competitiveness as a means for the "measures to induce socio-economic stability and stronger competitiveness" in November 1989. To this end, the government devised the "plans for special facility funds management" and mandated the bank to supply funds worth KRW 50 million. As such, the bank issued bonds to finance the special facility funds, and formulated the "Guideline for Special Facility Funds Management" to be commonly applied to 25 financial institutions that were providing SME loans. Meanwhile, the bank's business scope included the determination of limits for lending banks and companies, extension of loans to lending banks and the business to handle application for interest make-up agreements to the government, thus greatly contributing to revive the depressed investment atmosphere for SMEs.

Moreover, the bank considerably increased loans to SMEs for facility investments from April of the same year under an agreement with the Export-Import Bank of Japan in January 1999. With KRW 1.3 billion in financial resources, the bank extended long-term facility loans to SMEs at low interest, i.e., to facilitate the introduction of foreign and domestic machinery and purchasing of business sites, thus significantly contributing to greater facility investment for SMEs.

3.3.3.2. Support for Export Industries

Driven by the economic internationalization and globalization, one of the core challenges facing Korea's economy was enhancing the international competitiveness and identifying comparative advantages of the SME sector. Amid the rapid expansion of the economy's scale and corresponding increase in production capacity, SMEs actively sought to increase demand by tapping into overseas markets to overcome domestic market restraints and sufficiently utilize the increasing production capacity. In particular, the government's export-oriented growth strategies and Korea's international comparative advantage of labor-intensive products turned favorable for SMEs to convert domestic industries to export industries.

From the mid-1960s, the government extended policy support to export-oriented SMEs. This led to a growth of SME products and exports based on their low competitive wages. Such export expansion not only increased facility expansion of SMEs but also strengthened the sales power of SMEs, driving their growth to the fullest. It is noteworthy that the growth basis for SMEs has been expanded and strengthened continuously driven by the growth in the production capacity through the expansion of facility investment on the supply side, while driven by the export growth on the demand side.

During this period, the bank focused on the development of SMEs that contributed to the saving and acquisition of foreign exchange reserves, because the production basis for SMEs was weak, thus, it was challenging to increase exports. Also, it was more feasible to enhance the balance of international payments by fostering import-substituting industries in the initial phase of Korea's economic development.

However, as the production capacity of SMEs gradually expanded and their export potential to secure foreign currencies was highlighted, the bank started to extend support to SMEs to facilitate trade transactions. The bank actively supported trade financing and began foreign exchange services starting from 1967. At the same time, the bank actively catered to the government policies to support SME exporters from the mid-1960s, and provided policy support first to SMEs designated as exporting companies and as specialized companies.

Moving onto the 1970s, the bank continued to focus on supporting export strategy industries, while supporting efforts to identify high-growth companies with bright export prospects. Moreover, the bank encouraged SMEs to enhance their international competitiveness of vulnerable industries by upgrading their technologies such as printing, dyeing and finishing, plating, molding, boiler making and packaging.

Moreover, the bank started Type A foreign exchange operations from 1972, further strengthening its role as an SME financial institution by facilitating trade finance in export and import activities. From the mid-1970s when the heavy and chemical industry drive was promoted, the scale of the government's support gradually decreased. As a result, the bank conducted the loan services where financial funds are converted into government funds as the counterpart funds from government funds gradually decrease from the mid-1970s. By doing so, the bank supported the growth base for SMEs by consistently expanding the supply of policy funds to encourage the growth of SME exporters.

In the 1980s, the bank spearheaded the SME special funds whereby the size of the fund grew rapidly every year. Throughout the course, the bank provided funds to SME exporters to fund facilities and working capital. During this time, greater policy priority was put on supporting the export-led heavy and chemical industry.

In the 1990s, the bank actively carried out various services such as improved conditions for foreign exchange transactions, expansion of the domestic and international sales bases and overseas foreign exchange transaction networks and introduction of advanced financing techniques in a bid to trigger the export of SMEs and respond to the diversified international financing. As such, the Bank strived to sophisticate the export product structure and induce export growth on end by strengthening the basis for foreign exchange reserves and international financing services and adding values to SMEs.

3.3.3.3. Exploring and Supporting Promising SMEs and Venture Companies

Before and after 1980, growth restraints resurfaced which had been accumulated during Korea's rapid economic growth. Accordingly, the government carried out multifaceted policies for SMEs with a focus on expanding the growth base of SMEs as a strategy to promote substantial economic growth.

In May 1983, the bank devised a "system to explore and support promising SMEs" so that promising SMEs could obtain the support needed and could greatly raise productivity with minimal support. In March 1985, the government included medium-sized exporting companies with strong export potentials on the list of promising SMEs, seeking to increase the effectiveness of SME promotion policies.

The bank actively adopted such government policies from 1863 by targeting promising SMEs that included export businesses with great growth potential, import-substituting production companies, parts producing companies, high-tech companies and specialized local enterprises, by giving them prioritized support and preferential interest rates.

Moreover, the bank intensified the provision of non-financial support such as technological and management guidance, tax and accounting courses for middle managers, and information services. Such efforts to support promising SMEs significantly contributed to establishing a self-sufficient growth base for SMEs. From 1988, the bank established a graduation system for promising SMEs that were judged to be able to achieve growth on their own, striving for efficient management of the limited SME financial resources.

In the late-1990s, meanwhile, creative and flexible venture companies were recognized as the growth leaders of SMEs, which would lead the transformation into a knowledge-based economy in the 21st century. From the late-1990s, support for venture companies served as a critical concept to foster SMEs. Accordingly, the bank pursued multifaceted support by providing financial support for venture companies, forming SME venture investment funds and establishing venture company support centers.

Specifically, the bank providing the following support for SMEs: continued expansion of the financial support for venture companies, preferential interest rates for venture companies and flexible lending period. The bank also contributed to stabilizing venture companies and establishing the base for sound venture companies by setting up a venture company support center for investment consulting and making investment for venture companies at Teheran Valley.

3.3.4. Support for Restructuring of SMEs

3.3.4.1. Support for Technological Development Activities

In the early industrialization phase in the 1960s, SMEs sought to increase their productivity and export capacity in the labor-intensive light industries where technological changes are comparatively small. Quantitative growth could be achieved driven by favorable conditions of abundant low-wage labor and favorable external economic conditions.

However, in the 1970s, the overall environment changed in the following: realignment of the industrial structure towards heavy and chemical industry, stronger protectionism and demand for more sophisticated goods amid the improved income level. As a result, SMEs ended up losing the comparative edge in the production of low-priced goods under low wages. As such, SMEs had to make technical advances to overcome such setbacks.

Against this backdrop, supporting the technology development of SMEs started to surface as a policy initiative in the mid-1970s. The Industrial Bank of Korea provided financial support through its New Technology Enterprise Fund in 1978. The bank devised for the first time a

"Loan Service for New Technology Development Enterprise" in 1977 in a bid to encourage the technological development of SMEs and facilitate the usage and commercialization of developed technologies. Moreover, the bank supported policy funds among SME special funds from 1978, playing a pioneering role in providing financial support for the technological development of SMEs.

This was such an advanced policy. Since the Technology Development Fund holds high risks and a long payback period, general financial institutions have been passive in extending technology development-related funds for SMEs. One of the obstacles to promoting technology development activities of SMEs was the challenge in procuring a long-term stable fund. Given this, the bank's support played a pivotal role in raising the qualitative functions for allocating financial support to SMEs and leading the technology development of SMEs.

Meanwhile, as the roles and importance of technology development of SMEs became newly recognized in the 1980s, the bank further strengthened its fund support. From 1982, the bank strived to foster companies that commercialized new technologies and expanded the allocation of long-term stability funds. To this end, the bank conducted the "investment services for companies to commercialize their new technologies" whereby SMEs acquired new stocks and converted bonds in the projects for new technology development plans. The bank formulated the "Guideline on Fund Support for Technology Development Companies" in 1983, facilitating the R&D activities and technologies of SMEs and extending funds necessary for assimilation and adaptation of imported technology. As a result, the bank's scope of extending the Technology Development Fund expanded from the commercialization stage to the technology adoption stage.

Since the mid-1980s, in particular, advanced countries sought to protect their technologies, leading to a tendency to prevent technology transfer. Amid such circumstances, the bank started to allocate funds from the Industrial Technology Improvement Fund generated from funds procured since 1986 by the Petroleum Enterprise Fund. By doing so, the bank strongly backed the efforts of SMEs to strengthen their own technology development capacity and to enhance productivity by raising their technological prowess. The funds were provided under favorable conditions, i.e., annual interest rate of 5.0% and maximum lending period of 10 years for the development of prototype products in the parts industry, development of basic technology and enhancement of competitiveness for exports to Japan.

Prior to 1996, the bank supplied funds to product development efforts of SMEs and state-of-the-art technology development projects were made eligible for loans from the Korean Machinery Industry, the Electronic Industries Association of Korea, Korea Electrical Manufacturers Association, Korea Federation of Textile Industries, and Korea Institute of Industrial Design and Packaging under the Industrial Technology Fund. A new fund separately extended from 1996 from the business sector of pilot products and state-of-the-art technology development business among the existing funds, that is, Industrial Technological Basis Formation Fund, the Industry-based Technology Development Fund and the Industrial Development Fund. Moreover, the bank set in place the "Guideline for the Technological Expertise-secured Loan Services" to actively support SMEs with growth potentials and profitable new technologies.

In 1998, the bank provided financial support to high-tech start-up companies that were developing technology based on joint recommendations by the Bank and Korea Credit Guarantee Fund.

3.3.4.2. Support for Restructuring Projects

Upon the launch of the civil government in 1993, the government specifically carried out initiatives to improve the SME structure to strengthen the competitiveness of SMEs. The structural improvement initiatives took place amid a huge interest of SMEs at a time when the national economy needed to be revitalized. The measure greatly contributed to Korea's economic recovery by extending funds in lump sum in the short periods of time, while strengthening the fundamentals of SMEs, thus improving the production, export and added-value and quality.

Under the first structural improvement implemented until 1997, the core target was automating the production by making facility investments. At the same time, the focus was enhancing the overall competitiveness to ease the labor shortage, address the high cost and low efficiency business environment, increase the production capacity, and promote quality enhancement, cost reduction and technology development.

Under the second initiatives, the aim was to effectively respond to the globalization of the international economic environment. The goal was to foster internationally competitive SMEs with creativity and limitless growth potentials to transform Korea into a knowledge and information power in the 21st century.

The policies unfolded in two directions: to intensively foster manufacturing SMEs with strong growth potentials and companies engaged in knowledge and information industries to create ripple effects across all the industries. Moreover, the bank strived to intensify its competitive fundamentals under the so-called "creative management activities" by innovating new technologies, products and services, as well as the distribution structure, as the core strategy in corporate management.

Accordingly, the bank made every effort to support the allocation of restructuring funds to SMEs for technical guidance, personnel training and information services, industrial development in rural and fishing areas, automation and process improvement, and cooperative and IT projects.

3.3.4.3. Facilitating Specialization

In the initial economic development phase, Korea carried out industrialization by supporting large conglomerates that were horizontally and vertically integrated. As a result, the new large conglomerates and the existing SMEs could not have a productive relationship. However, after the 1970s, as the heavy and chemical industry was fostered and developed, production was more spread out and specialized, thus it increased the division of labor or specialization along assembly and processing functions. In the 1980s, as the number of unit parts increased and the types of products diversified, labor become more specialized, leading to a division of labor between large companies producing finished products and parts, and small companies or SMEs in the processing sector further intensified.

Meanwhile, the policy support to facilitate the division of labor among companies originated from the policies to promote SMEs in the machinery industry in 1967, which flourished in 1975 when the Small and Medium Enterprise Integration Facilitation Act was formulated. Then, the bank induced the cross-company division driven by the subsidiary relationships through efficient allocation of funds.

As the economic downturn continued before and after 1980, SMEs found it extremely difficult to secure a stable order volume. Accordingly, in order to further integrate SMEs in the same industry, the government implemented an integration system where SMES were notified of items that need to be produced for industries that took a large share of the national economy and were dominated by large conglomerates. Along with this, various other policies were carried out to promote fairness in contracting transactions. Under such institutional support, as investment adjustment took place in the heavy and chemical industry and the expertise of SMEs intensified in the 1980s, cooperation between large companies and SMEs became inevitable.

The bank strived to facilitate operational stability and higher sales for SMEs that were sub-contractors to large companies, and to strengthen parent companies' cooperation for guidance, considering the government policies and the demand of the times. The bank expanded its allocation of funds to companies involved in subsidiary integration backed by the SME Promotion Fund from 1979, while broadening the fund support and guidance projects to SMEs doing business with large companies.

In the 1990s, the bank also focused on extending policy-related funds to companies doing the subsidiary integration and parts producing companies for their operating funds, facility funds, technology development and incubation supporting funds. The bank also explored and supported parts producing companies first under the policies to explore and foster promising SMEs. Thanks to such support, SMEs ended up securing a sound presence and a high level of specialization. SMEs became core suppliers of major components, working in partnership with large companies for mutual growth.

3.3.5. Facilitating Credit Guarantees and Stability in SMEs

3.3.5.1. Introduction of the Credit Guarantee System and the Credit Loan Mechanisms

Upon its foundation in 1961, the bank adopted the credit guarantee reserves system, playing a leading role to facilitate financial support for SMEs. The bank collected and accumulated a certain percentage of credit guarantee reserves when extending loans to SMEs pursuant to Article 15 of the Enforcement Decree of the Industrial Bank of Korea Act (deleted on March 23, 1979). Accordingly, when bad loan were written off, the reserves could be used as funds to cover the amount - a measure to facilitate financial support of SMEs which holds comparatively high bad debt risks.

At the same time, the bank amended the by-laws on lending so that the lending ratio on the secured valuation could increase from 80% to 100% for loans collecting credit guarantee reserves so that the Bank could at least partially complement the shortage of security solvency of SME entrepreneurs.

Since then as the accumulated amount of the credit guarantee reserves increased, the bank formulated the "Guideline on Management of the Credit Guarantee Reserves" on July 1964 to efficiently utilize it. The main idea was to ensure that secured loans could be covered by 10 times of the accumulated reserves so that the bank could cover insufficient collateral. As such, the credit guarantee system conducted for the first time by the bank was revised in a constructive manner as the Small and Medium Enterprise Credit Guarantee Act was formulated in March 1967. The bank then established the Credit Guarantee Fund backed by the credit guarantee reserves and the government's contributions and guarantee fees. The bank was designated as the administrator of the fund. With this, the bank's credit guarantee services officially kicked off targeted at all financial institutions in extending SME fund loans.

In 1972, under the "August 3 Economic Emergency Measure," the funds procured exponentially expanded, and the eligible recipients of the fund expanded to include all companies with insufficient collateral regardless of their corporate size. Furthermore, the list of institutions eligible to contribute and manage funds expanded to include all financial institutions. However, as the credit guarantee increased in scale and the scale of funds expanded, the need for efficient management of the fund property and specialization of the guarantee services increased.

Accordingly, the government legislated a new Credit Guarantee Fund Act in December 1974, and designated the bank as a credit guarantee fund service institution, albeit temporarily. The bank launched the Credit Guarantee Fund Secretariat in April 1975 and came up with the regulations for the credit guarantee services to align and strengthen the services. As a result, the bank played a critical role in setting up the Korea Credit Guarantee Fund, a special corporation in June 1976.

Even after Korea Credit Guarantee Fund was launched as an independent institution, the bank continued to expand the provision of secured loans. In particular, the bank actively utilized the trust guarantee to support the search for small enterprises, and strengthened the support in line with the Korea Credit Guarantee Fund to provide financial support to local SMEs that were highly profitable and excellent in management capacity but lacked sufficient collateral.

In the Early and Transitional Period after the Launch of the Credit Guarantee System[31]
<Planning Director at the former Planning and Survey Division, Jang wi-sang (August 1, 1961 ~ March 3, 1965)>

The credit guarantee system was adopted as a credit guarantee reserve system pursuant to the Enforcement Decree from the initial period of IBK's foundation as a financial institution specialized in SMEs. As the Small and Medium Enterprise Credit Guarantee Act was formulated in 1967 (managed by IBK) and the system was strengthened under the so-called "8 • 3 Measure" in 1972 (expanded to each financial institution), while the Credit Guarantee Fund Act was formulated in 1974 (three credit guarantee-related acts integrated and IBK put in charge from March 1975), Korea Credit Guarantee Fund was established as an independent corporation on June 1, 1976 - a history of sea change for 16 years.

One day after its founding, IBK received a request from an SME owner that was given a special presidential award and granted a patent for an invention at an industrial fair. In making the request, the SME owner said: "Please make sure that we could get the credit guarantee since even our invention is as outstanding and can contribute to the nation, as we cannot access the fund without

31. Extracted from the "Ark of Blessings (August 1, 1991)" and modified.

collateral.” Unfortunately, this request could not be met and the invention was lost, for which I felt heartbroken.

In the Early and Transitional Period after the Launch of the Credit Guarantee System[31]
<Planning Director at the former Planning and Survey Division, Jang wi-sang (August 1, 1961 ~ March 3, 1965)>

This institution was first devised by the founding governor of IBK at a time when the credit guarantee reserves system was established to finance SMEs with insufficient collateral, under which a percentage of the income from loans was accumulated. The amount of the reserves built up every year, which, according to some, required that a separate, independent institution be set up to for it. In 1967, the institution was legislated under the leadership of the Commerce and Industry Committee of the National Assembly.

This Act passed public hearing and was temporarily called the Small and Medium Enterprise Credit Guarantee Act, which was overseen by the Industrial Bank of Korea. However, a long time was wasted since the guarantee for loans IBK provided was not in accordance with the private law. If the Act had been established as the Korea Credit Guarantee Fund Act instead of the Guarantee Act after long discussions with expert lawmakers in the National Assembly, and the governor of IBK were to be the chief manager of this fund, setbacks resulting from the private law would have been resolved. Finally, the Act was passed by the Commerce and Industry Committee. As this Act passed the Commerce and Industry Committee and was transferred to the Finance and Economy Committee for approval, the Finance and Economy Committee believed it should oversee this Act. After modifications by the two committees, the Finance and Economy Committee became the supervising committee and the Commerce and Industry Committee agreed to serve as an agreement committee, which helped the Small and Medium Enterprise Korea Credit Guarantee Fund Act to be formulated.

Since then, this committee has been expanded according to government policies, to include large companies as eligible recipients of the credit guarantee. So the Act was renamed as the Korea Credit Guarantee Fund Act.

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Since then, this committee has been expanded according to government policies, to include large companies as eligible recipients of the credit guarantee. So the Act was renamed as the Korea Credit Guarantee Fund Act.

The Bank, meanwhile, strived to expand credit loans focused on credit worthiness and business feasibility in order to fulfill the role of an institution for supporting the promotion of SMEs. In December 1990, the bank introduced the "credit loan limit system" for the first time as a domestic financial institution, setting in place institutional means to expand credit loans. From 1991, lending was made possible without the need for physical collateral or joint guarantors within a certain limit, greatly contributing to reducing financial costs and simplifying lending procedures. Not only that, it served as a turning point for lending systems of financial institutions in Korea and establish a creditworthy society.

In particular, the bank strived to reduce the financial burdens of SMEs that lacked sufficient collateral, and to establish a credit loan system that moved towards a credit evaluation based lending practices. As a result, after two years of research, the bank developed an exclusive SME credit ratings valuation model for the first time as a domestic financial institution, which was up and running from May 1995.

In August 1999, the bank's existing SME credit ratings valuation model was upgraded. This system raised the soundness of loans through enhanced predictability of default and improved corporate analysis and loan monitoring, paving the way for a systematic approach to managing credit risks.

3.3.5.2. Timely Support for Short-term Operating Funds

Throughout its history, the bank has initiated efforts to distribute the policy-related funds that commercial financial institutions have difficulty allocating. Moreover, the bank strived to supply short-term operating funds in a timely manner necessary to stabilize the management of SMEs in order to maximize the effects of financial support.

32. A system to purchase the notes in a discount received by an SME through a commercial transaction.

The bank actively utilized the commercial note discount system[32] prior to the arrival of the repayment date by turning it into cash for working capital, while adopting and implementing the factoring loan system in 1983 to turn SME receivables into cash in advance.

SMEs, in most cases, tend to purchase raw materials in cash in the production and sales process, while acquiring the sales proceeds as long-term receivables, which severely burdens them in their credit transactions with other companies. The bank, as such, eases the credit burden through the commercial note discounts and factoring loan system to bring about operational stability for SMEs.

In particular, commercial note discounts frees up working capital for SMEs but also improves resource procurement through a higher turnover rate and discounts.

Moreover, the bank achieved rapid growth along with the expansion in the economic scale in that financing is an anti-inflationary one related to the actual distribution in terms of monetary management and that it indirectly contributes to the integration of large companies and SMEs in terms of industrial policies. As a result, the bank's performance on commercial note discounts for SMEs which stood at merely KRW 48 million in 1961, skyrocketed to KRW 173 billion in 1981. The volume reached KRW 3.7 trillion at the end of 2000, taking up 17.0% of the financial fund loans.

The bank also implemented the "Operating Fund Limit Transaction,"[33] which resulted in a reduction in financial costs for SMEs, simplification of loan documents and flexible operation of funds. In November 1990, driven by the Guideline to Cover Revolving Loans for SME Funds," the list of the eligible companies within a limit expanded and management methods exponentially improved.

The bank, meanwhile, joined the world-renowned Factors Chain International (FCI) in January 1989 for the first time as a domestic foreign exchange bank, and started to handle international factoring transactions favorable to exporting SMEs mostly engaged in micro-transactions from June of the same year. Accordingly, export and import transactions on credit for non-L/C trades were easily accessible. Not only that export proceeds on credit could be available in cash prior to redemption through financing, and as import proceeds were immediately paid, SMEs could be relieved of the financial burden so that the short-term fund burden could be eased in SMEs' export and import.

33. A system to set the lending limits for operating funds for SMEs with strong business feasibility and creditability and to constantly enable the borrowing and repayment of funds within the scope when necessary.

In 1999, in particular, the Bank established the "Discount Bank" worth KRW 1 trillion of a discount note-exclusive fund for low-yielding SMEs, thus inducing great operational stability for SMEs.

Besides, the bank strived to prevent corporate bankruptcies resulting from the transient, short-term liquidity issues by promptly extending the Emergency Fund for Management Stability for SMEs facing severe difficulties due to a natural disaster, labor disputes and/or extreme changes in the business environment.

3.3.5.3. Support for Joint Projects

As the economic development plans were pursued under the industrialization initiative in the early 1960s, the rapid growth of large companies aggravated the concentration of economic power among a few companies. Such a trend weakened the business environment for SMEs whose scale and capital base is small. As a result, SMEs had difficulty competing with large companies, finding it challenging to purchase raw materials in a timely manner or tap into new markets on their own.

Accordingly, a need for joint business activities emerged to promote the common interests of SMEs and to promote their economic status as the Small and Medium Enterprise Cooperatives Act was enforced in 1961. However, SMEs could not mobilize funds internally due to their small capital stock and a lack of organizational functions, so they had to rely on the support of external funds.

Under such circumstances, the bank formulated the "Guideline on Lending Business Funds to Small and Medium Enterprise Cooperatives and their Councils" in 1962, and started to extend joint purchasing funds for Small and Medium Enterprise Cooperatives from August of the same year. In 1963, the bank additionally extended the government funds as counterpart funds received from the government to joint sales projects. By doing so, the bank strived to expand the sales channels and improve the sales conditions by facilitating the standardization of SME products, building joint sales sites and establishing an export system exclusively for cooperatives. The bank started to earmark and allocate funds from the Special Raw Materials Reserves Funds as joint project funds to support the joint stock-up activities for special raw materials in 1966. Starting from 1967, the fund was diversified as the Bank separated the Jointly Used Facility Fund from the joint project funds.

In the 1980s, meanwhile, the bank greatly eased the lending conditions and procedures, further intensifying the support for joint project activities. As a result, the bank's financial support to the Small and Medium Enterprise Cooperatives amounted to KRW 67 billion at the end of 2000 from KRW 500 million in 1962.

