

# Korea's Financial Industry and Capital Markets at a Crossroads

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# Contents

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- Questions for Korea's Financial Industry and Capital Markets
- Properties of the Korea's Financial Industry
- Properties and Future Direction of Korea's Capital Markets
- A Closer Look at the Korean Securities Industry
- Capital Markets and National Pension Service(NPS)
- Concluding Remarks

# Questions for Korea's Financial Industry and Capital Markets (1)

- ❖ Why is Korea's financial industry not as developed as real sector industries?
- ❖ Why doesn't Korea's financial industry have globally competitive companies? Why isn't there an equivalent of Samsung in the financial industry?
- ❖ Where can Korea's financial industry find a competitive edge?
- ❖ Why have most Korean financial companies not been successful in their overseas businesses?
- ❖ Financial markets and public finance/taxes: friends or enemies?

# Questions for Korea's Financial Industry and Capital Markets (2)

- ❖ What are the fundamental problems in the Korean capital markets?
  - Financing dimension, investment rate of return dimension
  - How to look at “volatility and liquidity”?
- ❖ Why should IBs be developed in Korea? Why aren't they advanced yet? What needs to be done to upgrade Korean IBs?
- ❖ What does NPS' economic influence mean for Korean capital markets and Ibs?

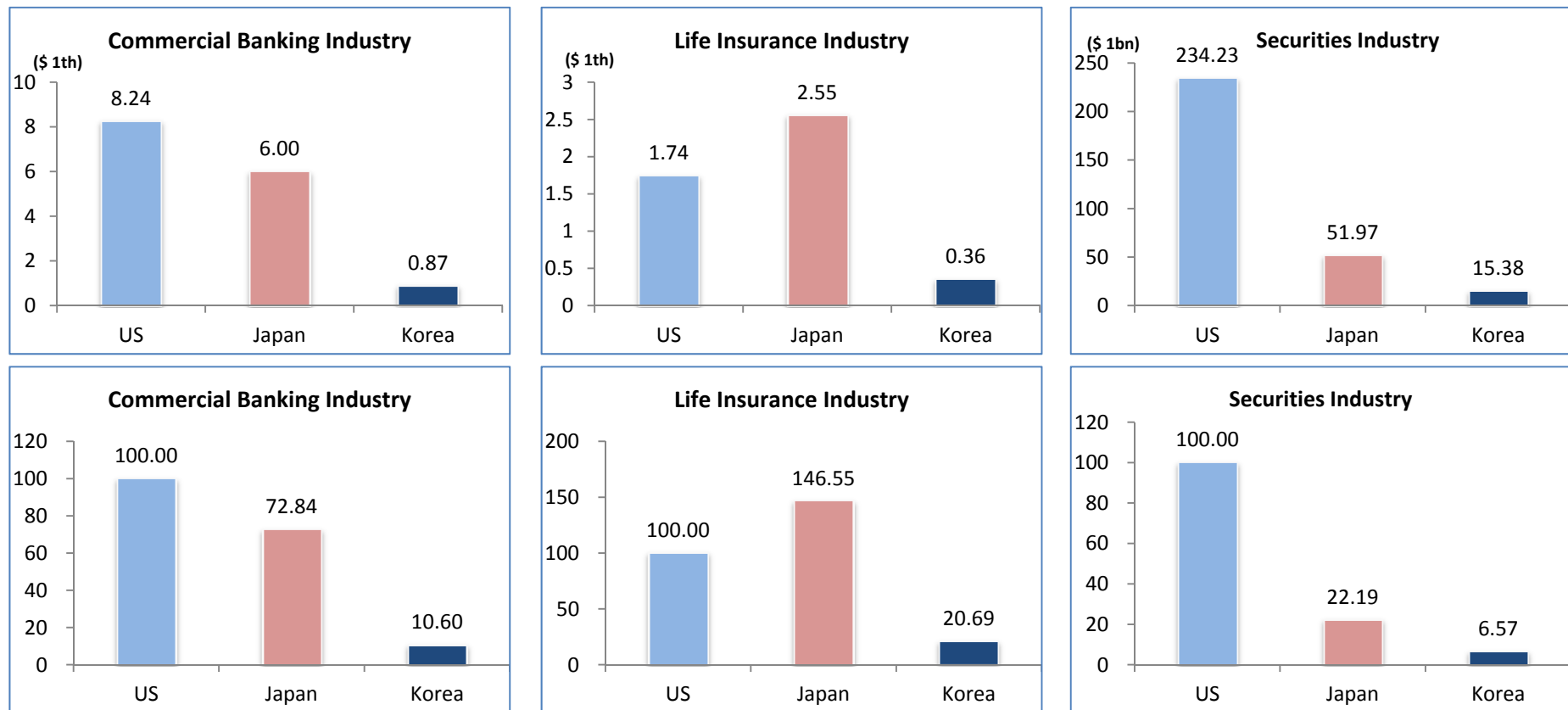
## Properties of the Korea's Financial Industry