Driven by the bank's promotion of the joint business funds, SMEs made efforts to join together in purchasing inputs working with companies in the same industry. They could purchase raw materials, etc. in lump sum and in large amounts at lower prices than the market prices, which reduced their raw material costs. Moreover, as the bank intensified the financial support for joint sales through cooperatives, and contributed to the sales growth of SME products.

3.4. Establishing Comprehensive Support System

3.4.1. Strengthening the Cooperation

The bank promoted the enhancement of corporate management capacity and technology development among SMEs while it provided financial support to them. To this end, the bank's cooperation projects greatly contributed to improving the fundamentals of SMEs and fostering and developing SMEs efficiently.

SMEs in the early 1960s were underdeveloped; their management style was outdated, their facilities were run down, and their capital stock was low. Moreover, they lacked the human resources to undergo transformation by adopting and utilizing new management techniques or advanced technologies. Such structural weaknesses of SMEs could not be resolved with financial support alone, which could even negatively affect their business.

Therefore, the bank established the Corporate Guidance Division in 1962 and built SME consulting centers in 37 in the head office and branches nationwide where the bank conducted consulting and education services on finance, corporate management, corporate accounting, tax, etc. covering the whole management sector.

Initially, the bank's focus was on corporate management. However, as the bank jointly conducted project with the UNDP from 1967, the level of guidance improved.[34] The bank used various methods of guidance including one-on-one consulting and tutoring, pilot training programs, on-site analysis, online guidance, and the establishment and operation of export centers, which made the bank's guidance more diversified and efficient.

34. "The White Paper on SMEs (1966) of the Ministry of Commerce and IBK", a technology promotion initiative with the UNDP: IBK initiated jointly with the UNDP upon its approval in June 1966 on a long-term promotion project from 1967 to 1979.

Bolstering the Bank's SME Guidance (in the 1960s)[35]
2nd IBK Governor Suh Jin-soo (June 14, 1963 ~ July 26, 1966)

Back then, SMEs in Korea were small in scale and in shortage of personnel to the extent in which a single corporate manager had to be in charge of all the tasks from financing, technological acquisition to accounting. As such, it was extremely difficult to adapt to a new environment with the financial support alone. Therefore, it was thought that expected achievements would not come about without improving such factors, so the bank decided to strengthen its corporate guidance project.

Accordingly, the bank's Corporate Guidance Division took the help in appointing advisors to conduct the consulting and guidance programs, while selecting pilot companies for in-depth corporate analysis and management guidance. In order to provide feasible help for SME entrepreneurs to do business, the bank instructed on tax and accounting by circulating throughout its branches nationwide repeatedly, garnering strongly positive responses from different fields.

It was a time when the bank could not secure government funding and had to secure financing on its own to fund policy loans, making all its executives and employees to build up the deposits. This led many bank employees to deposit their own, and their relatives, money in the bank. Under such circumstances, SME entrepreneurs were grateful for our endeavors to provide them with practical help through the corporate guidance project.

The joint guidance project with the UNDP was completed in August 1975. Since then, the bank has focused on weak SME sectors such as machinery, textiles, chemical engineering, dyeing, electricity and production and management based on the accumulated experiences in guidance and knowledge.

Moreover, the bank conducted innovative analyses and provided information and materials on technology to SMEs that did not have their own labs and facilities by entering into a technological assistance service contract with the Korea Institute of Science and Technology in 1977.

In the 1980s, the technological level of SMEs became more sophisticated amid rapid technological progress. Accordingly, in order for foreign advanced technologies to be more smoothly transferred to SMEs, the bank commissioned foreign consultants and experts and paid for the costs, to conduct on-site technical assistance. Moreover, as the scope of guidance requested by SMEs diversified, the bank commissioned domestic experts from various fields to expand the scope of the topics covered under the technical assistance program. The bank played a pivotal role in fostering the operational capacity and technological capabilities of SMEs.

35. Extracted from the "Ark of Blessings (August 1, 1991)" and modified.

In the 1980s, the bank also organized the SME CEO Seminar and the Excellent SME CEO Seminar, to reflect the current concerns of SMEs. It also sought to enhance communication and cooperation between the bank and the SMEs and to gather recommendations from its customers for improving the bank's products and services.

In May 1989, the bank launched the Company Information Center by strengthening the functions of the existing SME Service Center. The center promptly provides various types of business information on corporate management for SMEs that struggle to obtain in information. The center also conducted consulting services on overseas investment.

In addition, the bank set up a permanent exhibition site in the main branch in 1990 to promote SME products. Moreover, the bank strived to complement SMEs' weak marketing capacity by brokering trades and consulting on the export market for local SMEs. In January 1996, in particular, the bank started the M&A services by acting mainly as a broker for sellers and buyers, to support their competitive edge and business diversification so that they could grow as sound and mature enterprises.

Moreover, the bank actively supported the different businesses of SMEs spotlighted as a new management strategy. For instance, the bank facilitated a forum where expertise or management strategies could be shared and exchanged between different businesses from various industries.

In order to support the promotion and sales growth of SME products, the bank set up a permanent exhibition site at the main branch and at its network of branches in 1990, exhibiting 5,000 items from 1,167 companies. The bank set up a sample exhibition site which displayed SME products at the branches from 2000 so that it could help SMEs promote their products and increase exports through business consultation with buyers. The bank also participates in product promotions and marketing through the "Special Discount Sales Exhibition for Excellent SME Products."

3.4.2. Facilitating Research and Review Projects

The bank has conducted research initiatives on SMEs since its foundation, significantly contributing to the efficient management of financial support to SMEs and formulation of SME policies.

Moreover, the bank has conducted quarterly report on business trends and conditions since the fourth quarter of 1961, becoming a database for SME statistics. From 1963, the bank has conducted a nation-wide survey of trends every month, while providing critical information for the formulation of SME policies as part of Korea's economic development efforts by conducting site inspection on SMEs in mining and manufacturing.

Moreover, the bank's role has been critical in collecting and analyzing related information on advanced countries as well as conducting systematic research on SME issues and carrying out theoretical and empirical studies. Once it had established the research and data collection functions, the bank was more actively engaged in the government's SME policies from the late 1960s.

In the 1970s, the bank sought to identify new growth paths for SMEs amid the government's drive towards the heavy and chemical industry. Moreover, the bank contributed to raising awareness about the functions and roles of SMEs by promoting the vision of the SME industry within a highly industrialized society.

Meanwhile, the 7th amendment to the Industrial Bank of Korea Act in December 1980 served as a turning point for the bank's research activities, as its SME research was designated as a government-recognized formal project along with the corporate guidance project. Countries confronting the global economic downturn before and after 1980 took a more protectionist stance. As such, Korea as a resources-lacking country had no choice but to come up with multifaceted measures to sustain its national growth including transforming the industrial structure based comparative advantages and intense development of technology-intensive value-added industries.

Accordingly, the bank selected timely research topics and initiated various research activities that would assess the SME industry and identify SMEs with growth potential, so as to formulate policies to promote these SMEs. The bank would also use the research to improve the financial support to SMEs.

Moreover, starting from the late 1980s, SMEs required not only fund support but also diverse and comprehensive support amid the rapid economic changes impacting SMEs. With such circumstances, the bank produced various research materials based on on-site studies of SMEs, which contributed to setting up policies on SMEs.

After the 1997 financial crisis, many SMEs suffered bankruptcy one after another amid the economic turmoil, which threatened their industries. The bank, then, sought to support them to overcome the national economic crisis through in-depth researches on SME stabilization measures and financing measures. While continuing to strengthen the information services, the bank promptly responded to recommendations and suggestions made by SMEs on policymaking as their representative.

3.4.3. Expansion of Banking Activities through Subsidiaries

3.4.3.1. Diversification of Facility Financing

SMEs have contributed to the national economy in laying the base for stable growth by being resilient and flexible in the 1980s - a result of their active advancement into new industries and enhancement in productivity, along with the bank's multifaceted support of such efforts.

To raise the competitiveness and secure the growth path of SMEs, the bank allocated more financial support to technological development and facility modernization. Moreover, the bank established a subsidiary to be solely in charge of lease financing so that facility financing could be more efficiently extended to meet the increasing demand for facility investment. In December 1985, the bank set up the Korea Leasing Corporation, which was co-invested by the local banks and local merchants.

It was set up to specifically handle facility lease financing for SMEs under an unsecured basis. Thus, the bank supplied the long-term stability funds to SMEs with insufficient collateral. Moreover, the bank established a local subsidiary for the first time in Hong Kong as a domestic lease company in October 1990 to support the efforts of SMEs entering the Southeast Asian market.

3.4.3.2. Supporting Business Start-ups and Installment Financing

In order to facilitate the incubation of technology-intensive SMEs, the bank launched the New Technology Commercialization Fund in 1970, which took an upturn in the 1980s. The bank continued to extend funds to SMEs to support their growth from the development phase to the commercialization phase and to the early operational phase.

Given that the development and commercialization of new technologies are risky and require a long investment gestation period, financial support from general financial institutions has not been sufficient. Accordingly, the government formulated the Support for Small and Medium Enterprise Establishment Act in May 1986 to facilitate the set up of an investment company to invest in high-tech SME start-ups through direct equity participation.

Under such circumstances, the bank established the Korea Development Financing Corporation as its subsidiary in November 1986, kicking off its investment and loan support for SME start ups. The name was changed into IBK Development Financing Corporation in 1996, and was further strengthened to offer various comprehensive services covering management and technological consulting on business startups and information services.

Moreover, in order to expand financial support for SMEs as well as promote their sales and marketing activities, the bank established the IBK Factoring Corporation (later changed into IBK Discount Financing Corporation) in October 1992 as its subsidiary whose main business is discount financing and factoring.

In January 1999, the subsidiary was newly launched as IBK Capital following the merger of IBK Development Financing Corporation and IBK Discount Financing Corporation.

3.4.3.3. IT Support

Amid advancements in science and technology along with the acceleration and diversification of information processing and transfer, movement towards IT has fast grown. In today's world, information is regarded as one of the critical production elements for companies. SMEs comparatively lacking in financial capacity, technological expertise and personnel now have no choice but to make advancements in IT to effectively respond to various changes in the economic conditions.

Accordingly, the bank has expanded various technical cooperation projects to bring about operational streamlining and improvement in processes. Moreover, the bank set up Kieun Computing Development Inc. (later changed to IBK Tech Inc.) a computing subsidiary in March 1991 to support SMEs' IT business.

The company conducts various businesses such as developing software for SMEs with low in IT computing capacity, consulting services including feasibility study for computer system setup and usage, and IT training and technical support. As a result, the bank has prevented redundant investment resulting from the proprietary development of SMEs and enabled for them to enjoy management streamlining through the early adoption of the computing system.

4. Comprehensive Insights and Implications

4.1. Providing Stability to SMEs during Crisis

Korea's export ranks ninth in the world as of 2009 - an improbable achievement considering Korea was barely surviving on foreign aid amid the ruins of the Korean War in 1950. Many say that the Korea's economic success cannot be thought of without the success of IBK. Amid the economic growth driven by the government, the bank efficiently supplied funds to SMEs in tandem with the government's SME policies, thus contributing to the development of SMEs and the national economy.

Currently, many developing countries believe in the importance of SMEs, but are struggling to provide financial support due to a lack of systematic SME support system and policies. Therefore, the successful story of IBK could provide important lessons for developing countries to overcome the current challenges and difficulties.

In retrospect, IBK led the financial support of SMEs both in terms of quantity and quality. Quantity-wise, IBK extends necessary funds to SMEs depending on their development stage, growth rate and soundness. The bank actively extends funds to sectors comparatively high in credit risks but can have a strong impact on the national economy such as newly formed companies, small companies and local SMEs to which commercial banks are reluctant to lend. Besides, the bank contributed to expanding the growth engine of SMEs through the Technology Development Fund and Long-term Facility Fund.

IBK's activities throughout its history are as follows. The bank focused on supplying necessary facility funds to expand and modernize SME facilities in the 1960s and 1970s. In the 1980s and 1990s, the bank targeted small enterprises and newly formed SMEs that were neglected by the institutional banking sector. After the financial crisis, the bank did its best to provide comprehensive financial services by providing steady financial support and innovative products and services. IBK is fulfilling its role as an economic cycle coordinator. In bad times, the bank increases the scale of loans to support SMEs, and upon the economic recovery, the bank enables commercial banks to expand their provision of SME loans. In other words, when SMEs are financially struggling in the downturn, it is the norm for general commercial banks to reduce their lending in managing risk, but the bank actively expanded its funds for SMEs to support their business activities.

IBK also played a critical role upon each national crisis in late 1990, the card debt crisis in the early 2000, and the global financial crisis in the late 2000 by stabilizing the financial market for SMEs and strengthening the national competitiveness. In particular, when SMEs suffered from the credit crunch due to the 1997-end financial crisis, the bank actively expanded credit to prevent massive bankruptcies while helping to revitalize the national economy.

Even during the economic downturns of 2004 and 2005, the bank supplied over half of all SME loans in the banking sector, striving to provide financial relief in times of financial trouble. Even during the 2009 financial crisis initiated by the bankruptcy of Lehman Brothers, the bank increased its lending by a net volume of KRW 10.4 trillion, that is, 57.8%, well over half of the increases in SME loans (worth KRW 18.4 trillion).

4.2. Challenges to Establishing Advanced System for Supporting SMEs

During the initial period, the bank relied on the government's support for funding its lending to SMEs; but now bank does not rely on the government for financing and is able to provide financial support to SMEs competitively, as it can secure financing on its own. Among the bank's total sources of financing, government funds take up only about 10%.

It is not confined to the quantitative aspect alone. Quality-wise IBK is dominant. IBK is the No. 1 bank to SMEs. Though specialized in SME banking, it still enjoys high profits and maintains soundness by having the lowest delinquency rate among domestic bank. As of September 2009, the actual delinquency rate was 2.8% for K Bank, 2.7% for S Bank, 3.8%for W Bank and 4.4% for H Bank while that of IBK was the lowest with 0.8%.[36]

The bank's sound performance despite the relative riskiness of lending to SMEs is due to its ability to develop innovative lending products specialized for SMEs and utilizes SME credit ratings valuation models.

Since its foundation 50 years ago, the bank has a differentiated credit rating system for SMEs, excellent monitoring system and advanced risk management systems based on its accumulated know-how through specialization in SME lending. Not only that, the systematic relation banking with SMEs transacting with the bank and its research capacity on SMEs are driving forces behind the bank's continued strong competitiveness in the SME sector.

IBK has specialized in SMEs from the beginning and has grown into a leading bank in the SME sector in Korea. Its total assets amount to KRW 156 trillion with SME loans of KRW 83.8 trillion as of the end of 2009, securing the No. 1 market share in banking for SMEs (19.5%), while 21.4% of listed companies (766 total) and 46.2% (473 total) of KOSDAQ-listed companies (a total of 1,023 banks with IBK).

As such, the bank does not rest on its achievements of the past and the present, instead striving to provide comprehensive financial services as the dominant player in the market.

36. Based on the late-2009 superficial delinquency ratio and the business report of Financial Supervisory Service.

4.3. Successful Implementation of Public Policies and Competitiveness of Commercial Banks

The founding of IBK, at first, raised some controversy on whether to found it based on the government funds pursuant to the 'SME Treasury Act' or to establish an SME-specialized financial institution with its own financing functions in accordance with the 'IBK Act.'

The national economy was severely damaged by the Korean War, while most SMEs suffered from chronic capital shortage. In order to provide financial relief for SMEs, there had to be an SME-oriented financial institution, a way to support SMEs other than through government policy loans. That is why it was decided to establish an SME-oriented financial institution, which brought about the launch of IBK with the adoption of the 'IBK Act.'

From the 1960s to the late 1970s since its foundation, IBK has supported SMEs based on policy funds. Over 70% of its loans were for SMEs according to the IBK Act. With the priority on SMEs, the bank had little capacity to extend loans to the general public. To address this, IBK was approved by the government to issue SMIF Bonds in 1982 along with capital increases on five occasions to overcome the global financial crisis (i.e., cash equivalents/cash worth KRW 1.3 trillion). IBK made a preemptive response by actively requesting for capital stock increases. IBK has grown into a leading bank with No. 1 market share in the SME industry with total assets of KRW 174.4 trillion (as of November 2010), being the only bank with this scale without having had a merger.[37]

IBK, meanwhile, as an SME-specialized financial institution must try to strike a balance between its public and commercial features. The bank targets and supports innovative SMEs and extends funds for investment in technology development and facilities during market failures. If these companies grow successfully, they in turn, become banking customers in the private sector. Here, focus of the public sector must be on exploration and support of SMEs subject to market failures. In other words, companies that overcome the crisis must be covered in the private sector.

In the medium and long-term, it is possible to establish a system where funding secured via SME financial bonds or borrowings could be supplied to the public sector and funds financed in the market to the private sector. Once the economy is stabilized, the portion of the bank's public features would inevitably stop. The private features where comprehensive financial services are provided to SMEs are likely to expand driven by the market demand.

37. IBK.

As noted in the founding and development of IBK, if an SME-specialized bank is to be established or functions are to be added to the existing one in developing countries, their government must extend various supports such as securing funding for the bank and establishing systems and laws thereof. And then, the SME-specialized bank itself must secure financing depending on its macroeconomic and financial circumstances.

The economic environment in most developing countries would starkly differ from that of Korea in the 1960s. However, IBK has made a successful transformation as a large-scale financial institution, fulfilling its given roles as a national policy bank. The bank supported SMEs through government funds in the initial period, successfully supporting SMEs by securing funding on its own and becoming a top bank. The model of IBK can offer numerous implications that can be drawn for developing countries.

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1. Adoption and Current Status of the Mandatory Loan Extension Ratio System

1.1. Background

Adopted in April 1965, the system aimed to strike a balance in the provision of policy loans between large enterprises and SMEs by increasing loans to SMEs with insufficient collateral.

Before then, financial institutions used to extend loans to SMEs in a smaller-than-the-optimum scale due to asymmetric information between lender and borrower and the moral hazard resulting from loan defaults. As a result, SMEs found it extremely difficult to access banks compared to large enterprises with high accessibility to banks. Thus, the government imposed regulations for financial institutions to supply an optimal scale of loans to SMEs in order to raise the availability of funding for SMEs.

1.2. Major Points

Under this system, financial institutions are mandated to extend a certain percentage of loans out of total loans or deposits to SMEs. It is currently mandatory for commercial banks to extend over 45% of the increases in the won-denominated financial fund loans, over 60% for local banks and over 35% for foreign banks.

At the initial stage, it was recommended to extend a certain percentage of loans to SMEs. After 1976, banks were obliged to extend over a certain percentage of increases in total loans. Accordingly, from December 1976 to April 1983, local banks were the main source of financial support for SMEs. In order to facilitate local banking, the mandatory loan ratio for SMEs was raised up to 80% at local banks, much higher than that of commercial ones. However, concerns constantly arose that such a high ratio impeded efforts to secure customers for loans. The ratio has now been revised downwards to the range of 60%. In the 1980s, this system was applied to all non-banking sectors including investment banks, insurers, merchant banks and leasing companies as well as domestic branches of the Foreign Exchange Bank and foreign banks (The system was abolished for lease companies in 2005).

The mandatory loan ratio for SMEs for domestic banks has dropped from 36% in 2002 to 34.1% in 2005 and increased to 35.6% in 2006. By contrast, for local banks, the ratio is relatively high at over 60%. As for special banks except for IBK, the ratio is less than 60%. Despite the increasing volume in SME loans by the Exim Bank and KDB since 202, it has remained at 30% to 40% as of 2006.

Table 1-23 | Loans to SMEs by Bank Type

(Unit: %)

	2002	2003	2004	2005	2006	2009
Commercial Banks	36.0	37.8	36.0	34.1	35.6	39.6
Local Banks	62.7	63.8	63.6	62.1	64.0	66.5
Korea Development Bank	23.3	25.9	29.9	32.8	36.6	37.9
Exim Bank of Korea	19.2	22.7	25.7	29.1	30.8	43.8
IBK	83.4	83.9	83.9	81.7	80.9	79.4
Special Banks	43.8	59.2	57.7	56.5	57.0	56.8

Source: Bank of Korea.

1.3. Evaluation and Significance of the Mandatory Loan Ratio System

In the initial stage of the mandatory loan system, the bank significantly contributed to providing loans to SMEs especially in the supply market. Timely allocation of funds to SMEs pursuant to government policies was enabled by national policy banks including IBK. Back then, such banks that received funding from the government found it relatively easy to lend to SMEs under the mandatory loan ratio system. However, triggered by the financial crisis, the financial industry underwent drastic restructuring, changing the overall financial environment and conditions. Now, national policy banks must secure funding in the market. Under such circumstances, policy banks, in a way, tend to be put in worse position compared to commercial banks due to the mandatory loan ratio system.

Securing profitability and low-interest financing has become more critical in the financial sector amid advanced financial liberalization. At this critical juncture, a severe imbalance between financing and lending significantly threatens the competitiveness of policy banks with commercial banks, possibly hampering stable financial support to SMEs. Therefore, in a bid to increase lending to SMEs by securing household deposits and low financing costs to provide loans with lower rates to SMEs, national policy banks' mandatory loan ratio must be readjusted at an appropriate level.

If developing countries seek to adopt the policy of mandatory loan ratio for SMEs, it is recommended to implement the policy in a flexible way as Korea did; to set a high SME loan ratio at the earlier stage of the policy and to gradually lower its ratio in order to ensure stability.

Chapter 02

Establishment of Korea Credit Guarantee Fund and Its Operation

Chapter 02

Establishment of Korea Credit Guarantee Fund and Its Operation

Yongju Chin, Hyo-Eui Kim (Korea Credit Guarantee Fund)

<Summary>

KODIT was established in 1976, the last year of the Third 5-year Economic Development Plan, when the Korean economy was faced with the challenge of developing the heavy and chemical industries and of enhancing the industrial structure on the back of the economic growth attained since 1960s. It can be said that KODIT was established at a time when the Korean economy was preparing for a new take-off after coping with the difficulties of early 1970s under the government's dynamic growth policies.

The credit guarantee system has its meaning in that it selects enterprises which lack the ability to provide collateral but have the growth potential, and promotes their growth by providing them with financial support. By doing so, it encourages them to play an important role in economic development. Korea started its economic development with the implementation of the 5-Year Economic Development Plan in early the 1960s, and pushed ahead with developing its industrial structure in 1970s, centered on the heavy and chemical industries. The government deemed it necessary to strengthen financial systems to ensure economic development, and therefore introduced the credit guarantee system. The purpose was to help achieve the goal of economic growth smoothly by concentrating financial support through credit guarantees in sectors which needed policy-oriented financing.

Article 1 of the Korea Credit Guarantee Fund Act and Article 2 of the Articles of Incorporation of KODIT clearly state the purpose of KODIT's establishment, which is to contribute to balanced development of the national economy by facilitating SME financing by extending credit guarantee to enterprises which lack tangible collateral and by establishing

sound credit risk management through building credit information. KODIT can be viewed as a special non-profit legal entity which was established under the Korea Credit Guarantee Fund Act and has characteristics similar to a foundation. The organization of KODIT has advanced in order to achieve the management goals in response to the changes in its environment. The provisions related to this can be found in the Korea Credit Guarantee Fund Act, the Articles of Incorporation of KODIT, the Instruction of Business Methods of KODIT, etc.

Table 2-1 | Major Businesses of KODIT

Classification	Contents	Introduction
Credit guarantee Business	General Guarantee helps companies finance from banks and financial institutions P-CBO Guarantee guarantees SPC's Collateralized Bond Obligation(CBO)	1976 2001
Credit insurance Busines	Protecting SMEs from chain-reaction bankruptcies arising from dishonored commercial bills or non-payment of sales receivables by covering their loss with compensation	1997 Corporate Bill Insurance 2004 Sales receivable insurance
Classification Contents Introduction	Guarantee for loans or bonds when private investors or private project initiators get to finance for government planned infrastructure projects	1995 (Startof business) 1999 (KODIT become sole provider)
Guarantee-aligned equity investment	Directly invest in SMEs that use the credit guarantee in order to enable them to utilize the funds in a stable manner for the long term	2005
Support for startups	Customized one-stop services, from Preliminary Consulting to post-establishment consulting (Preliminary Consulting → Entrepreneurial Training → Credit Guarantee →Post-establishment Consulting)	2008

The government enacted the SME Bank Act and the Enforcement of SME Bank Act on July 1, 1961. The Credit Guarantee Reserve system was introduced in the SME Bank (currently Industrial Bank of Korea) and started to reserve the fund for credit guarantee operation. The government enacted the SME Credit Guarantee Act on March 3, 1967 in order to strengthen the function of credit guarantee by supplementing the shortcomings of the Credit Guarantee Reserve system. While the purpose of the Credit Guarantee Reserve system was to facilitate lending to SMEs by covering the losses of financial institutions arising from SME loans, the purpose of the credit guarantee system under the SME Credit Guarantee Act was to encourage lending to SMEs by financial institutions based on their creditworthiness. Under the Emergency Order for Economic Growth and Stabilization, the government made great efforts to expand the capital of the SMEs Credit Guarantee Fund and invigorate credit guarantee services. The government enacted the Korea Credit Guarantee Fund Act on December 31, 1974 and enforced it from March 1, 1975. The credit guarantee system under various acts; the SME Credit Guarantee Act, the 8.3 Emergency Order, and the Act on Credit Guarantee for Exporters, were integrated into one and the functions were expanded. The guarantee services were entrusted solely to SME Bank.

It is stipulated that KODIT' s capital be raised through contributions from the government, financial institutions, enterprises, and others. But, in practice, KODIT heavily relies on contributions from the government and financial institutions. In determining the government's contributions, the amount of guarantee supply and the leverage ratio are used first, and costs such as payments under guarantees are estimated, and then the revenues of guarantee fees, operating profit from the fund and contributions from financial institutions are also taken into account. The amount of government contribution requested by KODIT each year is reflected on the budget of the Small & Medium Business Administration and finalized through deliberation of Ministry of Strategy and Finance and the resolution of the Parliament. The Korea Credit Guarantee Fund Act stipulates that financial institutions should contribute to KODIT in an amount not exceeding 0.3 percent per annum of the average monthly balance of outstanding loans subjected to contribution by the end of the next month.

The guarantee supply for SME loans has expanded as the economy has grown. The size of outstanding credit guarantees increased steadily until 1997, but after the onset of the Asian currency crisis, the guarantee supply increased drastically to ease the credit crunch and the outstanding balance of guarantees skyrocketed to 21,454 billion won in 1998 compared to 158 billion won at the time of establishment of KODIT in 1976. Once the financial markets stabilized on the back of improvements in economic conditions after 2002, the scale of guarantee supply gradually decreased from 2005 in step with the IMF' s recommendation of reducing the guarantee supply and the government's policy to restrain the expansion of guarantee supply. But the global financial crisis triggered in the second half of 2008 and the ensuing credit crunch made it difficult for SMEs to access financing. In response to the urgent need for credit guarantee support, the outstanding balance of guarantees jumped again in 2009 to 46,913 billion won.

The credit guarantee supply and economic business cycle show an inverse relationship. When GDP growth rate rises, the guarantee supply declines, and vice versa. Credit guarantee doses not directly engineer economic growth but it can induce growth through a rise in the productivity of enterprises, and the expansion of guarantee supply during economic slowdowns is considered a timely counter-cyclical policy.

Credit guarantee, a typical policy-oriented financing, is useful in that it contributes to the stability of financial markets. The risk weight for loans guaranteed by KODIT was adjusted downward (10%→0%) in accordance with Basel II. This enhances the usefulness of guarantees in facilitating loans and in reducing the capital requirement of financial institutions. By utilizing credit guarantees, commercial financial institutions can have more room for credit supply, thereby performing the role of public agency in part. In other words, guarantees indirectly contribute to the expansion of SME lending.

Major countries of the world have introduced a credit guarantee system and are operating it. The extent to which the guarantee system has been established and utilized varies from country to country. Some developing countries have, however, adopted the system of advanced countries without careful study of their own level of economic development and the state of their financial markets, resulting in poor performances that fall short of their expectations. A developing country which intends to introduce and implement a guarantee system needs to benchmark successful examples beforehand and to minimize implementation by trial and error. Policy consultations for the introduction of a guarantee system and the establishment of a guarantee institution are presented to minimize implementation by trial and error and contribute to the early actuation of a guarantee system.

It is suggested that developing countries adopt a public guarantee system and establish a credit guarantee institution under the control of the government to implement a credit guarantee system. It seems that the most suitable system for developing countries which are preparing for the introduction of a credit guarantee system is the public guarantee system, under which the financial resources for guarantee system can be formed at the early stage of the introduction of the system through the government's contributions and the government's policy can be effectively carried out by an independent guarantee institution.

It is also suggested that the legal basis for formation of financial resources be prepared for the stable operation of acredit guarantee system and the financial resources for credit guarantee services be secured through contributions from the government, financial institutions, SMEs and other interested parties. The success or failure of a credit guarantee system depends on the credibility of the guarantee institution, and it is very important to secure financial resources for guarantee services and the capital fund in order to maintain credibility.

It is necessary, after introduction of a credit guarantee system, for a developing nation which does not have solid financial infrastructure to build up a credit information database and a network for sharing credit information among financial institutions for the early actuation of the credit guarantee system.

For the early actuation of a credit guarantee system, it is also necessary to strengthen education and training, to foster financial service professionals, and to expand workforce equipped with professional evaluation skills who can evaluate SMEs with growth potential.

1. Establishment of KODIT

1.1. Economic State of Korea at the Time of KODIT's Establishment

1.1.1. Economic and Financial State

KODIT was established in 1976, the last year of the Third 5-year Economic Development Plan, when the Korean economy was faced with the challenges of developing the heavy and chemical industries and of enhancing the industrial structure based on the economic growth attained since 1960s.

After achieving high growth in the 1960s, the Korean economy faced various difficulties at home and abroad. The tone of free trade faded with the expansion of protectionism, and the first oil shock triggered by the Mideast war in October 1973 dealt a severe blow to the export-led growth policy. This caused a rise in the bankruptcies of export-oriented enterprises, making the issue of distressed firms ever more serious. To cope with these difficulties at home and abroad, the government implemented a series of robust economic policies and tried to promote rapid high-growth systematically.

The recessions in 1970s provided an opportunity to identify the weaknesses in the Korean economy and complement them systemically. The recessions could in part be attributed to the worsening external economic conditions, but the structural weaknesses aggravated during the process of implementation of the First and the Second 5-year Economic Development Plans were more to blame. Therefore, the issues on restructuring industries as well as strengthening financial markets came to the fore. As the nurturing of heavy and chemical industries was one of the main goals for the national economy, so, to this end, changes and complements for Korea's financial systems were also pushed ahead.

To respond the economic changes at home and abroad and also to stabilize social welfare, the government released the Emergency Order for Stabilization of Social Welfare promulgated on January 14, 1974 (the 1.14 Emergency Order). This Order included the plans for financially supporting SMEs. The government established the Guidelines for Selective Lending by Financial Institutions to limit banks from lending to neither essential nor urgent sectors. It also recommended that financial support be concentrated in industries with high productivity and provided SMEs with long-term and low-interest special funds. But the world economy did not recover and economic risk factors continued to grow until the end of 1974, and the Korean economy could not get out of the recession in spite of the economic stimulus policies. So the government announced the Special Economic Measure to address the trade deficit and to support economic recovery on December 7, 1974, aiming at promoting exports, facilitating production activities, maintaining employment levels, and stabilizing prices.

Government's efforts to cope with the recession continued until the second half of 1975, and the national economy started to turn around as the economic conditions in major advanced countries such as the United States, Japan and Germany improved. The Korean economy returned to its high growth track in early 1976 as exports were higher than expected and industrial activities were on the upswing. So it can be said that KODIT was established at a time when the Korean economy was preparing for a new take-off after coping with the difficulties of early 1970s under the government's dynamic growth policies.

1.1.2. Management Environment for SMEs

The Korean economy in the early 1970s was structurally weak. The causes could be found in the growth pattern, which relied on foreign capital and the industrial structure centered on export-oriented industries. As a consequence, Korea's reliance on exports deepened, and the deficit in trade widened. Internally, the issue of imbalance in growth between large enterprises and SMEs became more serious. Since the 1960's, the government's policy had favored export-oriented large companies, and this left SMEs unattended. SMEs faced various management difficulties as their business areas were encroached on by large enterprises. This made it necessary to come up with measures to provide financial support to SMEs.

Table 2-2 | Number of Enterprises and Employees of SMEs (as of the end of 1975)

Classification	Industry		
	Mining	Manufacturing	Construction
No. of enterprises	1,390	21,914	2,684
No. of employees	31,095	635,594	24,060

Source: Annual statistics report (1984), Economic Planning Board of Korea (currently Ministry of Strategy and Finance).

The framework of the SME policies in the Third 5-Year Economic Development Plan which started in 1972 boils down to the continued promotion of export-oriented SMEs and intensive support for policy-target enterprises. The purpose of the System of Intensive Support for SMEs by Type which was implemented during this period was to provide support suitable for SME characteristics so as to narrow the gap between large enterprises and SMEs which resulted from the growth policies centered on large enterprises and to strengthen the constitution of SMEs. In the early 1970s, as a rapid drop in real interest rates made it difficult for banks to mobilize financial resources, they could hardly satisfy increasing demand for enterprise loans. This drove SMEs to rely on informal money lenders. The Emergency Order for Economic Growth and Stabilization of 1972 (the 8.3 Emergency Order) strengthened financial support for SMEs, which were given special long-term loans, credit guarantees to supplement collateral and funds for industrial restructuring. The Act on Facilitation of Systematization of SMEs was enacted in December 1975 and the institutional device for active, systematic promotion of SMEs was put in place. The purpose of this Act was to facilitate cooperation between large enterprises and SMEs and enhance their mutual benefits on the one hand and to protect SMEs by preventing large enterprises from delaying payment on the other hand.

Keys of the Emergency Order for Economic Growth and Stabilization (the 8.3 Emergency Order)

❶ Relieving the burden of enterprises from informal money lenders

Enterprises were asked to report curb market loans by August 9, and the terms and conditions of the reported loans were changed to bear an interest rate of 16.2% per annum and to be paid back in installments over 5 years after a grace period of 3 years, thereby reducing the burden of enterprises.

❷ Replacement of existing loans with long-term and low-interest loans

Financial institutions were allowed to issue special financial bonds in the amount of 200 billion won, which were underwritten by the Bank of Korea. And, with the financial resources raised through such arrangement, they provided enterprises with loans with interest rate of 8% per annum and condition of repayment in installments over 5 years after a grace period of 3 years, in an amount equivalent to 30 percent of their existing short-term loans. This resulted in providing debt relief to enterprises.

❸ Expansion of credit guarantee system for SMEs

The credit guarantee system for SMEs was expanded with contributions of 1 billion won from the Industrial Bank of Korea (IBK) and Kookmin Bank (KB) each, and a credit guarantee fund was also reserved in every financial institution, which was required to contribute the equivalent of 0.5 percent of their average outstanding balance of loans for 5 years to come.

SME loans by financial institutions accounted for 36.3 percent of total loans. Commercial banks had to lend over 30 percent of total loans to SMEs under the decision of the 17th Monetary Policy Committee in 1965. This decision was revised in March 1973 to strengthen the financial support for SMEs, and each of the national banks and regional banks was encouraged to lend to SMEs over 30 percent and over 40 percent of their annual increase in total lending, respectively.

Table 2-3 | Financial Institutions' Lending Performance to SMEs

(Unit: million KRW)

Classification	1975			1976		
	Total loans(A)	SME loans(B)	B / A(%)	Total loans(A)	SME loans(B)	B / A(%)
5 Private National Banks*	1,495,282	341,788	22.9	1,861,768	437,546	23.5
Regional Banks	272,909	96,379	35.3	346,113	146,391	42.3
Industrial Bank of Korea	189,267	183,635	97.0	231,004	225,428	97.6
Kookmin Bank	191,877	131,396	68.5	253,073	166,498	65.8
Total	2,149,335	753,198	35.0	2,691,958	975,863	36.3

Note: * 5 private national banks: Commercial bank of Korea, Hanil Bank, Choheung Bank, Korea First bank, Seoul Bank
Source: Bank of Korea.

1.2. Background of Introduction of Credit Guarantee System

1.2.1. Reason for Introduction of Credit Guarantee System

The credit guarantee system has its meaning in that it selects enterprises which lack the ability to provide collateral but have the growth potential, and it promotes their growth by providing financial support. By doing so, it encourages SMEs to play an important role in economic development. In particular, developing countries whose economic and industrial structures are vulnerable to external impacts and whose financial markets are also immature need to build a strong financial industry to support the industrial structure and constant economic development. To this end, they can utilize the credit guarantee system as an instrument for their economic and financial policies. Korea started its economic development with the implementation of the 5-Year Economic Development Plan in early 1960s, and pushed ahead with developing its industrial structure in 1970s, centered on the heavy and chemical industries. The government deemed it necessary to strengthen financial systems to ensure economic development, and therefore introduced the credit guarantee system. The purpose was to help achieve the goal of economic growth smoothly by concentrating financial support through credit guarantees in sectors which needed policy-oriented financing. To look at the economy at the time the guarantee system was introduced in major Asian countries which adopted a government-led public guarantee system, it is noteworthy that they achieved economic development in a short span of time by focusing on public financing policies for nurturing SMEs at the early stage of economic growth and that the guarantee system was utilized as one of the key policy instruments.

Table 2-4 | Economy of Major Asian Countries when the Guarantee System was Introduced

Classification	Introduction	Economy at the time		Remarks
		GDP	GNI per capita	
Korea	1976	30 billion USD	69 billion USD	Establishment of KODIT
Japan	1958	44 billion USD	61 billion USD	Establishment of Small Business Insurance Corporation
Taiwan	1974	36 billion USD	85 billion USD	Establishment of Small and Medium Enterprises credit Guarantee fund
Thailand	1984	42 billion USD	79 billion USD	Establishment of Small Business Credit Guarantee Corporation
Vietnam	2009	93 billion USD	101 billion USD	Start of VDB's credit guarantee business

Source: World Bank.

Credit guarantee systems are classified into the following: mutual guarantee system, public guarantee system and loan guarantee system according to the operational methods. Korea adopted a government-led public guarantee system.

Operation Methods of Credit Guarantee System

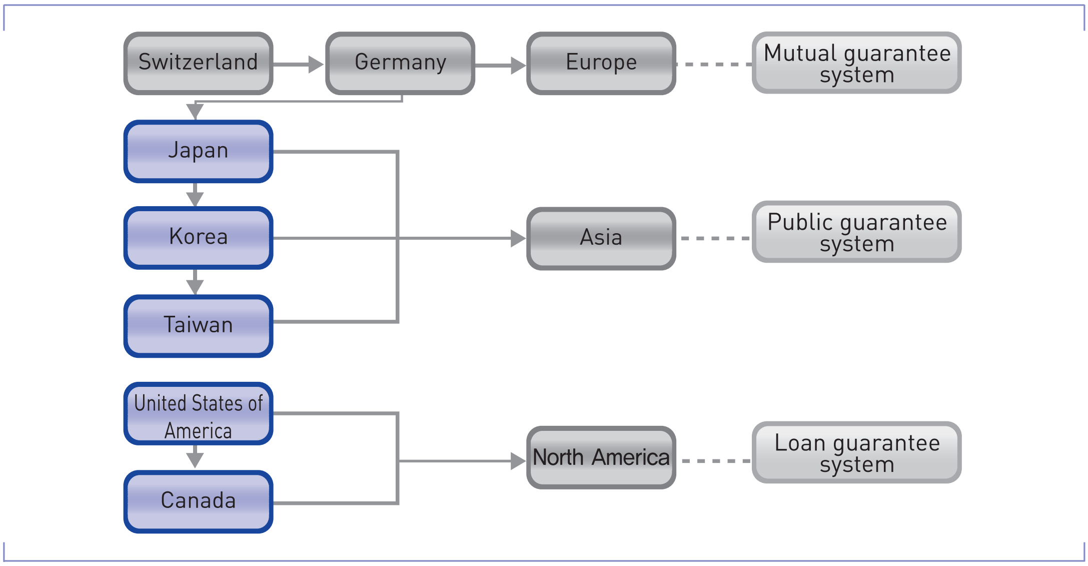
❶ Mutual Guarantee System
Member enterprises establish a mutual guarantee union as the operating body, which builds financial resources for guarantee through contributions or investments from members and provides guarantees to member enterprises.

❷ Public Guarantee System
The formation of financial resources relies mainly on government's contributions or investments, and an independent credit guarantee institution operates the system and provides guarantees to unspecified enterprises.

❸ Loan Guarantee System
Unlike the mutual guarantee system or public guarantee system, there is no independent guarantee institution, and the system is operated by financial institutions as a form of government program, with financial resources formed through government's contributions or investments.

The Korean government made improvements on the guarantee system through several amendments of related laws since the introduction of the system. But the guarantee system had not been actively operated until 1976 when KODIT was established because the provision of guarantees was entrusted to financial institutions. The industrial structure and economic environment in Korea at that time were far different from those of Europe where SMEs in the same trade or in the same region formed mutual guarantee unions, which evolved with such unions. And it was difficult to operate the guarantee system systematically under the loan guarantee system since the primary agent operating the guarantee system was not an independent guarantee institution, but financial institutions entrusted with guarantee operations. And Korea already acknowledged the flaws of the loan guarantee system from its experience of letting financial institutions provide guarantees. Therefore, the Korean government decided to adopt neither the European mutual guarantee system nor the American loan guarantee system but to adopt the public guarantee system, and sought to establish an independent credit guarantee institution.

Figure 2-1 | Routes of Spread of Credit Guarantee System



1.2.2. Purpose and Meaning of KODIT's Establishment

Article 1 of the Korea Credit Guarantee Fund Act and Article 2 of the Articles of Incorporation of KODIT clearly state that the purpose of establishing KODIT is to contribute to balanced development of the national economy by facilitating SME financing by extending credit guarantees to enterprises which lack tangible collateral and by establishing sound credit risk management based on accumulated credit information.

The establishment of an independent institution made it possible to carry out its business consistently by setting up an operational plan and exploring new businesses independently. And the environment changed where more importance was placed on creditworthiness in facilitating financial transactions, away from collateral-based lending practices. As a consequence of the credit guarantee system based on credit evaluation and credit ratings, more emphasis was put on the creditworthiness of an enterprise such as its growth potential and ability to pay back its debt. This served as a momentum to spread credibility in business among enterprises.

The establishment of KODIT also served as an opportunity to provide SMEs with full-fledged credit guarantees. Debt covered by credit guarantees were not only limited to loans by financial institutions, but the scope of those debts also were gradually expanded to address issues related to quality of collateral and credit profile of borrowers.

2. Key Aspects of KODIT

2.1. Form of KODIT

2.1.1. Legal Status of KODIT

KODIT can be viewed as a special non-profit legal entity which was established under the Korea Credit Guarantee Fund Act and has characteristics similar to a foundation. As for KODIT, there is no concept of stakeholders, as is the case for a foundation. The KODIT is capitalized mainly with contributions from the government and financial institutions, which are similar to donations to a foundation. Therefore, contributors can neither demand dividends nor claim their portion of residuary assets when KODIT is dissolved or liquidated.

2.1.2. Organization of KODIT

The organization of KODIT has advanced in order to achieve the management goals in response to the changes in its environment. The provisions related to this can be found in the Korea Credit Guarantee Fund Act, the Articles of Incorporation of KODIT, the Instruction of Business Methods of KODIT, etc.

2.1.2.1. Board of Policy

A Board of Policy is the top decision-making body that deliberates on the fundamental policies concerning the operation and management of KODIT and relevant rules and regulations to enforce the policies according to the Korea Credit Guarantee Fund Act, the Enforcement Decree of the Korea Credit Guarantee Fund Act, and the Articles of Incorporation of KODIT. The board consists of 12 members: the chairman of KODIT, one nominated by the Financial Services Commission from among a pool of public officials belonging to the Commission, one nominated by the Minister of Strategy and Finance from among a pool of public officials belonging to the Ministry, one nominated by the Administrator of Small and Medium Business Administration from among a pool of public officials belonging to the Administration, one nominated by the Governor of the Bank of Korea from among a pool of executives belonging to the Bank of Korea, one nominated by the president of the Industrial Bank of Korea from among a pool of officers belonging to the Industrial Bank of Korea, one executive officer nominated by the head of a financial institution designated by the Financial Services Commission, three members from among a pool of officers or executives of financial institutions, and two members from among a pool of representatives of industry associations. The CEO of KODIT automatically becomes the chairman of the Board of Policy and assumes the chairmanship of both the board of policy and the meetings. The meetings are divided into two types: two regular sessions held in February and November, and ad-hoc extraordinary sessions. The meetings can be held only when more than half of the members are present; and over half of the present members agree to make a decision or pass a bill.

At the time of KODIT's establishment, the Board of Policy made resolutions on important matters concerning KODIT's operation and management. But, in order to respond quickly to the increasing operational demands of KODIT, the first amendment of the Korea Credit Guarantee Fund Act was made on December 28, 1979, in which the Board of Policy took the role of decision-making on the operational framework of KODIT. And the newly established Board of Directors took the role of making decisions on and enforcing important matters concerning operation and management of the institution.

2.1.2.2. Board of Directors

The Board of Directors is KODIT's decision making body established by the first amendment of the Korea Credit Guarantee Fund Act to deliberate on important details pertaining to KODIT. The Board of directors is composed of the chairman, the executive vice president and the executive directors, while the auditor is not represented on the Board, but may attend meetings of the Board of Directors and state their opinions. The Chairman of KODIT convenes the Board of Directors and chairs the Board of Directors. The Board meeting is held when over one third of the members request a meeting, and any decision or bill must be approved by over half of the members.

2.1.2.3. Officers

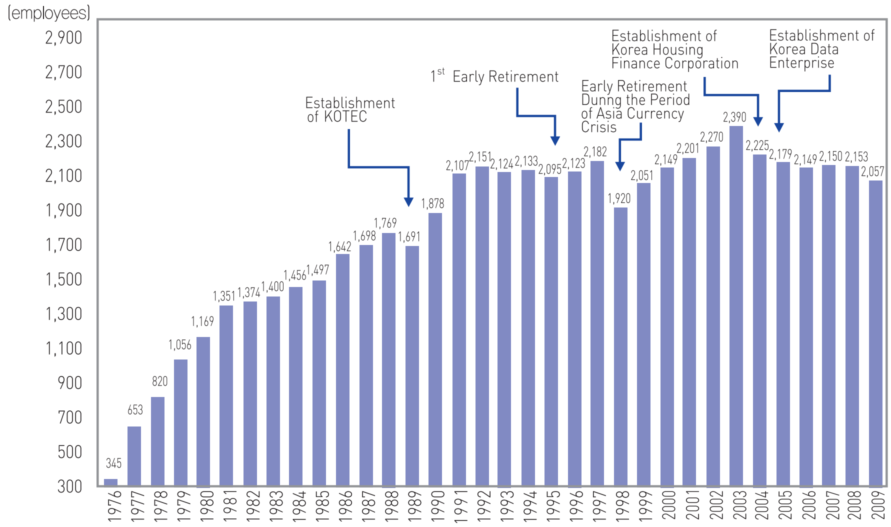
KODIT may have, as its officers, one chairman, one executive vice president, seven executive directors or less, and one auditor, according to the Korea Credit Guarantee Fund Act and the Article of Incorporation. At the time of KODIT's establishment, KODIT had five officers; the chairman, the executive vice president, two executive directors, and an auditor. However, as of the end of 2010, KODIT had seven officers, including the chairman, the executive vice president, the auditor and four executive directors. The chairman of KODIT also chairs the Board of Policy and the Board of Directors and oversees the overall operation and management of KODIT, as the CEO. The chairman is appointed by the Financial Services Commissions, and the term of the officers is three years.

The executive vice president assists the chairman and has the duty of acting chairman in a case the chairman is unable to perform his duties. The executive directors assist the chairman and the executive vice president and are involved in management of KODIT. If both the chairman and the executive vice president are unable to perform their duties, the executive directors in the order designated in advance by the chairman are expected to perform the duties of chairman. The terms of the executive vice president and the executive directors are three years and the positions are appointed by the Financial Services Commission upon the recommendation of the chairman of KODIT. The auditor is appointed by the Financial Services Commission, and has a term of three years.