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# Size of Financial Companies

- ❖ Korean financial companies are small compared to their global counterparts, especially in the securities industry

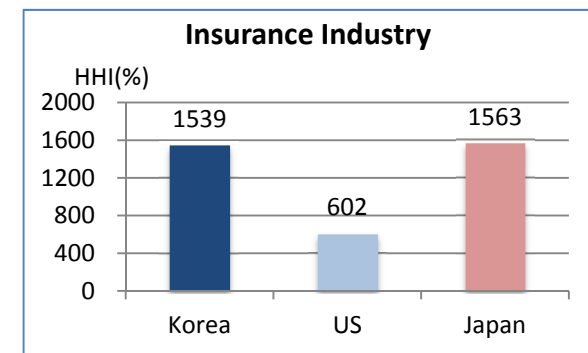
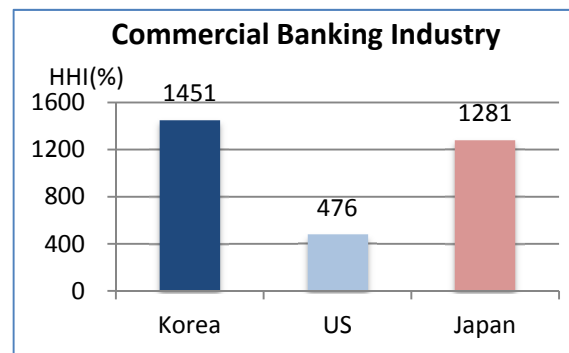
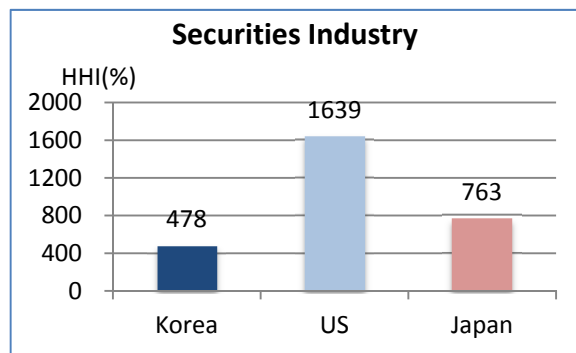
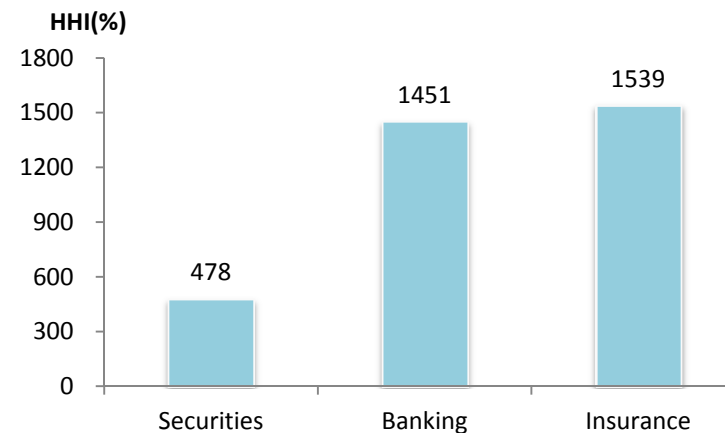
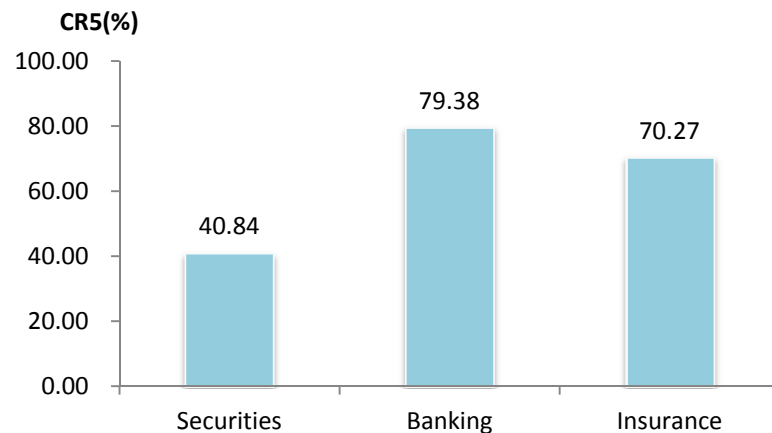
Comparison by country and sector



Note: CBs and Insurance cos- asset base, Securities cos- capital base  
Source: The Banker, 10-K or Annual report

# Concentration of Financial Companies

- ❖ In contrast to the commercial banking and life insurance industries, the securities industry is least concentrated in terms of market share
  - The securities industry does not have a clear industry leader