2.1.2.4. Employees

The total number of employees including officers of KODIT was 65 at the time of its establishment, most of them came from financial institutions, the Korea Appraisal Board and ministries relevant to KODIT. Thereafter, the number of employees increased continuously in step with the growth of KODIT's operations, totaling about 2,050 at the end of June 2010, 31 times the number at the time of establishment.

Figure 2-2 | Changes in the Number of Employees



KODIT started with four departments, one office and fourteen sections at the headquarters. Thereafter, KODIT's organization has continuously changed through organizational transformation in response to growth and changes in the management environment.

Table 2-5 | Changes in Organization

Description	1976	1986	1996	2006	2010
Organization	Headquarters 4 Departments, 1 Office, 14 Section	Headquarters 11Departments, 4 Offices 41 Branches	Headquarters 9 Departments 3 Offices 81 Branches	Headquarters 4 Divisions 11 Departments 12 Offices 85 Branches	Headquarters 4 Divisions 12 Departments 3 Offices 99 Branches

2.2. Business Lines of KODIT

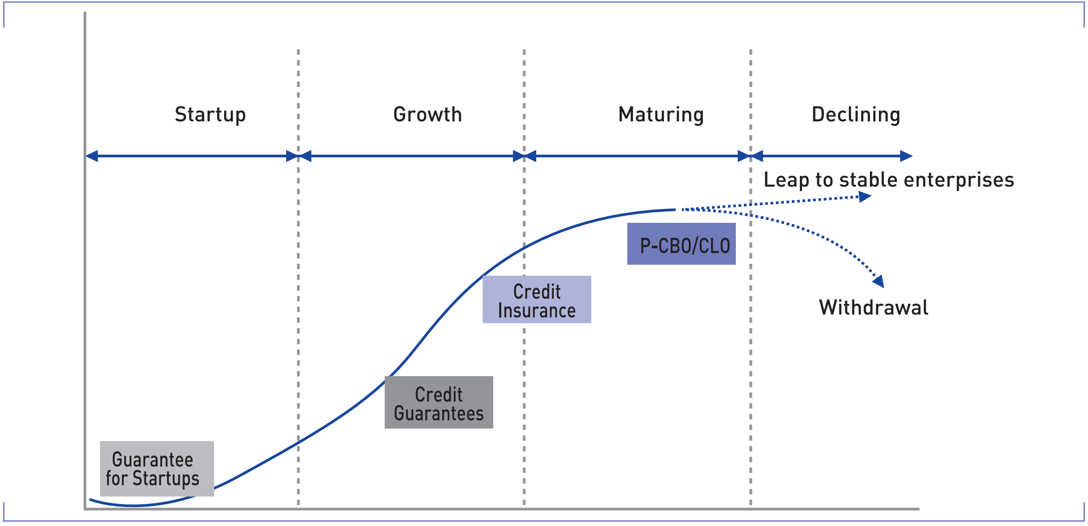
2.2.1. Overview

KODIT is establishing its identity as a policy-oriented financial institution through customized guarantee services in line with the growth stage of SMEs.

Figure 2-3 | Guarantee Services by Stage of Growth of Enterprise

Stage of growth	Startup	Growing	Maturing	Declining
Goal	▪ Creation of employment	▪ Value creation	▪ Self sustainability	▪ Restructuring and business transition
Effect	▪ Invigoration of startup	▪ Expansion of growth engine ▪ Expansion of growth engine	▪ Upgrading of business	▪ Withdrawal of marginal enterprises ▪ Restructuring

Figure 2-4 | Support of Guarantee Product by Stage of Growth of Enterprise

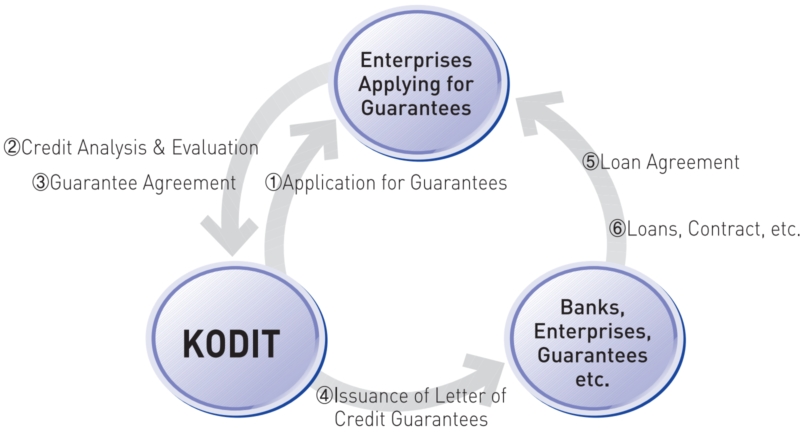


2.2.2. Major Business of KODIT

2.2.2.1. Credit Guarantee Service

There were four types of guarantee at the time of KODIT's establishment: guarantee for bank loans, guarantee for payment of bank warrants, guarantee for corporate bonds, and guarantee for tax and duty payments. With the emergence of new financial products, changes in the way commercial transactions were transacted among enterprises and the needs of the national economy, the type of guarantees expanded continuously to reach 11 types at the present. It is now possible for KODIT to provide guarantees for all kinds of financial transactions, including guarantees for indirect financing, direct financing, commercial transactions between enterprises, and tax payments. A guarantee for bank loans here means a credit guarantee for monetary obligations which an enterprise bears toward a financial institution by borrowing money and is the most common form of guarantee in the credit guarantee system and plays the most important role of credit guarantee support. Guarantees for bank loans account for more than 80 percent of total guarantee support since borrowings from financial institutions are the most common way of raising external funds required for working capital or facility investments.

Figure 2-5 | Framework of Credit Guarantee



Eligible Enterprises

Individuals and legal entities conducting business for profit and their bodies. (e.g. the Korea Federation of Small and Medium Business)

Gambling or similar types of activities and speculative activities are unqualified for guarantee services.

2.2.2.2. Types of Guarantees

Type	Details
Guarantee for Bank Loans	Guarantee of loans for working capital or facility investment from financial institutions • Working capital, facility investment, export financing, purchaser financing, bill discounts, various technology development funds, etc.
Guarantee for Loans from Non-Banking Financial Institutions	Guarantee of loans for working capital or facility investment from second-tier financial institutions • National Agricultural Cooperative Federations, National Federation of Fisheries Cooperatives, Small & Medium Business Corporation, Merchant Banks, Insurance companies, Venture Capital, Korea Agro-Fisheries Trade Corporation, etc.
Guarantee for Commercial Bill	Guarantee for bills issued by enterprises for collateral or as a means of settlement in commercial transactions • Guarantee for bills as a collateral and bills as payment belonging to accounts payable or accounts receivable
Guarantee for Execution of Contract	Guarantee used as collateral when enterprises bid for contracts or enter into a construction contract and supply of goods or services. • Bidding bond, contract deposit, gap deposit, payment guarantee, warranty deposit • Guarantee to be issued to: government, municipal governments, public agencies, financial institutions, original contractors with the afore-mentioned, project planner under the Act on Private Investments for SOC, and others determined by the Financial Services Commission
Guarantee for Payment Warrant of Banks	Guarantee for payment of warrants of financial institutions to help enterprises receive guarantee from financial institutions • Guarantee for L/C payment, etc.
Guarantee for a Corporate Bond	Guarantee for payments of principal and interests of corporate bonds for utilizing direct financing through capital market • Eligible: corporate bonds issued under Article 119 of the Act on Capital Markets and Financial Investment Services
Guarantee for Tax and Duty	Guarantee used by enterprises as collateral for payment obligations on national or local taxes when taxes are to be paid in installments or payment collection is deferred basis.
Guarantee for E-commerce	Guarantee for payment obligations of SMEs in regards to E-commercial business transactions

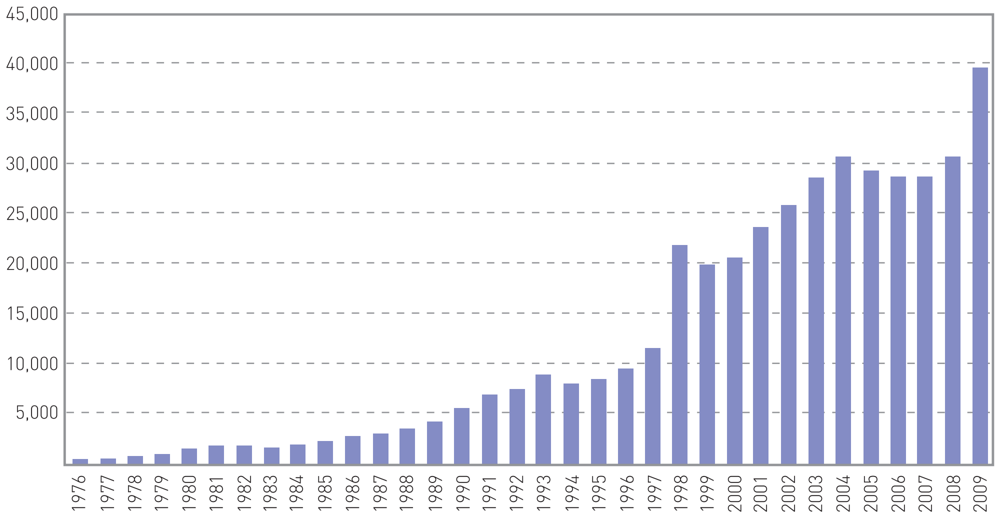
2.2.2.3. Flow of Guarantee Service

Table 2-6 | Flow of Guarantee Service

Stage	Process
Application and Interview	• Submit on-line application on KODIT home page or application through a visit to branch • Prospective customers are asked to visit to a branch; conduct phone interviews with existing customers
Documents and Credit Analysis	• Filing documents necessary for credit review and evaluation • Credit analysis through documents and applicant interviews
Evaluation and Approval	• Credit rating • Reviewing of maximum guarantee limit for working capital • Review as to if requirements are met for approval • Approval
Issuance of Letter of Credit Guarantee	• Credit guarantee agreement • Guarantee fees (Credit cards available)

Figure 2-6 | Outstanding Balance of Credit Guarantee

(Unit: billion KRW)



Note: excluding P-CBO guarantee.

2.2.2.4. Credit Insurance Services

Korean SMEs rely on corporate bills for making payments; thus, when a buyer goes bankrupt, the seller is also likely to go bankrupt. In particular, since Korea's Asian currency crisis in late 1990s, there had been an increasing concern that a considerable number of domestic enterprises faced the risk of being caught up in a wave of bankruptcy if bill issuers defaulted. So insurance for corporate bills was introduced in order to prevent the bankruptcy of SMEs and facilitate commercial transactions via credit. The government enacted the Act on Special Measures for Support of Small Enterprises on April 10, 1997 in order to facilitate production activities of small enterprises and to help improve their structure and management stability. This act laid the ground for corporate bill insurance products. KODIT received contributions of 10 billion won from the government and began offering the insurance product from September 1, 1997. This helped reduce the risk of non-payment arising from sales on credit and expanding transactions on credit which had contracted during the Asian currency crisis.

As the risk of bankruptcies receded in the wake of the Asian crisis, the use of bill insurances gradually declined. So KODIT introduced products to insure sales receivables to induce changes in payment practices among enterprises and prevent sales receivables from becoming toxic assets. The government laid the legal ground for the introduction of sales receivable insurance products by amending the Act on Special Measures for Supporting Small Enterprises and Small Merchants/Industrialists on July 29, 2003. KODIT began offering sales receivable insurance from March 2, 2004.

Corporate Bill Insurance

A supplier who provides goods or services purchases a corporate bill insurance to cover the risk of non-payment by a buyer. The supplier receives insurance money when the buyer defaults on the bills.

Figure 2-7 | **Framework of Corporate Bill Insurance**

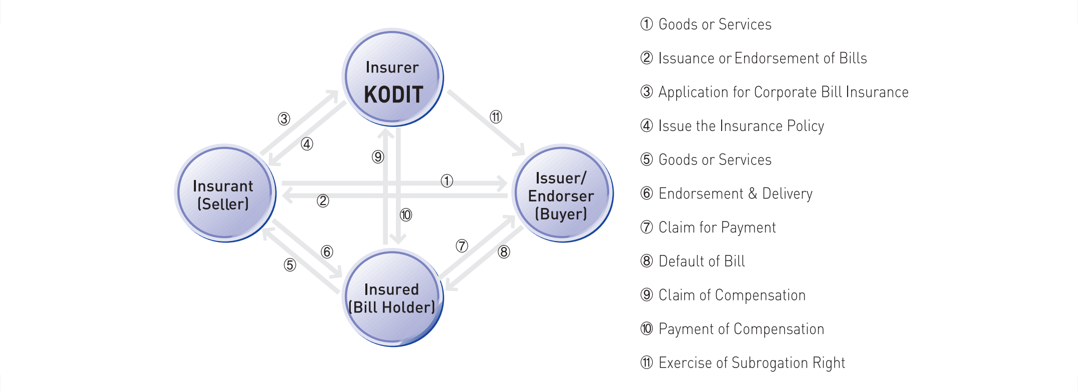
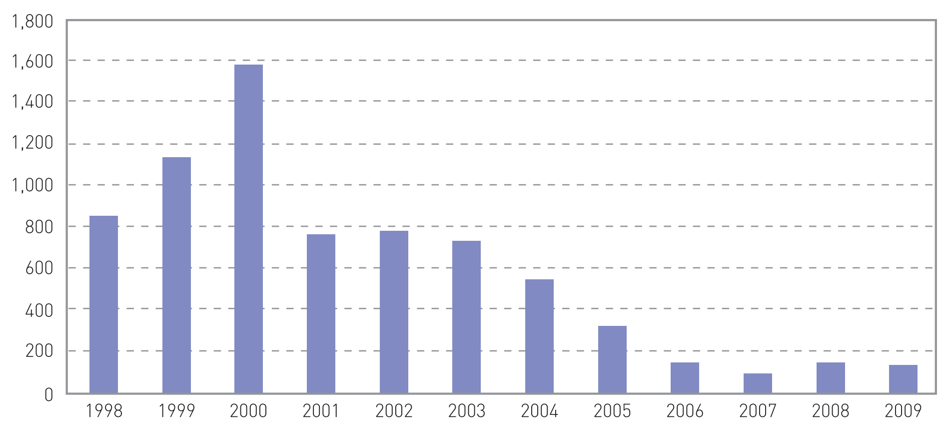


Figure 2-8 | **Underwriting of Corporate Bill Insurance**

(Unit: billion KRW)



Sales Receivables Insurance

A supplier who provides goods or services purchases a sales receivables insurance to cover the risk of non-payment on sales receivables. The supplier receives compensation when losses arise due to a buyer's inability to pay.

Figure 2-9 | **Framework of Sales Receivables Insurance**

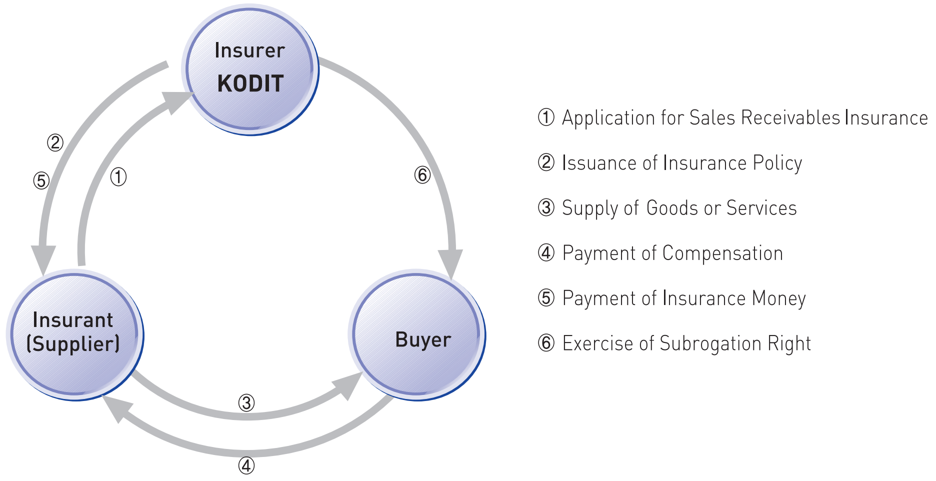
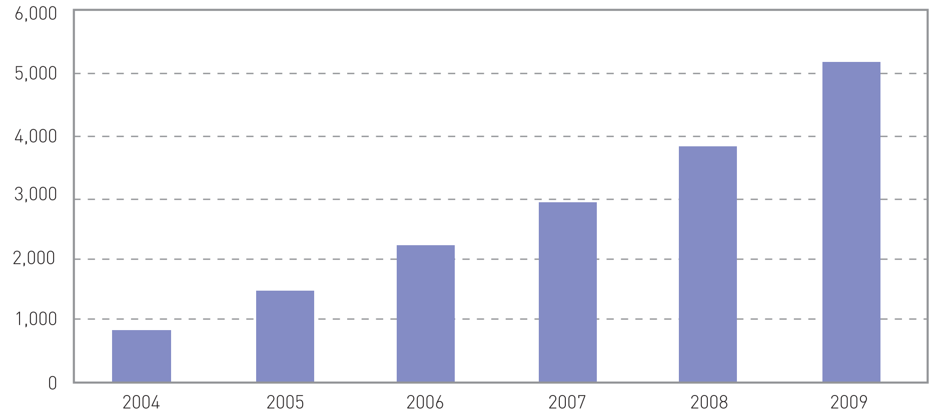


Figure 2-10 | Underwriting of Sales Receivables Insurance

(Unit: billion KRW)



2.2.2.5. Infrastructure Credit Guarantee Services

The government enacted the Act on Promoting Private Investments for Infrastructure on August 3, 1994 by facilitating private investments. Under the Act, contributions of 20 billion won (5 billion won to KODIT, 5 billion won to KOTEC and 10 billion won to Korea Development Bank) were made to the Infrastructure Credit Guarantee Fund in May 1995 for the purpose of providing credit guarantees to facilitate private investment projects. The Fund was managed and operated by KODIT, KOTEC and KDB initially, before being consolidated and transferred to KODIT on January 1, 1999. This Fund contributes to enhancing the efficiency of government policy. It supports government infrastructure projects by inducing private investment in the projects.

Figure 2-11 | Framework of Infrastructure Credit Guarantee

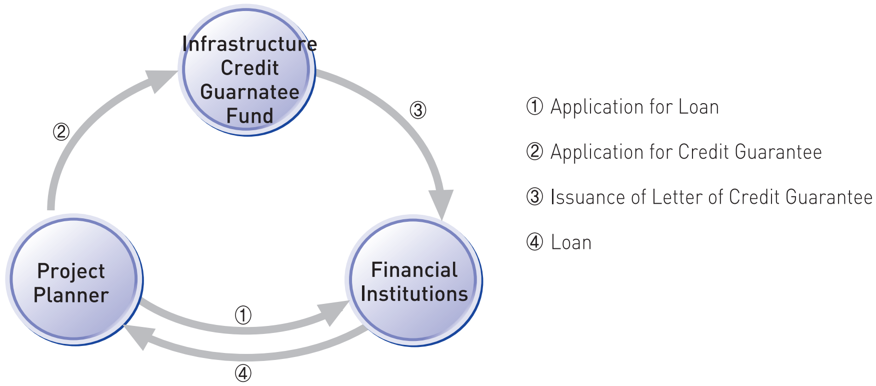
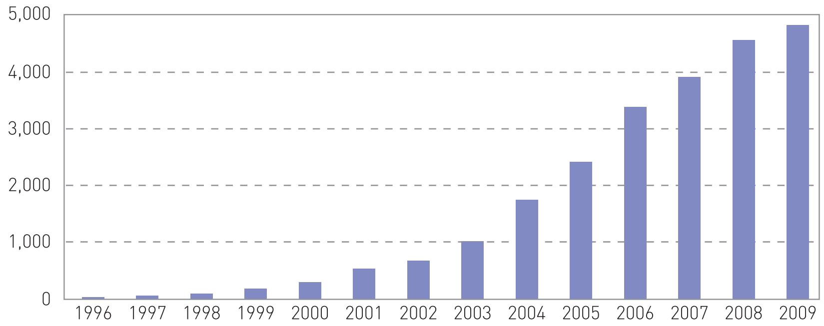


Figure 2-12 | Outstanding Approved Infrastructure Credit Guarantee

(Unit: billion KRW)



2.2.2.6. P-CBO Guarantee Services

During the restructuring of financial institutions after the "Asian currency crisis," banks focused their efforts on underwriting risk-free bonds to enhance their BIS capital adequacy ratio. However, investment trust companies which were big players in the Korean corporate bond market and buyers of these bonds, turned conservative. Under these circumstances, most companies except for a few blue-chip companies faced difficulties not only in issuing new bonds but also in issuing refunding bonds. To ease the situation, the government released the Guidelines on Operation of Special Guarantees for Vitalizing Issuance of Corporate Bonds. As KODIT introduced P-CBO guarantees and P-CLO guarantees on July 1, 2000, enterprises which had faced difficulties in issuing in the primary bond markets began to recover management stability and the capital markets stabilized.

In 2003, KODIT stopped providing new P-CBO/CLO guarantees, instead providing P-CBO guarantees for rolling over debt to those enterprises which were not able to repay their debts at maturity. However, in order to revive the capital market which remained inactive in the wake of the global financial crisis in the second half of 2008 and economic downturn, KODIT resumed providing new P-CBO guarantees.

Collateralized Bond Obligations (CBOs) reference a pool of bonds that were purchased via a special purpose company (SPC). CBOs are classified into senior securities and subordinated securities. KODIT provides guarantees for senior securities, which allows them to be rated AAA. The senior tranche are then sold in the capital markets, and subordinated tranche are purchased by the issuing enterprise. SPC covers all the costs, including guarantee fees, related to issuing CBOs with the cash surplus earned through the excess spread between the underlying assets and CBOs.

Figure 2-13 | Structure of P-CBO Guarantee

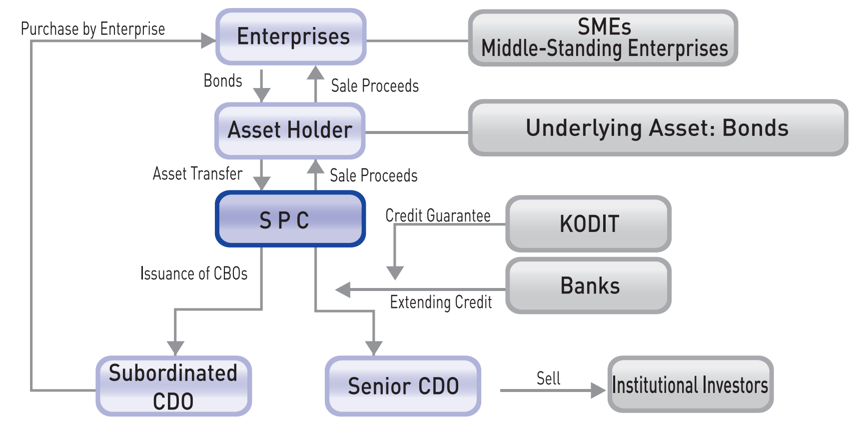
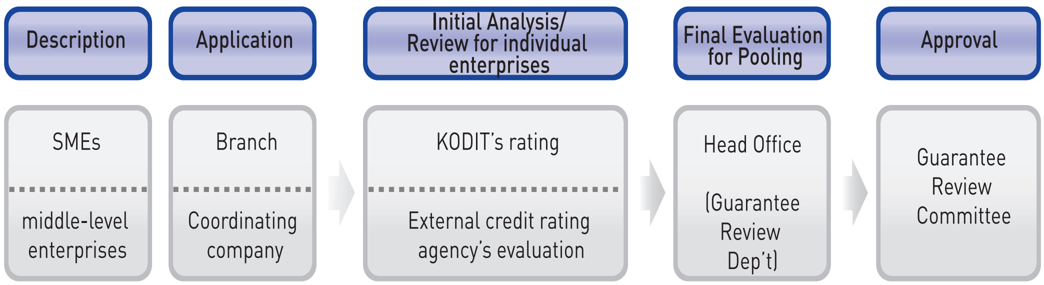


Figure 2-14 | Flow of P-CBO Guarantee



Note: The application process for those with valid corporate bond rating by external credit rating agencies and listed companies on stock market is handled by the coordinating company.

Figure 2-15 | Outstanding Balance of P-CBO Guarantee

(Unit: billion KRW)

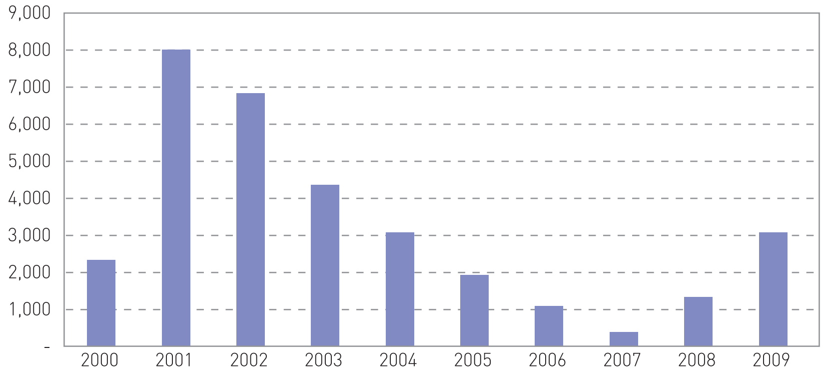


Table 2-7 | Major Businesses and Services of KODIT

Classification	Details	Introduction
Credit guarantee Business	General Guarantee helps companies finance from banks and financial institutions P-CBO Guarantee guarantees SPC's Collateralized Bond Obligation(CBO)	1976 2001
Credit insurance Busines	Protecting SMEs from chain-reaction bankruptcies arising from dishonored commercial bills or non-payment of sales receivables by covering their loss with compensation	1997 (Corporate bill insurance) 2004 (Sales receivable insurance)
Infrastructure Credit Guarantee Busines	Guarantee for loans or bonds when private investors or private project initiators get to finance for government planned infrastructure projects	1995 (Startof business) 1999 (KODIT become sole provider)
Guarantee-aligned equity investment	Directly invest in SMEs that use the credit guarantee in order to enable them to utilize the funds in a stable manner for the long term	2005
Support for startups	Customized one-stop services, from Preliminary Consulting to post-establishment consulting (Preliminary Consulting → Entrepreneurial Training → Credit Guarantee → Post-establishment Consulting)	2008

3. Procedure of the Establishment of KODIT

3.1. Before the Establishment of KODIT

3.1.1. Implementation of Credit Guarantee Reserves system

The government enacted the SME Bank Act and the Enforcement of SME Bank Act on July 1, 1961. The Credit Guarantee Reserve system was introduced in the SME Bank (currently Industrial Bank of Korea) and started to accumulate reserves for credit guarantees. But, as the purpose of the Credit Guarantee Reserves system was not intended to provide credit guarantees to SMEs but to cover the loss of banks lending to SMEs, it was a transitional form of the credit guarantee system. The SME banks set the Guideline on the Credit Guarantee Reserve on August 26, 1961. The scope of loans subject to collection of the credit guarantee reserve was limited to SME loans, and 3 percent per annum of SME loans was reserved.

Table 2-8 | State of Accumulation of Credit Guarantee Reserves

(Unit: million KRW)

Year	Accumulation	Cover for write-offs	Total net accumulation	Remarks	
				Amount of increase	Increase rate
1961	8	-	8	-	-
1962	50	-	58	50	625.0
1963	64	-	122	64	110.3
1964	74	2	194	72	59.0
1965	85	1	278	84	43.3
1966	91	30	339	61	21.9
March 1967	13	-	352	13	3.8

Source: Chronicle of KODIT (1986).

3.1.2. Enactment of the SME Credit Guarantee Act

The government enacted the SME Credit Guarantee Act on March 3, 1967 in order to strengthen the function of credit guarantee by supplementing the shortcomings of the Credit Guarantee Reserves system. Under this Act, banks lending to SMEs were entrusted to manage the SME credit guarantee fund until the establishment of an independent institution which would take charge of credit guarantee services. The credit guarantee system under this Act was essentially different from the previous Credit Guarantee Reserves system. While the purpose of the Credit Guarantee Reserves system was to facilitate lending to SMEs by covering the losses of financial institutions arising from SME loans, the purpose of the credit guarantee system under the SME Credit Guarantee Act was to encourage lending by financial institutions to SMEs based on the creditworthiness of SMEs. The credit guarantees were provided from April 1967, but they could not meet the increasing demand because capital raisings for the fund under the Act was limited to contributions from the government and guarantee fees paid by enterprises.

Table 2-9 | Performance of Credit Guarantee (1967~1971)

(Unit: million KRW, times)

Year	Capital fund (A)	Outstanding balance of guarantees (B)	Leverage ratio (A/B)
1967	428	2,514	5.9
1968	549	3,438	6.3
1969	693	5,937	8.6
1970	872	8,192	9.4
1971	1,030	9,848	9.6

Source: Chronicle of KODIT (1986).

3.1.3. Emergency Order for Economic Growth and Stabilization

Under the Emergency Order for Economic Growth and Stabilization (the 8.3 Emergency Order), the government made great efforts to expand the SME Credit Guarantee Fund and credit guarantee services. In the early 1970s, the number of distressed enterprises increased due to high inflation and prevalence of high interest rate private loans, resulting in the need to expand SME support. Under such circumstances, the government implemented emergency economic measures and allowed all financial institutions to provide guarantee services. The scope of eligible industries was expanded, so that more enterprises could access credit guarantee services. For the expansion of capital fund, contributions could be made not only by the government but also financial institutions. Accordingly, each financial institution had to contribute to its own credit guarantee fund in an amount equivalent to 0.5 percent per annum of balance of loans for five years (until August 3, 1977). The government made contributions of 50 million won each year since the enactment of the SME Credit Guarantee Act in March 1967, but increased the amount of contributions to 100 million won after the 8.3 Emergency Order and made an additional contribution of 2 billion won in 1973. Thus, the total amount of government contributions reached 2,350 million won.

Table 2-10 | Contributions before the Establishment of KODIT

(Unit: million KRW)

Classification / Year	Gov't	Banks	Total accumulated	Classification / Year	Gov't	Banks	Total accumulated
1967	50	378	428	1972	100	1,220	2,350
1968	50	71	549	1973	2.000	4,306	8,656
1969	50	94	693	1974		6,758	15,414
1970	50	129	872	1975		9,395	24,809
1971	50	108	1,030				

Source: Chronicle of KODIT (1986).

Keys of the Emergency Order for Economic Growth and Stabilization (the 8.3 Emergency Order) relevant to the guarantee system

❶ Establishing reserves for a credit guarantee fund within each financial institution
The government had established the Credit Guarantee Fund for SMEs in SME Bank, but, after the 8.3 Emergency Order, the government allowed all financial institutions to reserve the fund to provide credit guarantees.

❷ Expansion of the scope of eligible enterprises
Before the 8.3 Emergency Order, the scope of eligible enterprises had been limited to manufacturing or mining businesses, but the restrictions on the type of industries and scale of enterprises were abolished and all enterprises were eligible to access the credit guarantee system.

❸ Expansion of financial resources for the capital fund
The capital fund was greatly expanded by requiring financial institutions to make contributions in an amount equivalent to 0.5 percent per annum of the balance of outstanding loans.

3.1.4. Enactment of the Korea Credit Guarantee Fund Act

Under the 8.3 Emergency Order, the government enacted the Korea Credit Guarantee Fund Act on December 31, 1974 and enforced it from March 1, 1975. The credit guarantee system under various acts: the SME Credit Guarantee Act, the 8.3 Emergency Order, and the Act on Credit Guarantee for Exporters, were integrated into one, and the functions were expanded. The guarantee services were entrusted solely to SME Bank. Therefore, SME Bank took over the operation of guarantees handled by other financial institutions as of February 28, 1975. It set up the secretariat for Credit Guarantee Fund within the Bank and performed the business by making entrustment agreements with financial institutions. But, this arranged raised arguments on moral hazard; in that, moral hazard may if lending and the provision of guarantees were not separated and the passive guarantee operations did not abate. As such, opinions that the guarantee operations can be more efficient through the establishment of an independent credit guarantee institution came to the fore.

Keys of the Korea Credit Guarantee Fund Act drafted by the government

❶ The name of the Act shall be Korea Credit Guarantee Fund Act, and the Korea Credit Guarantee Fund ("KODIT") shall be established to integrate the credit guarantee funds spread among various financial institutions.

❷ KODIT shall have capital funds as its fundamental operating asset. The capital funds consist of contributions from the government, financial institutions and enterprises. Financial institutions shall make contributions at a certain prescribed rate not exceeding 0.5 percent per annum of their loans from the date of the enforcement of the Act through December 31, 1980.

❸ Enterprises to be offered the guarantee services shall be individuals and juristic persons who run a certain business including mining, manufacturing, construction and whole sale and bodies comprising them. Debts to be covered by credit guarantees shall be loans and payment guarantees by financial institutions and other debts of enterprises prescribed by Presidential Decree.

❹ The outstanding credit guarantees shall not exceed 15 times its capital funds plus retained earnings.

❺ Financial institutions shall not provide loans for three years to the enterprises and their executive members whose debts were repaid but not collected afterwards by the Fund.

❻ The Fund may entrust whole or part of its services to financial institutions.

Table 2-11 | Performance of Credit Guarantee (1972~1976)

(Unit: million KRW)

Year	Building capital fund				Outstanding balance of guarantees (B)	Leverage ratio (B/A)
	Government	SME Bank	Other banks	Total (A)		
1972	350	947	1,053	2,350	13,230	5.6
1973	2,350	1,341	4,965	8,656	27,611	3.2
1974	2,350	1,779	11,285	15,414	38,038	2.5
Feb. 1975	2,350	2,397	13,320	18,067	39,023	2.2
1975	2,350	2,979	19,480	24,809	64,506	2.6
May 1976	2,350	3,774	22,598	28,722	101,622	3.5

Source: Chronicle of KODIT (1986).

Table 2-12 | Raising Capital Fund according to Amendments of Laws relevant to Credit Guarantee

Classification	Date	Methods of raising capital fund
Credit Guarantee Reserves system	Jul. 1, 1961	• SME Bank set aside the reserve for credit guarantee equivalent to 2 percent per annum of SME-loan in financial account and 3 percent per annum of SME-loan in banking account.
SME Credit Guarantee Act	Mar. 3, 1967	• The fund for credit guarantee was formed of government contribution in entrusted SME Bank, and credit guarantee department was newly established. And the reserve for credit guarantee was combined into the fund for credit guarantee. • The source of capital fund was expanded to government contribution, guarantee fees, collections from non-performing guarantee, and profits from Fund.
Emergency Order for Economic Growth and Stabilization	Aug. 3, 1972	• Credit Guarantee Fund was established in all financial institutions, and 0.5 percent per annum of all loans was contributed.

Source: Chronicle of KODIT (1986).

3.1.5. Preparations for Establishment of KODIT

As the Korea Credit Guarantee Fund Act was implemented on March 1, 1975, the Secretariat for Korea Credit Guarantee Fund for providing credit guarantees was set up in the SME Bank. Under the Secretariat, there were two departments: Planning Department for the operation of credit guarantee and Credit Guarantee Department for handling guarantee services. An independent credit guarantee institution could have been established when the Korea Credit Guarantee Fund Act was enforced, but it was decided to operate the new guarantee system and expanded it greatly through the SME Bank as a pilot program. The settlement of accounts in 1975 showed that the new guarantee system under the Korea Credit Guarantee Fund Act had gradually taken root, so that its performance as well as capital fund gradually increased. And it was also confirmed that the guarantees were operated in a sound manner. Consequently, the issue of establishing an independent credit guarantee institution started to be considered in more detail.

3.1.6. Composition of Establishing Committee

On April 8, 1976, the government announced the plan on establishing an independent institution to operate the credit guarantee fund, and thus, formed the KODIT-Establishing Committee with initial members.

Table 2-13 | Members of Establishing Committee and Officers of KODIT at the Time of Establishment

Members of establishing Committee	Officers of KODIT at the time of establishment
• **Chairman** -Two Vice Ministers of Ministry of Finance • **Vice-chairman** -Deputy Minister of Ministry of Finance -Director General of Financial Policy Bureau of Ministry of Finance -Secretary General of Credit Guarantee Fund of SME Bank -Senior Executive Vice President of SME Bank -Executive Director of Bank of Korea -Vice-president of Korea Appraisal Board	• Chairman and CEO • Executive Vice President • Auditor • Two Executive Directors

Source: Chronicle of KODIT (1986).

While the Establishing Committee was being formed, the Secretariat Committee responsible for practical affairs was set up with eleven members: two from the Ministry of Finance, six from the SME Bank, and three from the Korea Appraisal Board. Meanwhile, the Establishing Committee started its work on April 8, 1976; after preparing most of the standards concerning KODIT's organization and operation in just two months, it was dissolved as of June 25, 1976.

3.2. Establishment of KODIT

3.2.1. Structure of KODIT's organization

At the first meeting in April 1976, the Establishing Committee drew up the regulations of the Establishing Committee and Secretariat Committee for establishing KODIT. At the second meeting in May, a budget of 146 million won was approved to fund the establishment of KODIT. The budget was approved the by Ministry of Finance and the funds were borrowed from SME Bank, the agency for Credit Guarantee Fund. The first chairman of KODIT was appointed in May 1976 and the executive vice president, the auditor and the executive directors were appointed thereafter. The establishment of KODIT was completed on May 24, 1976, and it was publicized in the Seoul Daily Newspaper on May 27, 1976.

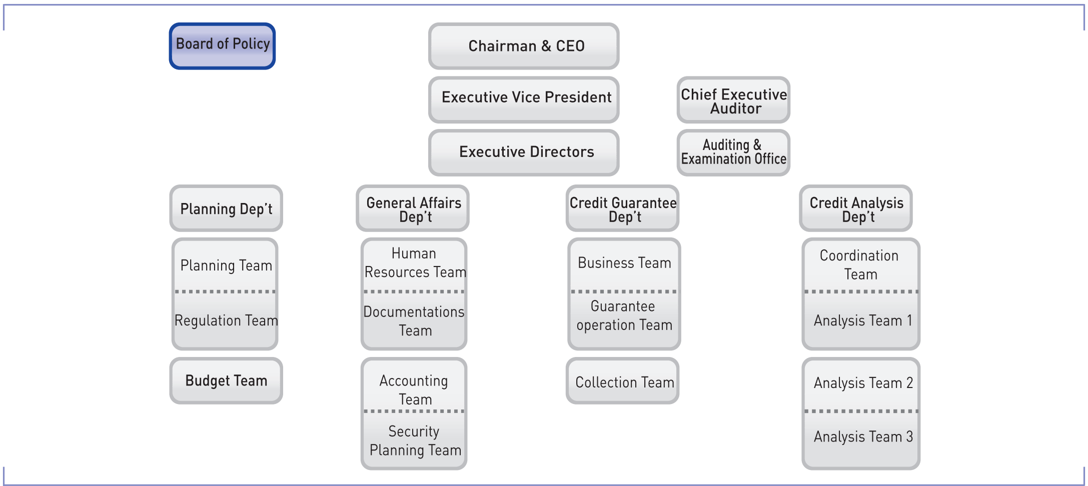
Table 2-14 | Preparations for the Establishment of KODIT

Year	Preparations
April 1976	• Regulations necessary for establishing KODIT, including the Establishing Committee Regulation and the Secretariat Regulation, were set up.
May 1976	• The budget for establishing KODIT was prepared at the second meeting of the Establishing Committee and approved by the Minister of Finance.
	• The Articles of Incorporation of KODIT was prepared and approved by the Minister of Finance.
	• The first chairman & CEO, the executive vice president, the chief executive auditor and two executive directors were appointed as board members.
	• The business plan of KODIT was prepared and delivered to KODIT at the time of its establishment.
	• The first-year budget plan was prepared, and delivered to KODIT.
July 1976	• KODIT succeeded credit analysis business from the Korea Appraisal Board. Source: Chronicle of KODIT (1986)

Source: Chronicle of KODIT (1986).

KODIT started its services with sixty five workers and four departments, one office and fourteen sections in its headquarter. Meanwhile, the Establishing Committee judged that it would be practically impossible for KODIT to take over guarantee business previously handled by various financial institutions with the necessary branch network and personnel. In the interim, it was decided that, until the end of September 1976, a guarantee exceeding 20 million won should be handled by a financial institution with the approval of KODIT but a guarantee of 20 million won or less should be handled by a financial institution at its own discretion, and that KODIT should directly provide its own guarantee services for customers as soon as it is ready.

Figure 2-16 | Headquarter in KODIT at Its Establishment



3.2.2. Raising Capital Fund

It is stipulated that KODIT should be capitalized with contributions from the government, financial institutions, enterprises and others. But, in practice, the fund heavily relies on contributions from the government and financial institutions for its capital.

In determining the amount of the government's contributions, the amount of guarantee supply and the leverage ratio are determined first, and costs such as the payments under guarantee are estimated, and then revenue from guarantee fees, the fund' s operating profit and contributions from financial institutions are also taken into account. The amount of government contribution requested by KODIT each year is reflected on the budget of the Small & Medium Business Administration and finalized through deliberation of Ministry of Strategy and Finance and the resolution of the Parliament.

The Korea Credit Guarantee Fund Act stipulates that financial institutions should contribute to KODIT in an amount not exceeding 0.3 percent per annum of the average monthly balance of outstanding loans subject to contribution. The loans subject to contribution had been listed in the Enforcement Regulation of the Korea Credit Guarantee Fund Act since its enforcement in March 1975 until November 1983. But thereafter, the method was changed to listing the loans not subject to contribution. Among loans of financial institutions, those with the nature of helping achieve goals of government policy, household loans and non-enterprise loans are excluded from the contribution amount.

Table 2-15 | Major Changes of Laws relevant to KODIT

Classification	Date	Major changes
Korea Credit Guarantee Fund Act (Enactment)	Dec. 21, 1974	• Credit guarantee funds in financial institutions were combined and operated by SME Bank. • Time limit for contributions shall end on December 31, 1980.
Enforcement Regulation (2nd amendment)	Feb. 14, 1977	• Contribution rates of 0.3% or 0.5% shall apply, depending on the types of loans.
Enforcement Regulation (3rd amendment)	Mar. 23, 1978	• Kookmin Bank' s loans to non-enterprises shall not be subject to contribution. • Contribution rate shall be 0.5% across the loans.
Korea Credit Guarantee Fund Act (1st amendment)	Dec. 28, 1979	• Contribution rates shall be adjusted from 0.5% to 0.3% to maintain and expand the capital fund. • Time limit for contributions shall be extended to December 31, 1985.

Classification	Date	Major changes
Enforcement Decree (4th amendment)	Jan. 23, 1980	• The leverage ratio for credit guarantees shall be changed from 15 times the sum of the capital fund and the earnings to 15 times the sum of the capital fund and the retained earnings brought forward.
Korea Credit Guarantee Fund Act (2nd amendment)	Aug. 7, 1984	• Time limit for contributions shall be extended to December 31, 1990.
Enforcement Regulation (8th amendment)	Apr. 1, 1989	• Due to the establishment of KOTEC, the contribution rate to KODIT shall be adjusted from 0.3% to 0.2%.
Korea Credit Guarantee Fund Act (3rd amendment)	Dec. 31, 1990	• Time limit for contributions shall be extended to December 31, 1995.
Enforcement Regulation (11th amendment)	Apr. 24, 1992	• The contribution rate shall be adjusted down from 0.2% to 0.17%, and the difference shall be contributed to KOTEC to help its early settlement.
Enforcement Regulation (15th amendment)	Aug. 25, 1994	• The contribution rate shall be adjusted down from 0.17% to 0.2%.
Korea Credit Guarantee Fund Act (5th amendment)	Aug. 4, 1995	• In addition to the government, financial institutions and enterprises, other entities may contribute to KODIT in order to diversify the financial resources for raising capital fund.
Enforcement Decree (11th amendment)	Dec. 14, 1995	• The leverage ratio shall be adjusted from 15 times to 17 times the sum of the capital fund and the retained earnings brought forward.
Enforcement Decree (12th amendment)	Dec. 29, 1997	• The leverage ratio shall be adjusted from 17 times to 20 times the sum of the capital fund and the retained earnings brought forward.
Korea Credit Guarantee Fund Act (9th amendment)	Sep. 7, 1999	• As regional credit guarantee foundations were established to help vitalize regional economy, each of these foundations as an original guarantor, may be protected by KODIT's counter-guarantee.
Korea Credit Guarantee Fund Act (11th amendment)	Dec. 31, 2000	• The provision on the time limit for contributions institution has been eliminated. • The number of members of the Board of Policy shall be adjusted from 16 to 12.
Enforcement Regulation (19th amendment)	Aug. 26, 2005	• To secure the financial resources of KOTEC, financial institutions' contributions to KODIT shall be temporarily transferred to KOTEC. • The time for contributions shall be adjusted flexibly.

Classification	Date	Major changes
Enforcement Regulation (20th amendment)	Jan. 24, 2006	• The contribution rate by financial institutions to KODIT shall be adjusted from 0.2% to 0.25%. • The contribution rate shall be differentiated, depending on the size of KODIT's total payments under guarantee compared to a financial institution contribution.
Enforcement Regulation (22nd amendment)	Jun. 4, 2007	• The contribution rate to KODIT shall be adjusted from 0.25% to 0.225%.
Korea Credit Guarantee Fund Act (17th amendment)	Feb. 6, 2009	• The P-CBO guarantee business which greatly contributed to the stabilization of corporate bond market during Asian currency crisis shall be open to KODIT as its regular business.

Source: Chronicle of KODIT (1986).

The amount of government contributions which were taken over at the establishment of KODIT was 2,350 million won, and there were no more government contributions until 1982. In the meantime, SME bankruptcies and KODIT's payment under guarantees increased sharply in 1979, due to domestic economic recessions caused by social and economic uncertainty. This caused KODIT' s deficits to widen from 1981, threatening the leverage ratio, consequently, the government began to make contributions again, starting with 25 billion won in 1983.

Table 2-16 | **Capital Fund at the Establishment (June 1, 1976)**

(Unit: million KRW)

Contributions			Retained earnings (B)	Capital fund (A+B)
Government	Banks	Total (A)		
2,350	25,563	27,913	4,470	32,383

Source: Chronicle of KODIT (1986).

During industrial restructuring that began in the 1990s, KODIT's capital decreased sharply due to an increase in non-performing guarantees; in turn, an increase of guarantee payouts caused by a chain of bankruptcies in the SME sector, especially among marginal enterprises, and by economic polarization. In particular, after the introduction of the real-name financial transaction system in 1993, the government's concentrated credit guarantee supply for SMEs magnified KODIT's leverage ratio. The leverage ratio at the end of 1993 reached 16.9 times, 15 times over what was provisioned in the Korea Credit Guarantee Fund Act. As KODIT's capacity for providing guarantees reduced sharply during 1994 and 1995, the government amended the Act to raise the leverage ratio from 15 times to 17 times and to increase contributions to KODIT, providing 240 billion won in 1994, 290 billion won in 1995 and 350 billion won in 1996.

By the 11th amendment of the Korea Credit Guarantee Fund Act on December 30, 2000, the time limit for contributions by financial institutions which had been extended several times by five years each time was abolished. Through this, KODIT was able to secure financial resources for its capital fund. After the Asian currency crisis, the government maintained its stance of expanding the supply of credit guarantees. As such, it made contributions of around 500 billion won each year until 2004, and the government's contributions exceeded by far the size of contributions by financial institutions. However, the government's policy change of providing support to SMEs on a selective basis resulted in a gradual decrease of contributions to 300 billion won in 2005 and 2006, and then 130 billion won in 2007, and 92.5 billion won in 2008. But as SMEs faced liquidity issues due to the rapid worsening of the real economy in the aftermath of the global financial crisis in the second half of 2008, the government decided to expand the supply of credit guarantees drastically to support SMEs, providing 1,980 billion won worth of contributions to KODIT.

Table 2-17 | Capital Fund after the Establishment of KODIT

(unit: 100 million KRW)

Classification	Government		Banks		Others		Total		Retained earnings(B)	Capital adjustment(C)	Capital Fund (A+B+C)
	annual	accumulated	annual	accumulated	annual	accumulated	annual	accumulated(A)			
1976		24	75	330			75	354	73		427
1977		24	140	470			140	494	116		610
1978		24	177	647			177	671	165		836
1979		24	237	884			237	908	212		1,120
1980		24	208	1,092			208	1,116	230		1,346
1981		24	276	1,368			276	1,392	-16		1,376
1982		24	422	1,790			422	1,814	-691		1,123
1983	250	274	543	2,333			793	2,607	-991		1,616
1984	150	424	637	2,970			787	3,394	-1,405		1,989
1985	83	507	778	3,748			861	4,255	-1,703		2,552
1986	100	607	96	471			1,059	5,314	-2,267		3,407
1987	200	807	111	582			1,312	6,626	-2,747		3,879
1988	150	957	117	698			1,315	7,941	-3,204		4,737
1989	220	1,177	98	796			1,201	9,142	-3,359		5,783
1990	80	1,257	100	897			1,083	10,225	-4,000		6,225
1991	50	1,307	126	1,023			1,310	11,535	-4,730		6,805
1992	870	2,177	147	1,169			2,335	13,870	-8,081		5,789
1993	900	3,077	167	1,336			2,568	16,438	-11,396		5,043
1994	2,400	5,477	196	1,532			4,363	20,801	-15,309		5,492
1996	3,500	11,877	2,834	20,669			6,334	3,255	-2,567		688
1997	4,000	15,877	3,307	23,976			7,307	3,985	-3,280		705
1998	8,550	24,427	3,515	27,491	20,260	20,260	32,325	7,218	-5,091		2,127
1999	9,900	34,377	2,928	30,419	111	20,371	12,939	8,512	-6,453		2,602
2000	5,100	39,427	3,238	33,657		20,371	8,338	9,346	-6,453		2,892

Classification	Government		Banks		Others		Total		Retained earnings(B)	Capital adjustment(C)	Capital Fund (A+B+C)
	annual	accumulated	annual	accumulated	annual	accumulated	annual	accumulated(A)			
2001	5,230	44,657	3,342	36,999	7,000	27,371	15,572	10,903	-7,445		3,458
2002	5,250	49,907	3,577	40,576		27,371	8,827	11,785	-8,276	-2	3,507
2003	6,560	56,467	4,243	44,819		27,371	10,803	12,866	-9,487	-9	3,370
2004	5,210	61,677	4,562	49,381		27,371	9,772	13,843	-10,634	-6	3,203
2005	3,000	64,677	3,080	52,461		27,371	6,080	14,451	-11,283	-2	3,166
2006	3,000	67,677	5,370	57,831		27,371	8,370	15,288 [2]	-11,564	-4	3,720
2007	1,300	68,977	6,943	64,774		27,371	8,243	15,600	-12,001	8	3,607
2008	925	69,902	7,804	72,578		27,371	8,729	16,47 [3]	-12,714	-37	3,721
2009	19,800	89,702	13,675	86,253		27,371	19,800 [3]	18,453 [3]	-12,119	42	6,376

Note: 1) Special contributions are contributions obtained for special guarantees: contributions made with borrowings from ADB and IBRD (2,026 billion won in 1998 and 11.1 billion won in 1999) and contributions of 700 billion won from the Small & Medium Business Corporation.

2) Deduction of 512.4 billion won which was contributed to the Small & Medium Business Corporation for the purpose of the Corporation's repayment of borrowings from the Korea Development Bank.

3) In 2009, contributions from the government were included in the total contributions and contributions from financial institutions, etc. were included in the retained earnings, due to the adoption of the national accounting standards.

3.3. KODIT's Progress and Its Business Lines

3.3.1. 1976~1979 (Phase-in Period)

In January 1976, KODIT took over the credit guarantee fund of 28 billion won and its operations officially, including those handled by the SME Bank (presently the Industrial Bank of Korea). KODIT was capitalized as a formal institution with contributions from the government and financial institutions and retained earnings. Financial institutions had to pay monthly contributions to KODIT amounting to 0.5 percent per annum of their average balance of loans until the end of 1980. With 28 billion won of capital at the time of KODIT's establishment, the credit guarantee fund expanded to 43 billion won in 1976 and 112 billion won in 1979.

With the establishment of an independent institution specializing in credit guarantees, the provision of guarantees began in earnest, which led to the rapid expansion of outstanding credit guarantees from KRW 101 billion at the time of establishment to 701 billion won by the end of 1979. In light of the outstanding balance of credit guarantees before KODIT's establishment, there were many constraints in actuating credit guarantee services as lending and the provision of guarantees were not separated.

Table 2-18 | Major Management Indices (1976~1979)

(unit: billion KRW, %, Times)

Classification	Jun.-Dec. 1976	1977	1978	1979
Guarantee supply	112	273	369	679
Default rate	1.1	2.0	1.4	2.7
Payments under guarantee	0.6	1.0	1.9	7.6
Government contributions	-	-	-	-
Leverage Ratio	3.7	4.3	4.9	6.3

3.3.2. 1980~1987 (Growth Period)

In the early 1980s, as the external business environment worsened, the government pushed for a strong stimulus policy, and along with this, implemented a guarantee expansion policy. KODIT, immediately after its establishment, made various efforts to meet the SMEs' demand for guarantees by diversifying guarantee types and improving the guarantee system. It at times faced difficulties due to the suddenly worsening the economic environment.

As the economic environment worsened in the early 1980s due to the second oil shock in 1979 and the political and social turmoil in Korea, the rate of default among SMEs kept increasing, which made KODIT's situation more difficult. Default rates on KODIT's guarantees increased rapidly and various management indices kept worsening. Against this background, KODIT's management problems worsened much more due to the government's push to expand guarantees. Also, the government made its first contribution in 1983 to increase KODIT's capital fund.

Table 2-19 | Major Management Indices (1980~1987)

(unit: billion KRW, %, Times)

Classification	1980	1981	1982	1983	1984	1985	1986	1987
Guarantee supply	1,761	1,842	1,549	1,386	1,649	1,871	2,236	2,371
Default rate	3.8	6.4	7.5	7.7	4.3	2.9	4.4	3.8
Payments under guarantee	23	58	103	57	72	62	67	93
Government contributions	0	0	0	25	15	8	10	20
Leverage Ratio	9.3	11.2	12.1	8.1	7.8	7.4	7.6	7.2

3.3.3. 1988~1996 (Maturing Period)

As the SME IT industry grew as a new economic driving force in the 1980s, the Korea Technology Credit Guarantee Fund (presently Korea Technology Finance Corporation) was established for the purpose of supporting technology-intensive SMEs. The regime of dual credit-guarantee institutions resulted in not only the quantitative expansion of credit guarantees but also a better quality of credit guarantees.

In the early 1990s, exports and investments became sluggish and the national economy slowed down because of the spread protectionism in the global economy. This a string of bankruptcies in the SME sector, leading to a rise in the default of guarantees. The recession led to a rapid rise in defaults and non-payments which in turn led to KODIT's capital to deteriorate. As such, KODIT had to reduce the supply of credit guarantees, which contributed to accelerating the vicious circle.

In 1993, credit guarantees were provided in large quantity in the wake of the government's implementation of the real-name financial transaction system and the New Economy 100-day Plan, which contributed to aggravating KODIT's overall management environment. In 1994, delinquent credit guarantees amounted to 916.9 billion won which was 12 percent of the outstanding balance of guarantees, and the number of companies under default increased to 11,497, accounting for 16 percent of the total guaranteed enterprises.

In light of this situation, KODIT set out to focus on providing credit guarantees more prudently, and realigned its various businesses. KODIT reduced the limit on guarantees, tightened the credit evaluation process and made systematic improvements, introducing, among others, the system of specialized reviewers.

Table 2-20 | Major Management Indices (1988~1996)

(Unit: billion KRW, %, Times)

Classification	1988	1989	1990	1991	1992	1993	1994	1995	1996
Guarantee supply	2,726	3,043	4,522	5,221	5,419	6,386	4,442	5,727	6,755
Default rate	3.5	2.6	2.3	4.2	9.1	4.9	9.0	9.1	5.6
Payments under guarantee	103	776	711	1,565	4,610	3,962	4,376	6,846	5,051
Government contributions	15	22	8	5	87	90	240	290	350
Leverage Ratio	6.9	6.7	8.4	9.7	12.4	17.0	14.0	15.5	13.4

3.3.4. 1997~2002 (Coping with the Asian Currency Crisis)

The rapid devaluation of the Thai Baht in July 1997 triggered a series of currency crises in Southeastern Asia, which in turn spread to the global financial markets. Foreign financial institutions refused Korea's requests for refinancing, causing a liquidity shortage in Korea, and given the structural problems of Korea's economy, the government was subject to an IMF bailout program.

Korea's real economy contracted rapidly due to a chain-reaction of defaults of large enterprises who failed in restructuring and the worsening state of financial institutions. The high-interest-rate policy intervention recommended by the IMF, the deterioration of Korea's sovereign credit rating and shortage of raw materials due to skyrocketing exchange rates of the Korean currency, combined to trigger a chain-reaction of defaults of many SMEs.

The mass default of SMEs gave rise to a rapid increase in KODIT's credit guarantee defaults and non-payments. Guarantee defaults in 1997 and 1998 were 1,220 billion won and 3,119 billion won, respectively, and non-payments in 1997 and 1998 amounted to 736 billion won and 2,011 billion won, respectively.

The government's bold reform measures, including sharply raising interest rates and restructuring the financial industry, resulted in tangible outcomes, and the national economy gradually recovered, with the end of 1998 as a turning point.

The government made a special contribution to KODIT in an effort to cope with the Asian currency crisis. KODIT strengthened its function and role to support SMEs and was able to perform its role as a policy-oriented financial institution in supporting SMEs and preventing further viable SMEs from going bankrupt. It was widely recognized in Korea during the so-called IMF Bailout program that the credit guarantee system was one of the most effective policy tools used to mitigate economic fluctuations.

In 1998, KODIT played a leading role to cope with the crisis in the SME sector by introducing various special guarantee programs, ranging from guarantees for secured loans to guarantees for export financing. In 1999, KODIT implemented the Special Guarantee for Livelihood-type Startup to support workers that lost their jobs during the economic crisis to start their own businesses. In 2001, KODIT introduced the special guarantee for P-CBO system to normalize the capital markets as the corporate bonds issued by large enterprises had to be repaid during the IMF restructuring.

Table 2-21 | Major Management Indices (1997~2002)

(Unit: billion KRW, %, Times)

Classification	1997	1998	1999	2000	2001	2002
Guarantee supply	8,314	22,416	19,933	22,377	30,529	27,334
Default rate	10.8	14.5	3.3	4.4	3.4	3.8
Payments under guarantee	736	2,011	1,119	815	888	839
Government contributions	400	2,881	1,001	510	1,223	525
Leverage Ratio	16.1	10.1	7.5	7.8	9.0	9.3

3.3.5. 2003~2008 (Adjustment Period)

After the Asian currency crisis, Korea gradually achieved economic recovery on the back of intensive industrial restructuring. Under the Kim Dae-jung government in 2003, the economic focus shifted to redistribution as well as growth. The SME policy direction also put emphasis on the enhancing the innovative capacity and strengthening competitiveness rather than protection and nurturing.

The outstanding credit guarantees at the end of 2001 exceeded 30,000 billion won and amounted to 33,570.8 billion won at the end of 2004 due to the policy of expanding the supply of guarantees to cope with Asian currency crisis.

In 2005, the government announced the SME Financing Policy (the 6.23 Measure) based on market principles in order to move into an innovation-driven economy. The policy aimed at the expansion of credit guarantee support for innovative startups and technology-driven enterprises and put emphasis on equity financing or combination of equity and debt-financing rather than simply loans.

The policy also emphasized financial support for SMEs through direct financing, and sought to change the direction of the SME financing support system from government-directed to market-based. The measure pushed for qualitative changes to support SMEs with growth potential through selection and concentration strategy instead of a quantitative expansion of credit guarantees.

Table 2-22 | Long-Term Government Guarantee Operation Plan Under the 6.23 SME Financing Policy and Actual Outstanding

(Unit: billion KRW)

Year	2006	2007	2008	2009	2010
Target outstanding	27,660	27,000	26,300	25,600	25,000
Actual outstanding of general guarantee	28,524	28,542	30,387	39,249	38,781

Note: Guarantee expansion policy was adopted in the wake of the global financial crisis in the second half of 2008.

Table 2-23 | Major Management Indices (2003~2008)

(Unit: billion KRW, %, Times)

Classification	2003	2004	2005	2006	2007	2008
Guarantee supply	30,918	31,845	30,728	29,602	29,592	30,282
Default rate	7.1	6.1	6.5	4.5	4.2	4.9
Payments under guarantee	1,726	1,674	1,325	665	775	1,066
Government contribution	656	521	300	300	130	93
Leverage Ratio	9.7	10.5	9.8	8.0	8.0	8.5

Major Changes in the SME Financing Policy (2005)

- In order to expand support for innovative SMEs such as startups and technology-driven enterprises, to utilize guarantee resources efficiently, and to strengthen the selective function of markets, enterprises which have used large amount of guarantee services for a long period shall graduate from the guarantee system by reducing guarantees to graduated SMEs, thereby creating room for new guarantees.

- Enhancing the efficiency of the credit guarantee system by through market segmentation to be served by KODIT or Korea Technology Financing Corporation (KOTEC)
  - KODIT shall specialize in supporting innovative enterprises, export-oriented enterprises and micro/small enterprises. On the other hand, KOTEC shall specialize in supporting technology-driven enterprises.

- Strengthening of cost-sharing principle among beneficiaries by adjusting differential credit guarantee fee rates and contribution rates
  - The credit guarantee fee rate differential shall be expanded according to credit ratings, term of guarantee, etc. (from 0.5-2.0% to 0.5-3.0%). Rate of contributions from financial institutions shall increase (from 0.3% to 0.4%), varying according to subrogation ratios.

- Support for restructuring as a way to strengthen competitiveness of SMEs and to promote an environment where underperforming SMEs can exit.
  - Promoting SME restructuring through comprehensive work-out such as withdrawal from market, business transition for marginal and unprofitable SMEs.

3.3.6. 2009~2010 (Coping with the Global Financial Crisis)

In the aftermath of world-wide economic slowdown triggered by the subprime crisis in the United States, SMEs faced liquidity issues and demand for credit guarantees increased rapidly. Since 2000, the government has emphasized the implementation of the credit guarantee policy based on market principles, but recently allowed significant expansion of guarantees to overcome the global financial crisis.

Table 2-24 | Major Management Indices (2009~2010)

(Unit: billion KRW, %, Times)

Classification	Guarantee supply	Default rate	Payments under guarantee	Government contribution	Leverage Ratio
2009	45,620	3.7	1,337	1,980	7.4
2010	44,732	4.7	1,269	-	7.4

Table 2-25 | Advancement Process of KODIT

Period		Major Changes	External Environment
Phase-in period	1962~1979	Amendment of the SME Bank Act to include provisions concerning the Credit Guarantee Reserve Fund system (1961) Enactment of Small and Medium Industry Credit Guarantee Act (1967) Enactment of Credit Guarantee Fund Act (1974) Establishment of KODIT (1976)	Announcement of the 1st 5-year Economic Development Plan (1962) Registration as the GATT's 72nd member (1967) The 1st oil shock (1972) Construction industry's booming emergence in the Middle East (1976)
Growth period	1980~1987	Introduction of investment business (1980) The 1st contribution from government and abolition of termination on contributions from financial institutions (1983) Establishment of Credit Analysis Center (1984)	The 2nd oil shock (1980) Preparation of SME invigoration plan (1985)
Maturing period	1988~1996	Establishment of the Korea Technology Credit Guarantee Fund(presently Korea Technology Finance Corporation) (1989) Special credit guarantees by SME Structural Improvement Fund (1993) Increase of financial institutions' contribution rate from 0.17% to 0.2% (1994)	Announcement of comprehensive economic vitalization plan (1989) Announcement of 100-day new economy plan (1993) Announcement of the real-name financial transaction system (1993) Conclusion of GATT UR Round of multinational trade negotiation (1993)

Period		Major Changes	External Environment
Asian currency crisis	1997~2002	Implementation of various special guarantees, including guarantee for secured loans and guarantee for export financing(1998) Implementation of special guarantee for livelihood-type startup fund (1999) Implementation of special guarantee for primary collateralized bond obligations (P-CBOs) (2001) Introduction of in-house corporate credit rating system (CCRS) (2001)	Preparation of financial industry restructuring measures (1997) Application for IMF bailout program (1997)
Adjustment period	2003~2008	Separation of business territories of KODIT and Korea Technology Finance Corporation (2006)	Announcement of comprehensive measures for credit-card companies (2003) Announcement of "6. 23 SME financing policy" (2005)
Financial crisis	2009~	Implementation of special guarantee for SME liquidity support (2009)	Global financial crisis (2009)

Source: Chronicle of KODIT (2006).

4. Performance of KODIT' s Credit Guarantee System

4.1. Performance of Credit Guarantee

The supply of credit to guarantee SME loans has expanded as the economy has grown. As can be seen in the figure 2-17 below, the size of the outstanding balance of credit guarantees steadily increased until 1997, but increased drastically in the wake of the "Asian currency crisis" to ease the credit crunch and the outstanding balance of guarantees skyrocketed to 21,454 billion won in 1998 compared to 158 billion won at the time of establishment of KODIT in 1976.

Once the financial markets stabilized as the economy recovered after 2002, the supply of credit guarantees gradually declined from 2005 in step with the IMF's recommendation of reducing the guarantee supply and the government's policy to restrain the expansion of guarantees. But the global financial crisis triggered in the second half of 2008 and the ensuing credit crunch made it difficult for SMEs to access financing. In response to the urgent need for credit guarantee support, the outstanding balance of guarantees jumped again in 2009 to 46,913 billion won.

Figure 2-17 | Outstanding Balance of Credit Guarantee of KODIT

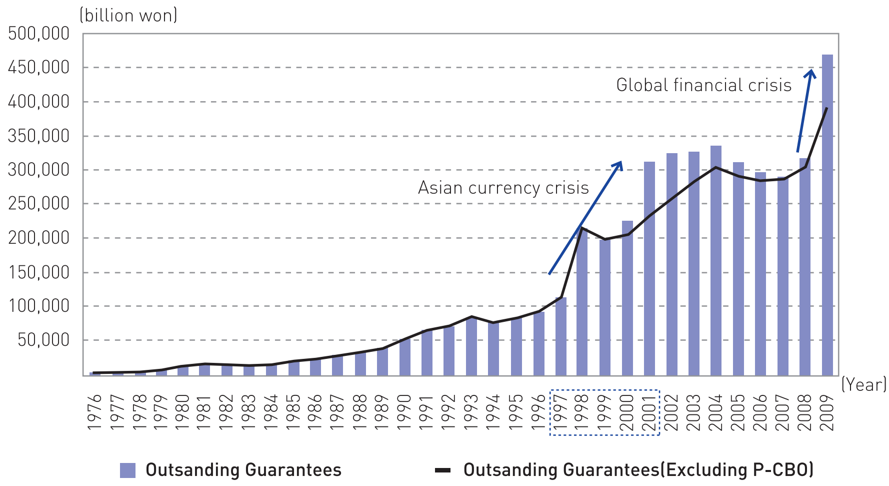


Table 2-26 | Yearly Outstanding Balance of Credit Guarantee of KODIT

(Unit: billion KRW)

Year	General guarantee	P-CBO guarantee	No of guaranteed enterprise
1976	158	-	
1977	265	-	
1978	408	-	
1979	701	-	1,185
1980	1,255	-	1,486
1981	1,544	-	1,864
1982	1,358	-	2,097
1983	1,310	-	1,904
1984	1,550	-	1,796
1985	1,896	-	2,098
1986	2,320	-	2,503
1987	2,780	-	2,815
1988	3,280	-	3,511
1989	3,857	-	3,834
1990	5,231	-	4,610
1991	6,595	-	5,228
1992	7,160	-	5,573

Year	General guarantee	P-CBO guarantee	No of guaranteed enterprise
1993	8,544	-	7,616
1994	7,665	-	7,013
1995	8,191	-	7,644
1996	9,247	-	9,352
1997	11,329	-	10,781
1998	21,454	-	14,072
1999	19,621	-	21,300
2000	20,278	2,313	26,343
2001	23,267	8,001	27,724
2002	25,689	6,826	26,754
2003	28,393	4,340	27,092
2004	30,515	3,056	252,567
2005	29,153	1,946	22,345
2006	28,524	1,110	20,311
2007	28,542	3,749	19,014
2008	30,387	1,356	19,366
2009	39,249	7,664	21,884

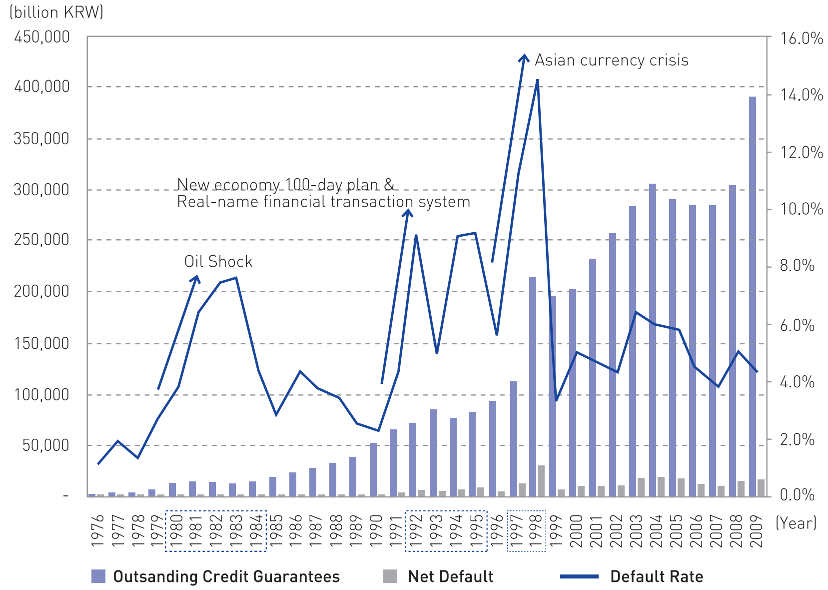
To look at the default rate as shown in the Figure 2-18 below, KODIT faced serious management crises three times. During the early 1980s from 1980 to 1984, prices soared due to the first oil shock and subsequent inflation. Economic growth dropped sharply, and the default rate of credit guarantees rose greatly because of countless bankruptcies among SMEs.

From 1992 to 1995, many enterprises went bankrupt due to the contraction of the real economy in the after the real-name financial transaction system was implemented. In addition, polarization between large companies and SMEs continued for a long time, and the default rate reached 9.1 percent in 1992.

In 1997, the economy was hit hard by the Asian currency crisis, and SMEs experienced increasing great difficulty because of faltering large companies and financial institutions. In particular, the high-interest-rate policy intervention of the IMF pushed loan interest rates up to 30 percent, and exchange rates rose sharply to more than three times. Under such circumstances, many SMEs suffering from a shortage of capital went bankrupt, and the default rate of credit guarantees reached 14.6 percent. This caused the government to make large contributions to KODIT to support SMEs.

Thereafter, the economy recovered, and the default rate of credit guarantees gradually went down, after KODIT introduced an elaborate credit rating system and strengthened risk management.

Figure 2-18 | Default Rate of KODIT



4.2. Contribution to Nurturing SMEs

4.2.1. Support for SMEs through Credit Guarantee

※ Analysis is based on the survey that measured the impact of KODIT's support on SME's management environment and startups.

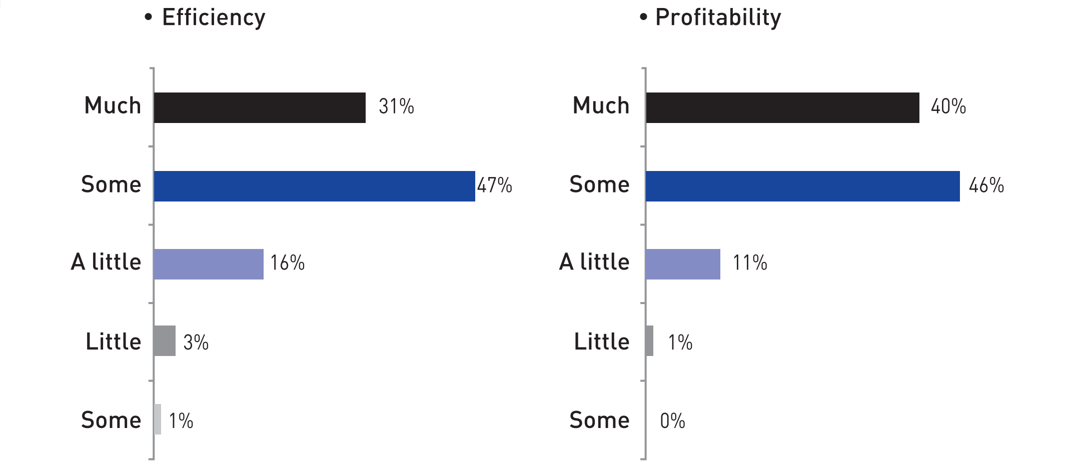
-The survey was conducted by the Performance Evaluation Department of KODIT from July 7 to July 13, 2009.

√ Source : KODIT, "2008 Analysis on Performance of Credit Guarantee and its Contribution to National Economy," *KODIT Report 2009-2*, pp. 74-81, 2009.

Based on the survey, about 78% of the enterprises responded that the credit guarantees had contributed to improving efficiency such as increased productivity, enhanced product quality, and reduced production costs.

In addition, about 86% of the enterprises responded that credit guarantees had contributed to improving profitability due to increased sales and operating income.

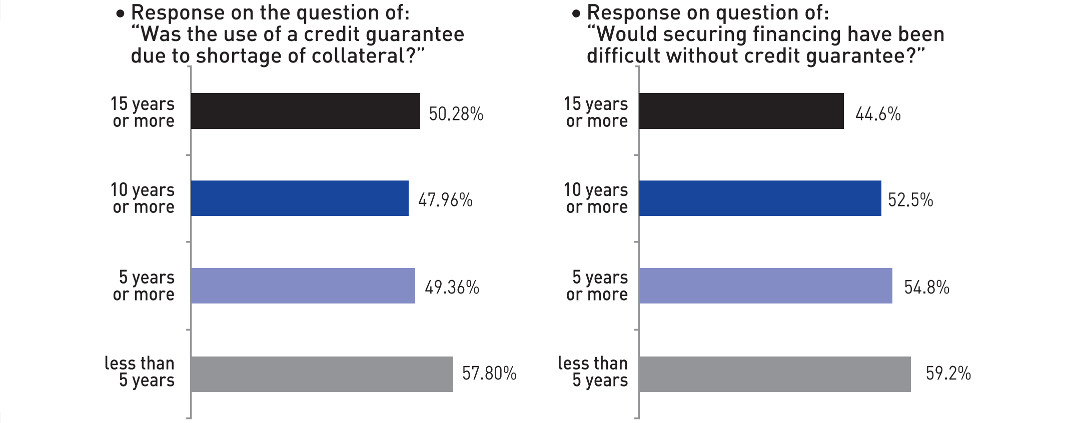
Figure 2-19 | Impact of Credit Guarantee on Improvement of SME Management



Many enterprises within five years of their establishment responded that they used credit guarantee due to lack of tangible collateral or insufficient credit line from banks. Indeed, 57.8 percent of enterprises within five years of their establishment responded that it would have been difficult to obtain financing without the credit guarantee.

This shows that KODIT is contributing to facilitate SME financing by providing guarantee services to companies that lack adequate collateral based on certain criteria.

Figure 2-20 | Impact of Credit Guarantee on Startup Enterprises



4.2.2. Improvement of Financial Performance of SMEs

※ Assessment of SME financial performance of financial ratios after receiving guarantee support.
√ Data : Financial statements for three years including the year credit guarantee is supplied
√ Source : KODIT, "2008 Analysis on Performance of Credit Guarantee and its Contribution to National Economy," *KODIT Report 2009-2*, pp. 53-59, 2009.

In 2009, KODIT analyzed the impact of credit guarantees by assessing the financial performance of enterprises that received guarantees. The analysis compared the financial statements of the years an enterprise did not get a guarantee with subsequent years a guarantee was provided. The results of the analysis showed that enterprises that received a guarantee had better financial performances up to two more years after having received support than those that did not.

The growth rate of enterprises that received a guarantee grew in the first and second year subsequent to receiving support. Their profitability was also better, compared to enterprises that did not receive guarantee support. The study shows that credit guarantees can have a positive impact on financial structure of SMEs by promoting their business activities.

Table 2-27 | Impact of Credit Guarantees on Financial Performance

(Unit: %)

Classification		Guaranteed enterprises				Non-guaranteed enterprises			
		2006 year of guarantee support	2007 first year thereafter	2008 second year thereafter	3-year average	2006	2007	2008	3-year average
growth	total-asset growth rate	37.48	20.79	17.21	25.16	12.41	12.81	17.04	14.09
	sales growth rate	18.19	17.96	20.33	18.83	9.62	16.22	19.32	15.05
	operating-income growth rate	20.14	21.75	27.76	23.22	11.08	18.46	24.61	18.05
	net-income growth rate	19.76	22.81	29.12	23.90	16.00	16.64	20.40	17.68
profita-bility	return on equity	27.22	23.29	24.43	24.98	15.89	15.71	13.44	15.01

Source: KODIT, "2008 Analysis on Performance of Credit Guarantee and its Contribution to National Economy," *KODIT Report 2009-2*, 2009.

4.3. Contribution to Growth of National Economy

※ Analysis of the ripple effects of KODIT's credit guarantee on the national economy, through 'inter-industry relations table' which shows mutual relationship between industrial sectors.

Analysis of the ripple effects of KODIT's credit guarantee on domestic industries; namely the primary ripple effect which brings about increase of production at SMEs that received a guarantee and the secondary ripple effect which helps increase the production of enterprises or industries which use the products of SMEs that received a guarantee.

√ Source : KODIT, "2008 Analysis on Performance of Credit Guarantee and its Contribution to National Economy," *KODIT Report 2009-2*, pp. 14-21, 2009.

- The concept of job-creation inducement effect involves employees, self-employed and unpaid family workers, while employment inducement effect involves only employees.

According to the results of the study on the impact of credit guarantees using inter-industry relations analysis, credit guarantees induced total production of 1,044 billion won, value-added of 499 billion won, the creation of more than 23 thousand jobs and employment of more than 13 thousand employees in 2008.

The ripple effects on the nominal value of production decreased a little in 2008 due to a contraction in the guarantee supply, but the ripple effects on production relative to the guarantee supply improved compared to 2005 and 2006.

Credit guarantees were shown to have created 23,256 jobs despite a decline in the guarantee supply, and the number of employed workers relative to total unemployed increased for four consecutive years, being 2.55 percent in 2005, 2.60 percent in 2006, 2.94 percent in 2007 and 3.02 percent in 2008.

Employment kept increasing since 2005 at the same rate jobs were created, and the number of employed workers relative to total unemployed workers kept improving every year, being 1.52 percent in 2005, 1.57 percent in 2006, 1.75 percent in 2007 and 1.77 percent in 2008.

KODIT focuses its guarantee supply on enterprises which have significant job-creation/employment effect, such as innovative SMEs, startup enterprises, export-oriented enterprises and green-growth enterprises, based on a 'selection and concentration strategy', and thereby contributes to job creation which is the government's top-priority task.

- Job creation effect relative to total jobless: 2.94% (2007) ⟶ 3.02% (2008)
- Employment effect relative to total jobless: 1.75% (2007) ⟶ 1.77% (2008)

Figure 2-21 | Job Creation Inducement Effect, Employment Inducement Effect, Value-Added Inducement Effect, Ripple-Effect on the Product

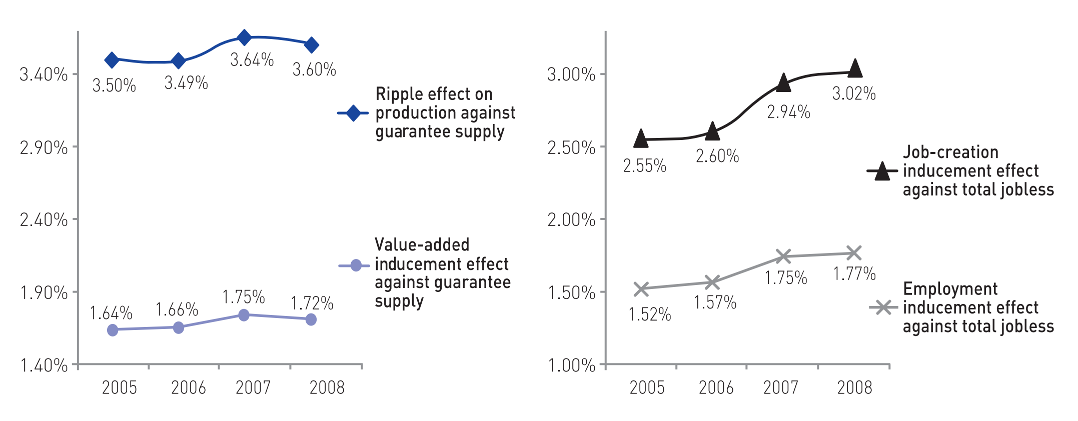


Table 2-28 | Economic Effects of Credit Guarantee based on Inter-Industry Relations Analysis

(Unit: billion KRW)

Classification	2005	2006	2007	2008
Guarantee supply (A)	30,432.4	29,318.8	29,501.1	29,016.5
Ripple effect on production(B)	1,064.5	1,022.1	1,073.5	1,043.7
Ripple effect on production relative to guarantee supply(B/A)	3.50%	3.49%	3.64%	3.60%
Value-added effect (C)	498.4	485.7	515.0	498.8
Value-added effect relative to guarantee supply (C/A)	1.64%	1.66%	1.75%	1.72%
Number of total jobless (D)	887,000	827,000	783,000	769,000
Job-creation inducement effect (E) (jobs)	22,592	21,536	23,014	23,256
Job creation effect relative to total jobless (E/D)(E/D)	2.55%	2.60%	2.94%	3.02%
Employees inducement effect(F)(employees)	13,487	12,948	13,723	13,635
Employment effect relative to total jobless (F/D)	1.52%	1.57%	1.75%	1.77%

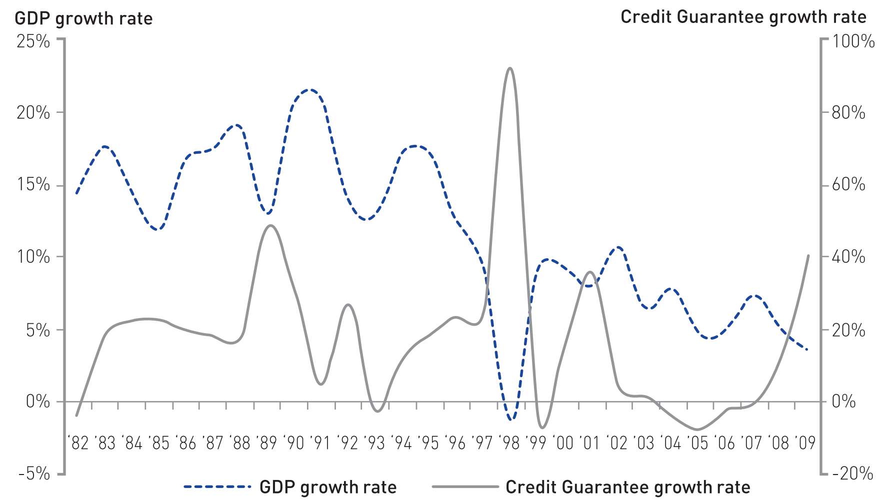
Source: KODIT, "2008 Analysis on Performance of Credit Guarantee and its Contribution to National Economy," *KODIT Report 2009-2*, 2009.

4.4. Contribution to Mitigating Economic Fluctuation

In an economic down cycle, the role of policy-oriented financing is required to meet the demand of SMEs for financing and mitigate economic fluctuation for the benefit of not only SMEs but also financial institutions. As we learned from the Asian currency crisis in 1997 and the global financial crisis in 2008, the most effective policy measure to secure stable SME financing markets and ensure liquidity in response to economic fluctuations is the supply of guarantees through guarantee institutions.

The supply of credit guarantees and economic fluctuations show an inverse relationship. When GDP growth rates increase, the guarantee supply declines, and vice versa. Credit guarantees do not directly engineer economic growth but induce it by enhancing the productivity of enterprises, and the expansion of guarantee supply during an economic down cycle is considered a timely counter-cyclical policy.

Figure 2-22 | Ratio of KODIT's Outstanding Balance of Credit Guarantee to GDP



Source: Korea Association of Small Business Studies, "Analysis of Credit Guarantee Performance and Computation of the Proper Leverage Ratio in 2009," 2009.

4.5. Contribution to Reducing Capital Requirements of Financial Institutions and Expanding SME Lending

Credit guarantees, one of the typical policy-oriented financing, can be useful in contributing to the stability of financial markets. The risk weight for loans guaranteed by KODIT was adjusted downward from 10 percent to 0 percent according to Basel II. This enhances the usefulness of credit guarantees in facilitating loans and reducing the capital requirement of financial institutions. By utilizing guarantees, commercial financial institutions can secure more room to lend, thereby performing the role of public agency in part. In other words, credit guarantees indirectly contribute to the expansion of SME lending.

In 2009, KODIT analyzed, under the assumption that enterprises obtain loans by providing other collateral instead of a credit guarantee, the impact of credit guarantees on the BIS capital adequacy ratio and the added capacity of financial institutions to supply credit. According to the results of the analysis, if domestic financial institutions extended loans in the same amount to guaranteed SMEs using other types of collateral instead of credit guarantees, the ratio drops by 0.19 percent, putting financial institutions at a disadvantage. In short, financial institutions can ease their lending burden through credit guarantees and have additional capacity to provide more credit.

5. Policy Implications

Major countries of the world have introduced a credit guarantee system and are operating it. The extent to which the guarantee system has been established and vitalized varies from country to country. Some developing countries have, however, adopted the system of advanced countries without careful study of their own level of economic development and the state of their financial markets, resulting in poor performance that has fallen short of their expectations. A developing country which intends to introduce and implement a guarantee system needs to benchmark successful examples beforehand and minimize implementation by trial and error.

Most SMEs in developing countries find it quite difficult to borrow capital from financial institutions. In particular, collateral-based lending practices prevail at financial institutions that lend to SMEs, and the management of credit information is almost non-existent for lack of financial infrastructure. This hinders financial institutions from lending loans to enterprise. To address such problems and to foster SMEs and vitalize financing, most developing countries are seeking to introduce a credit guarantee system and to establish a guarantee institution to administer it. However, there are many prerequisites to introducing a guarantee system, such as building a financial infrastructure, legal system, credit information infrastructure. It is also true that most developing countries have attempted to stabilize their credit guarantee system by trial and error. In this section, policy consultations for the introduction of a guarantee system and the establishment of a guarantee institution are presented to minimize implementation by trial and error, and to contribute to the early activation of guarantee system.

5.1. Proposals on Operational Methods and Management

It is suggested that developing countries should adopt a public guarantee system and establish a credit guarantee institution under the control of the government to implement a credit guarantee system. The industrial structures of most developing countries are quite different from that of Europe where mutual guarantee unions were formed and built around SMEs in the same trade or SMEs in the same area. As the mutual guarantee system restricts access to credit guarantees to its members, this system may not be suitable for developing countries, as it is not conducive to policies that promote SMEs and economic growth. Under a loan guarantee system, the provision of credit guarantees is conducted by a financial institution, and not an independent institution whose sole responsibility is providing guarantees, which makes it difficult to provide credit guarantees systematically. In a country where financial markets are underdeveloped, the level of awareness of a guarantee system tends to be low. These factors do not make it easy for developing countries to adopt the loan guarantee system.

Therefore, it seems that the most suitable system for developing countries preparing to introduce a credit guarantee system is the public guarantee system, under which the financial resources can be mobilized at the early stages of introducing the system with contributions from the government. Also, the government's policy can be effectively carried out by an independent guarantee institution.

Table 2-29 | Form of Guarantee by Country

Classification	Country
Public guarantee system	• Korea, Japan, Taiwan, Malaysia, Thailand, Philippines, Indonesia, India, Nepal, Papua New Guinea, Jordan, Egypt, Morocco • Hungary, Austria, Finland, Rumania, Turkey • Venezuela, Peru, Columbia
Mutual guarantee system	• Germany, Italy, Switzerland
Loan guarantee system	• Sri Lanka, Hong Kong • the United Kingdom, Netherlands, the Czech Republic, Slovakia • the United States, Canada, Chile
Public guarantee system + Mutual guarantee system	• France, Belgium • Argentina

Source: KODIT, "Credit Guarantee System of the World", 2005.

If developing countries adopt the public guarantee system, it will be necessary to establish a credit guarantee institution under the initiative of provincial governments or the central government in order to ensure its independence in the management and operation of the institution. An independent credit guarantee institution established by provincial governments or the central government share the following characteristics:

Local credit guarantee institutions have the advantage of being able to respond well to the needs of local SMEs, and be established with relatively small capital and can reflect policies of the provincial governments effectively. But there are also inefficiencies that may result from establishing several local guarantee institutions, which makes it difficult to establish a standardized guarantee system and to respond quickly to changes in the economic environment.

A credit guarantee institution established under the initiative of the central government has advantage of being able to achieve cost and management effectiveness, and to support the government's policies at the early stage of economic development and to respond quickly to changes in the economic environment. A credit guarantee institution governed by the central government can be modeled on one of the following system operational methods: the direct guarantee method where the institution builds a nationwide branch network and conducts credit analysis and credit approvals on guarantees, or the entrusted guarantee method where banks provide loans and credit guarantees through their branches satisfying pre-determined evaluation criteria. The weak point of the direct guarantee method is that it takes a great deal of investment to build a nationwide branch network; however, the method of relying on financial institutions could lead to moral hazard.

It is also necessary to introduce and implement a credit guarantee system in stages to ensure the stable activation of the system. It may be effective to first establish an institution for managing the credit guarantee system and to build the infrastructure needed for operating a credit guarantee business, and then to establish an independent guarantee institution specializing in credit guarantees and to expand management institutions when demand for guarantee grows. The first step should be to establish a management organization for the credit guarantee system, standardize the business processes and expand the scope of guarantee operation through the expansion of the management organization. Establishment of an independent guarantee institution should be the next step. To give an actual example of Korea, the foundation for implementing a guarantee system was laid in 1961 with the introduction of a credit guarantee reserves system, and Industrial Bank of Korea was entrusted with the operation of the credit guarantee system until the independent guarantee institution, KODIT, was established in 1976.

Table 2-30 | Proposals for the Establishment of a Credit Guarantee Institution in Stages

Classification	Implementation	Detailed implementation
1st stage	Selection of institutions for management of credit guarantee services	• To establish the organization in the central bank or a policy-oriented financial institution and organize personnel • To operate guarantees using organization and personnel of financial institutions (operation methods of entrusted guarantees possible) • To implement standardized processes for business and evaluation
2nd stage	Expansion of management organization	• To expand scope of operation of guarantee system through co-operating banks • To absorb personnel from financial institutions and foster professional personnel
3rd stage	Establishment of independent guarantee institution	• To secure capital funds, organization and personnel • To switch to direct guarantee method

Source: Ministry of Reconstruction, *Reconstruction White Book*, p.14, 1957.

5.2. Proposals regarding Raising Financial Resources

It is suggested that the legal basis for securing financial resources for the credit guarantee fund should be prepared for the stable operation of the credit guarantee system. The capital for the credit guarantee should be secured through contributions from the government, financial institutions, SMEs and other interested parties. Success or failure of the credit guarantee system depends on the credibility of guarantee institution, and it is very important to secure financial resources and the capital to maintain credibility. Possible sources of funding for a credit guarantee institution are as follows:

① Paid-in capital at the time of establishment
- ■ Contributions from government (central/municipal)
- ■ Contributions from financial institutions
- ■ Contributions from enterprises
- ■ Contributions from associations and entities related to SMEs

② Lawful aid capital provided by domestic and overseas organizations for the purpose of advancement of SMEs

③ Operating income of the credit guarantee fund

④ Membership fees from SMEs, etc

5.2.1. Government's Role

The most important prerequisite for the introduction and implementation of a credit guarantee system is the formation of financial resources because the lack of financial resources can lead to a lack of credibility in the guarantee system. Therefore, the government of a developing country should prepare the legal basis for mobilizing financial resources, making contributions to the credit guarantee fund through budget allocation and playing the role of promoting active participation of financial institutions and other interested parties in mobilizing of financial resources. In implementing the guarantee system, it is useful to set the contribution rate of the central government higher than that of financial institutions or SMEs at the early stage of the guarantee institution's establishment. When financial markets expand and financial institutions are able to stand on their own, it will become possible to supplement financial requirements through contributions from financial institutions and guarantee fees from enterprises even though the contribution rate of the central government gradually declines.

5.2.2. Contributions from Financial Institutions

In order to ensure the stable operation of a credit guarantee system and mitigate the difficulty in securing financial resources, contributions from financial institutions can be as indispensable as the government's financial support for a developing country. Through a guarantee system, financial institutions can reduce costs associated with lending to SMEs in terms of evaluating credit and collecting on bad debt. Furthermore, financial institutions can also benefit from increased interest income from increased lending and increased access to potential prime customers. Therefore, it is necessary to have financial institutions participate in securing financial resources from the viewpoint of promoting a mutually beneficial relationship with financial institutions.

- Financial institutions required to make contributions: all financial institutions which are registered under the Banking Act, operate business and are eligible to use credit guarantee system
  - ☞ Foreign banks which have been established under the Banking Act in a developing country and operate business are to bear the same legal and social responsibilities as domestic banks.

- Method of contributions: It is necessary to institutionalize a mandatory contribution system for the stable formation of financial resources.
  - ☞ In case of Korea, financial institutions' contributions to credit guarantee fund are mandatory under the law.
  - ☞ In case of Japan, financial institutions' contributions to credit guarantee fund are not required by law.

- Timing of contributions: It should be stipulated by law that financial institutions also make contributions periodically as the government does.

- Contributions rate: The contributions rate applicable to financial institutions should be determined flexibly in consideration of the government's policy goals, economic state of the nation, financial conditions of the credit guarantee fund and the like.
  ☞ In case of Korea, a financial institution is required to make periodical contributions at a certain ratio of total enterprise loans (average outstanding balance) subject to calculation of contributions.

5.3. Construction of Financial and Human Resources Infrastructure

After the introduction of a credit guarantee system, a developing country that lacks a solid financial infrastructure should build up a credit information database and a network for sharing credit information. The credit guarantee institution should accumulate various credit information on SMEs such as financial and non-financial information, and historical default information. This information should be stored in a database and used as a basis for evaluating SMEs with growth potential. Credit information infrastructure built up over a long period of time can provide a foundation not only for the construction of a credit rating system but also for the establishment of reasonable financial policy and the advancement of the financial industry.

For the early activation of a credit guarantee system, it is also necessary to strengthen the education and training of financial professionals, and to foster professional that have the skills to evaluate SMEs. In particular, it is necessary to strengthen training and education programs for guarantee evaluation reviewers on credit analysis and evaluation. It is also important to build up a knowledge management system to promote information sharing within the organization and disseminate know-how on analysis and evaluation accumulated through experience. It would also be meaningful to consider the introduction of a training system like the Korea Banking Institute to nurture professionals for guarantee institutions and financial institutions. It is also necessary to provide professionals with educational opportunities by dispatching them to advanced countries.

5.4. Considerations regarding Operation of Credit Guarantee System

5.4.1. Moral Hazard of a Guarantee Institution

For sound operation of a credit guarantee system as an independent institution, it is essential to prevent moral hazard within financial institutions and enterprises but also the guarantee institution itself. In particular, since the demand for guarantee far exceeds the supply in the financial market of a developing country, the decision to provide a guarantee has great impact on an enterprise, which can easily lead to moral hazard.

Such moral hazard greatly deteriorates the reliability of credit guarantees, and there is a strong likelihood that the growth and advancement of a guarantee institution can be impeded by providing guarantees to unqualified enterprises. Therefore, a guarantee institution should minimize the possibility of moral hazard through continuous promotion of ethical codes, strict supervision and audit.

5.4.2. Introduction of Partial Guarantee System

As government contributions increased to offset losses in the aftermath of an expansion in guarantee support during the process of coping with the Asian currency crisis, KODIT introduced the ‘partial guarantee system’ in order to ensure the sharing of loan risk between financial institutions and the guarantee institution, and to prevent moral hazard within financial institutions. Under the partial guarantee system, the guarantee institution and financial institutions share the losses arising from guaranteed loans based on a certain ratio. This system was first introduced on December 1, 1998 in connection with entrusted guarantees and was expanded to direct guarantees from April 1, 1999.

The introduction of the partial guarantee system sought to prevent moral hazard in connection with entrusted guarantees and to encourage sound operation of credit guarantees. In the meantime, a task force was organized, comprised of two officials from the Ministry of Economy and Finance, one from KODIT, one from KOTEC, one from the Korea Federation of Banks, and eight from commercial banks. An agreement between the guarantee institution and financial institutions on implementation of the partial guarantee system was finalized on March 15, 1999.

The coverage ratio under the partial guarantee system at the time of introduction was in principle set at 80-85 percent in case of a new guarantee and 90 percent in case of renewal. But the coverage ratio applied to banks that did not contribute funds was set at 70-80 percent. Thus, the ratios were differentiated between institutions that contributed funds to the institution and did not. Different ratios were also sued based on the characteristics of the funds used for loans. At present, KODIT applies a coverage ratio of 85 percent-50 percent depending on the credit rating of an enterprise and period of guarantee.

The introduction of a partial guarantee system could reduce non-performing guarantees by enhancing the risk evaluation capabilities of financial institutions. A full coverage guarantee can be more acceptable to banks and also lead banks to actively participate in the credit guarantee system, but it may hamper the advancement of the financial industry by weakening the risk evaluation functions of banks. When a full-coverage guarantee or a high-coverage guarantee is applied, banks may deal with highly risky loans, which would result in a higher rate of default of guarantees. The introduction of the partial guarantee system is very effective for the purpose of preventing moral hazard on the side of financial institutions. They have to strengthen their risk evaluation capacity to avoid more loss from possible defaults under partial guarantees.

5.4.3. Arguments on Long-Term and Large-Amount Use of Guarantees

The IMF and S&P have argued that the provision of excessive government-backed credit guarantees after the Asian currency crisis might cause distortions in the economy. The Bank of Korea argued that SMEs may become too dependent on guarantees which would lower the operational efficiency of financial resources allocated to the guarantee system. Of late, the government has sought to curb the provision of guarantees for enterprises that benefit from guarantees for over 10 years or large guarantees exceeding 1.5 billion won. This in turn would free up capital for new SMEs.

In general, SMEs suffer from a chronic shortage of capital and low profitability. So SMEs intend to roll over their guaranteed loans instead of repaying it at maturity. Consequently, the time span of using credit guarantee tends to become increasingly long. As SMEs rely too much on external capital resources and usually raise funds through loans from financial institutions, the amount of loans tend to become large in step with their growth. However, under an environment where financial markets lack flexibility due to lending practices centered on collateral, it is controversial to restrict and reduce unconditionally the supply of guarantee to enterprises which have used it for a long time or require a large amount.

Therefore, KODIT promotes the virtuous circle of funds by distinguishing good and healthy enterprises with growth potential from marginal and stagnant enterprises among enterprises, which have used it for a long time or require a large amount, by concentrating financial resources secured through selective reduction of guarantees on start-ups and enterprises with high growth potential. KODIT classifies enterprises, which have used it for a long time or require a large amount, into four groups according to their growth potential and credit rating: outstanding enterprises, potential enterprises, stagnant enterprises and marginal enterprises. Guarantee support for these enterprises are differentiated as follows.

Table 2-31 | Credit Guarantee Graduation Program of KODIT

Classification		Details
Long-term guarantee enterprise	Outstanding enterprises	■ Restricts new guarantees →Conversion to unsecured loans from financial institutions
	Potential enterprises	■ Charges additional guarantee fees, but new guarantees for growth allowed
	Stagnant enterprises	■ Restricts new guarantees and charges additional guarantee fees ■ Leads to guarantee graduation within five years
	Marginal enterprise	■ Restricts new guarantees and charges additional guarantee fees ■ Leads guarantee graduation within three years
Large-amount guarantee enterprise		■ Leads to partial repayment at maturity (10 percent recommended). ■ Charges additional guarantee fees

In the meanwhile, KODIT introduced a long-term installment-repayment guarantee system in April 2006 to help SMEs utilize capital in a stable manner. Under this system, the guarantee period is specified from the stage of application, so that a guaranteed enterprise can voluntarily establish a repayment plan and service it under various installment structures over a three- or five-year period. KODIT expects that this system will help enterprise graduate from the program.

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1. Meaning of Credit Guarantee System

1.1. Definition of Credit Guarantee System

Credit guarantee is a system designed to provide supports for enterprises which cannot normally get loans from financial institutions for lack of collaterals so that they may access funds smoothly, and it functions as a means of economic and financial policies. In particular, it helps SMEs which have only limited access to financial markets compared to large enterprises raise funds more smoothly and mitigates the financing gap between large enterprises and SMEs existing inherently in the financial markets. This makes it possible for them to grow together, and contributes to the sustained growth and advancement of the national economy.

1.2. Evolution of Credit Guarantee System

When today's credit guarantee system is defined as a system where credible institutions provide guarantees for enterprises which lack collateral so that they may smoothly raise funds, its origin may be found in the guarantee systems of France, Switzerland and Germany. In these countries, credit unions by locality and trade were formed in 19^{th} century based on local communities and guilds and specialized mutual guarantee institutions were established in early 20^{th} century.

In France, mutual credit organizations based on the principles of cooperatives were established around the same trade in late 19th century, dealing with financing and guarantee business. In early 20^{th} century, social consensus regarding the usefulness of these organizations spread and SCM (Societe de Caution Mutuelle) got into the legal system in 1917. This provided a momentum to promote mutual guarantee system[1].

Credit guarantee system was introduced in Switzerland a little later compared to France, but it is recognized as the prototype of modern credit guarantee system. In contrast to France where credit unions by trade evolved in line with the principles of cooperatives in latter half of 19^{th} century, the form of credit union by locality based on communities prevailed in Switzerland.

1. KODIT, "Credit Guarantee Systems of the World," p.13, 2005.

State governments and the Swiss federation of small and medium enterprises jointly established the Industrial Credit Guarantee Union (RGB: Regionale Gewerbliche Bürgerschaftsgenossen schaft) in Basel in 1923 as an advanced form of a credit union based on locality. And thereafter, the Central Federation of Industrial Credit Guarantee Unions established in Bern in 1935 evolved into Swiss Industrial Credit Guarantee Association (SVGB: Schweizerischer Verband der Gewerbliche Bürgschaftsgenossenschaft) under the support of the federal government. These two institutions form the central axis of the Swiss SME financing system[2].

In Germany where cooperatives remained powerful around the turn of the 20th century, guarantee associations (Garantieverband) with the nature of limited company were established for small- and medium- merchants and handicrafts under the influence from Switzerland.

The first of this kind was Berlin Guarantee Association formed in 1933, and starting in 1954 in Hamburg, credit guarantee unions were established nationwide[3].

In Japan, under the influence from the German trend, guarantee associations based on locality were established, starting with the establishment of Credit Guarantee Corporation of Tokyo in 1937, and the National Federation of Credit Guarantee Associations was formed in 1955. The Small Business Insurance Corporation (Currently JFC : Japan Finance Corporation) which is a re-insurance institution wholly invested by the government was incorporated in 1958. JFC and local credit guarantee associations advanced in parallel into a two-tier credit supplementation system.

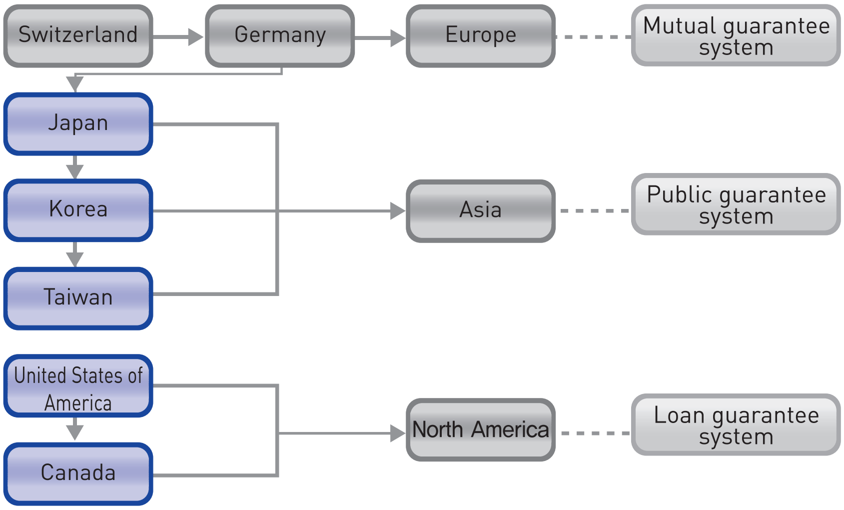
Taiwan government had credit guarantee systems of various countries studied, and, with the approval of the Executive Yuan, established Small and Medium Business Credit Guarantee Fund (SMEG) in 1974. Asian countries, including Indonesia (in 1971), Malaysia (in 1972) and Nepal (in 1974), recognized the usefulness of credit guarantee system and introduced guarantee systems suitable for their respective reality.

In the United States of America which has kept the tradition of market economy, a credit guarantee system with its own characteristics evolved. The United States used to have a view that a guarantee system runs counter to the market economy, but after 1950 recognized the importance of SMEs in economic growth and deeply felt the necessity of a financial system to support SMEs. Thus, the Small Business Administration (SBA) was established as a federal agency in 1953, and guarantee programs were put in place under Article 7 of the SME Act 1970 which provided the ground for introduction of loan guarantee system. A loan guarantee system was introduced in the United Kingdom and Canada which had economic management methods

2. KODIT, "Credit Guarantee Systems of the World," p.13, 2005.
3. National Federation of Credit Guarantee Association, "History of Credit Guarantee," pp. 1-7, 1992.

similar to those of the United States, and made great impacts on introduction of guarantee system by the countries in Central and South America which were within the sphere of influence of the United States[4].

Figure 2-1 | Routes of Spread of Credit Guarantee System



2. Application of Credit Guarantee System

Parties interested in credit guarantee system can be classified into guarantee institutions which operate guarantee, financial institutions and SMEs which are objects of guarantee, and guarantee system can be classified into 'mutual guarantee system', 'public guarantee system' and 'loan guarantee system', depending on how interested parties operate the guarantee system.

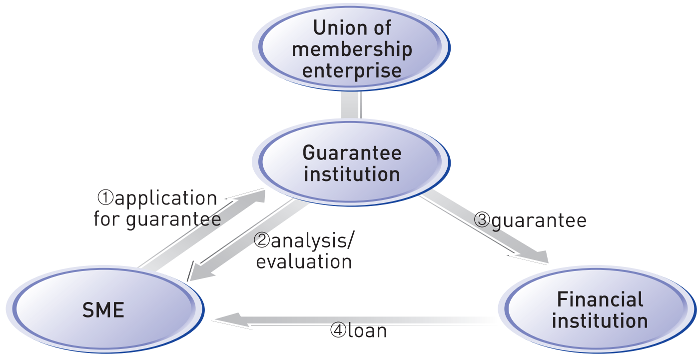
2.1. Mutual Guarantee System

In case of mutual guarantee system, member enterprises establish a mutual guarantee union as the operating body. The union raises the funds for guarantee through contributions or investments by member enterprises and provides credit guarantee for the members. Originating from the mutual assistance system of medieval guilds, this system is mainly operated in European countries such as Italy, Spain and Switzerland, and is the oldest form of modern credit guarantee systems.

4. Levisky, Jacob, "SME Guarantee Scheme: A Summary," *The Financier*, Vol. 4, No. 1&2, pp. 5-11, May 1997.

Under the structure of mutual guarantee system, SMEs engaging in the same trade or doing business in the same locality establish an entity to represent their common interests, and the entity provides credit guarantee for individual member enterprises, thereby helping them resolve the problems in financing. In the relationship between the SMEs and the guarantee institutions, the problem of 'asymmetry of information' can be mitigated because the guarantee institutions know the objects of guarantee well as their members.

Figure 2-23 | Outline of Mutual Guarantee System

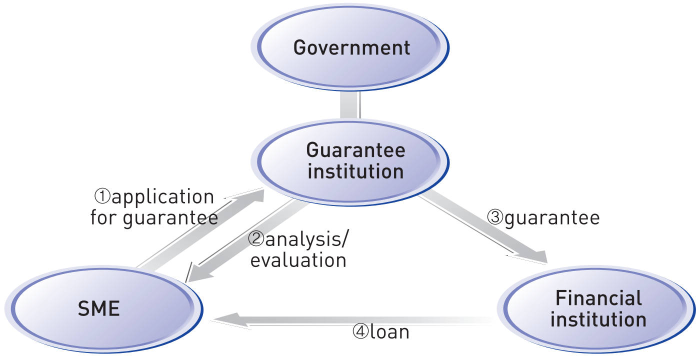


2.2. Public Guarantee System

Under public guarantee system, building financial resources of guarantee institutions mainly depends on contributions or investments by government, and independent guarantee institutions operate the system and provide guarantee support for unspecified enterprises. This system is used in Asian countries such as Korea, Japan and Taiwan. Under this system, the relationship among guarantee institutions, financial institutions and SMEs is clearly established, and guarantee institutions make their own policies and operate credit guarantees as independent institutions.

Under the structure of public guarantee system, guarantee institutions depend on the contributions or investments by government for building their financial resources, and the final liability of performing guarantee obligations is also borne by government. Accordingly, this system has a more credible and powerful guarantee function compared to other types of guarantee system, and is mainly utilized as part of economic and financial policies because of the high degree of government intervention. Guarantee institutions need relatively large organization in order to perform the functions of their own analysis and evaluation, and have the characteristic that their guarantee operation is of large scale.

Figure 2-24 | Outline of Public Guarantee System



2.3. Loan Guarantee System

In case of loan guarantee system, unlike mutual guarantee system or public guarantee system, there is no independent credit guarantee institution. This system is operated in the form of a government program, with the contributions or investments by government as its financial resources. Eligibility to credit guarantee services, limits on guarantee and other guarantee conditions are predetermined, and entrusted financial institutions provide guarantees for loans meeting the requirements and are compensated for their losses arising from such guarantees. This system is used in countries like the United States of America, the United Kingdom and Canada which have a strong tradition of market economy and mature financial markets, and in Central and South American countries which introduced the system through support from these advanced countries.

Under the loan guarantee system, the government focuses on indirect management such as management of the government budget, selection of financial institutions and management of guarantee limits. But, the practical guarantee operations are entrusted to financial institutions under this system. As the system is operated not by independent institutions but by as part of government program, it is difficult to operate the system systematically and SMEs' awareness of the system is low, but the costs for operating the system are relatively low.

Figure 2-25 | Outline of Loan Guarantee System

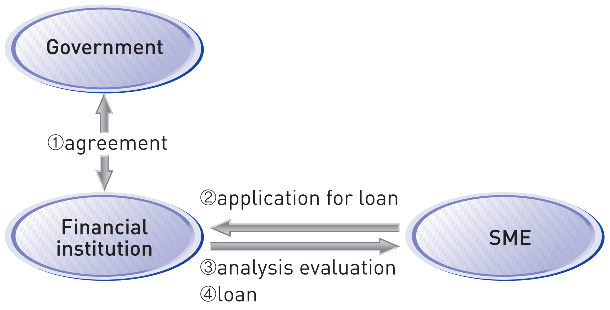


Table 2-32 | Characteristics by Type of Credit Guarantee System

Classification	Mutual guarantee system	Public guarantee system	loan guarantee system
Operating body	Association of enterprises	Independent guarantee institution	Bank
Form of guarantee	Guarantee by institution and counter-guarantee by government	Guarantee by institution	Guarantee by government
Subject to guarantee	Member enterprises	Unspecified enterprises	Unspecified enterprises
Credibility	Low	High	Medium
Guarantee amount	Small	Large	Medium
Guarantee utilization	Medium	High	Low
Operating countries	Europe	Asia	America

3. Functions of Credit Guarantee System

3.1. Fixing Market Failures in SME Financing

Financial institutions in major countries of the world show a passive attitude toward SME financing due to its intrinsic problems. Credit guarantee system is utilized as the best policy measures to correct such failures of the financial market for SMEs. The failures of the market for SMEs financing occur because there continues to be McMillan Gap[5] which implies that SMEs are marginalized in loan markets despite increase in supply of loans due to the asymmetry of information between SMEs and financial institutions in raising capital. The major causes for such discriminatory phenomenon in financing are as follows:

Factors Limiting the Access of SMEs to Financing

❶ High transaction Costs for Small Loans

Loan administration costs (such as information collection costs and follow-up management costs) are fixed regardless of loan size, and this makes the loan administration costs per unit higher in case of SME loans. In SME lending, financial institutions do not have much experience and costs for management of loans get higher, which makes the institutions less inclined to extend SME loans.

❷ Asymmetry of Information

This refers to the phenomenon that creditors face the uncertainty on repayments of loans because debtors have more information than creditors concerning the success potential of business, the ability to repay loans, etc. Because of this, it is difficult for financial institutions to grasp credit positions of SMEs correctly, and they impose higher risk premium on SMEs.

❸ Risks of SME Loans

SMEs are of small scale, do not have much experience in doing business and using financing, lack abilities to manage risks and respond to changes in external environment, and their default rates are relatively high. Financial institutions take into consideration the risks of SME loans and tend to avoid extending loans to SMEs.

❹ SMEs' Lack of Collateral

Financial institutions demand collateral from SMEs to supplement their low creditworthiness and reduce lending risks. But this practice limits the accessibility of SMEs to loans even if they have excellent business plans.

It is recognized that credit guarantee can resolve the problem of distortion of SME financing markets by removing the uncertainty which financial institutions have about SME loans, improving their lending practices and mitigating the problem of SMEs' lack of collateral.

5. In a report published in 1931 in the United Kingdom by the McMillan Commission in which J.M. Keynes and others participated, it was argued that there existed a discriminatory financial gap because SMEs faced difficulties relative to large enterprises in financing start-up and long-term funds and also had limitations in accessing direct-financing markets.

3.2. Contribution to Growth of National Economy

The significance of credit guarantee system can be found not only in that it corrects the failures of the SME financing market but also in that it is recognized as a policy measure contributing to the growth of the national economy. Credit guarantees do not have direct impact on economic growth but are recognized as enhancing productivity of enterprises by making SME financing easier and as facilitating economic growth by uplifting economic indicators such as increase in investments and employments by enterprises. In addition, credit guarantee contributes to the balanced growth of the national economy by mitigating the polarization between large enterprises and SMEs through removing the discriminatory phenomenon in financing that SMEs are marginalized compared to large enterprises in loan markets.

Also, credit guarantees which are provided in step with change in economic conditions play the role of mitigating business fluctuation. While SME lending shows pro-cyclicality in that its scale expands at time of business boom but contracts at time of recession, credit guarantee plays a counter-cyclical role in that it helps SMEs by facilitating SME financing at time of recession as a policy tool for economic stimulus.

3.3. Contribution to Advancement of SMEs and Financial Industry

If the function of credit guarantee system is grasped from the micro perspective, its meaning can be viewed in the narrow aspect of the main users of guarantee, namely SMEs and financial institutions. As for SMEs, credit guarantee system enhances accessibility to formal financing and makes it possible to raise additional capital. This leads to inducement of active investments by enterprises, production and creation of added value, and plays a role of enhancing profitability and productivity. A study6 shows that enterprises taking advantage of credit guarantee can strengthen the competitiveness such as profitability and growth by making good use of leverage. In addition, if it is true that, as the economy grows, guarantee system will be operated giving the first consideration to enterprises with good creditworthiness, credit guarantee system can be said to induce the transition into credit-oriented society by encouraging credit-based economic acts and enhancing the ability to manage credit.

As for financial institutions, the function of credit guarantee is the learning effect, i.e. accumulation of experiences in SME financing. Financial institutions can foster their abilities to deal with SME loans and to manage them through credit guarantee system and can make improvements on collateral-centered financing practices so that they may, in the future, handle unsecured loans without involvement of guarantees.

Inter-Industry Effects

① Production Ripple Effect

– Production ripple effect of credit guarantee supply is measured through multiplying the guarantee supply by industry by the production inducement coefficient computed through inter-industry relations table.

production ripple effect = Σ(guarantee supply by industry × production inducement coefficient by industry)

② Value-Added Inducement Effect

– Value-added here means the net value created in the economy through credit guarantee supply and is measured through the value-added coefficient of the sector concerned in production ripple effect.

value-added inducement effect = Σ(production ripple effect by industry × value-added coefficient by industry)

③ Job-Creation Inducement Effect

– Job-creation inducement effect is estimated from the viewpoint that increase of production through guarantee supply connects with increase of job creation.

job-creation inducement effect = Σ(production ripple effect by industry × job-creation inducement coefficient by industry)

④ Employment Inducement Effect

– Employment inducement effect is a concept which excludes self-employed and unpaid employee working for family business in computing job-creation inducement effect. It is measured using employment inducement coefficient.

employment inducement effect = Σ(production ripple effect by industry × employment inducement coefficient by industry)

Effects of Guarantee Supply on Improvement of SME Financial Performance (by Enterprise Size)

Classification			Guaranteed enterprises			Non-guaranteed enterprises		
			2006	2007	2008	2006	2007	2008
Growth	total assets growth rate	micro	29.06	25.48	21.32	5.77	21.14	26.67
		non-external audit	45.22	16.39	14.65	13.11	11.39	17.23
		external audit	45.40	17.59	16.84	15.09	11.03	16.00
	sales growth rate	micro	14.87	13.93	19.57	5.57	24.68	22.54
		non-external audit	22.03	22.30	20.60	10.75	14.90	18.69
		external audit	10.54	12.95	23.15	9.20	14.07	19.35
	operating income growth rate	micro	11.65	14.34	14.08	-18.46	22.83	51.64
		non-external audit	28.79	31.38	39.58	25.63	25.44	31.20
		external audit	16.47	-10.22	-12.23	-10.57	-5.15	-5.10
	net income growth rate	micro	20.90	22.28	15.34	-17.90	30.53	16.49
		non-external audit	21.05	30.16	33.62	30.14	21.51	25.28
		external audit	-13.73	-71.32	81.93	-1.34	-7.55	9.84
Profitability	return on equity	micro	33.67	29.79	31.99	20.20	25.81	22.49
		non-external audit	21.74	18.12	19.83	16.77	16.46	15.11
		external audit	14.91	6.17	22.25	10.22	6.34	4.85
Efficiency	value-added ratio	micro	21.72	21.68	22.44	31.59	31.55	28.84
		non-external audit	25.86	25.15	24.83	30.87	29.99	28.31
		external audit	21.23	19.23	20.80	25.69	24.28	22.65
Stability	equity ratio	micro	50.19	48.33	48.74	54.49	51.37	48.17
		non-external audit	41.14	41.14	44.15	49.42	50.06	50.46
		external audit	34.58	31.92	33.44	51.75	51.63	50.06
	debt-to-equity ratio	micro	175.17	195.24	209.35	117.59	140.84	142.77
		non-external audit	244.96	236.22	197.53	169.22	168.90	151.75
		external audit	347.99	329.88	294.80	152.51	148.03	148.68
	borrowings dependency ratio	micro	33.46	37.20	36.46	27.59	30.58	34.75
		non-external audit	44.86	46.56	43.37	33.81	34.34	34.18
		external audit	53.27	56.62	54.05	30.85	31.62	32.31

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