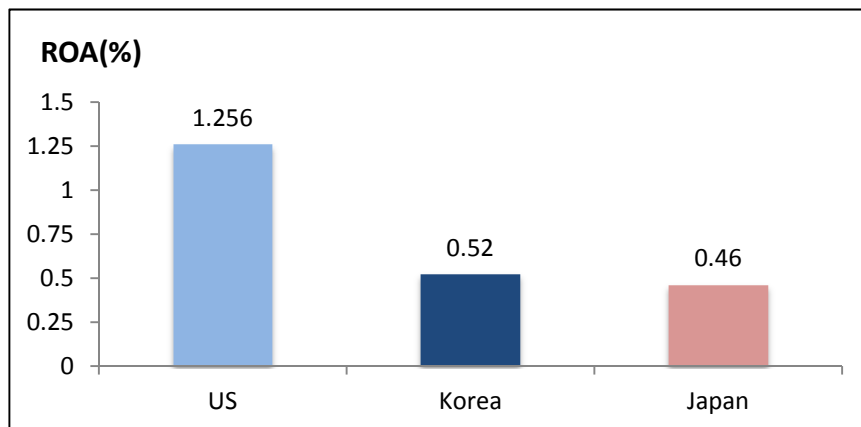
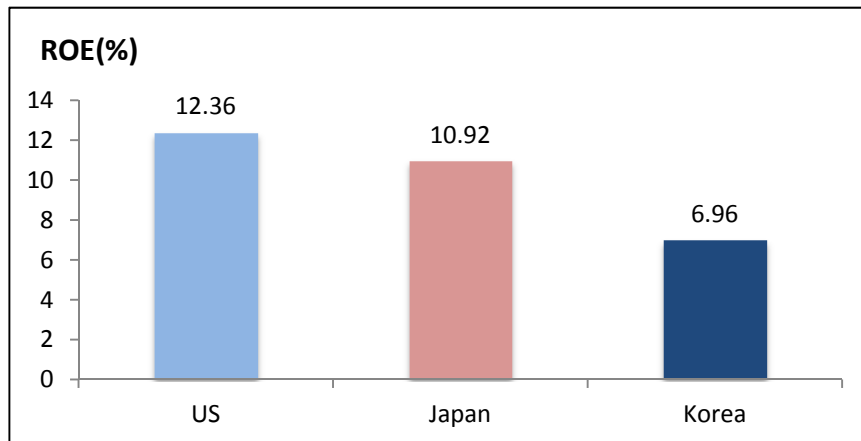


Source: The Banker, 10-K or Annual report(FY2012), Financial Supervisory Service

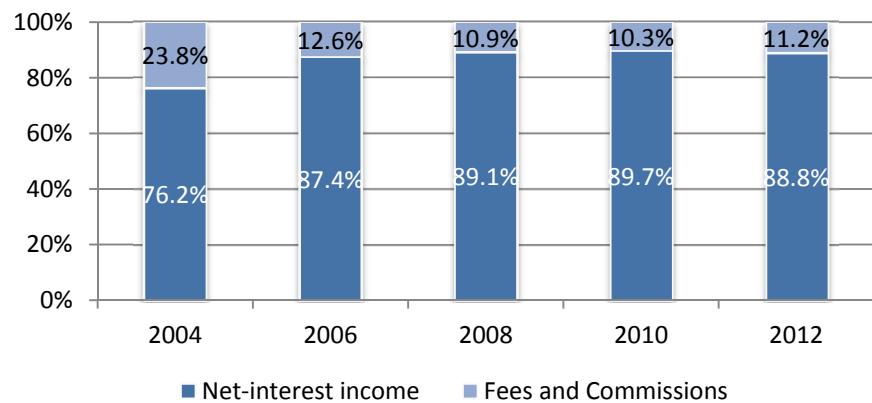
# Revenue Structure: Commercial Banks

- ❖ Korean banks' ROE is lower than their US and Japanese counterparts
  - Korean banks rely heavily on interest revenue

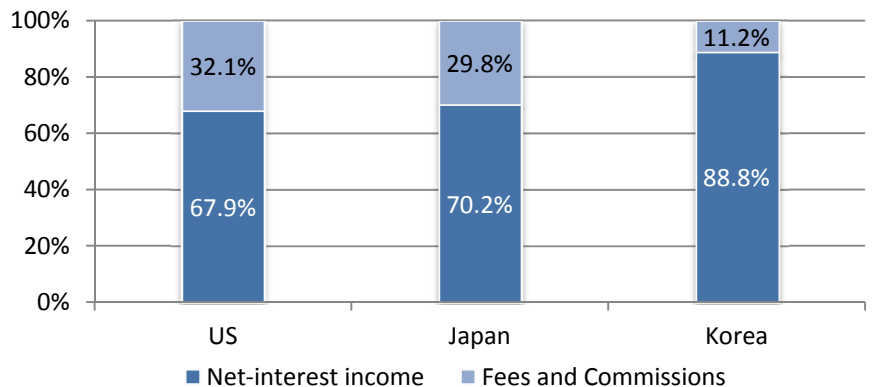
ROE and ROA of top 5 CBs (2012)



Korean CBs Revenue Structure



Revenue Structure of US and Japanese CBs (2012)

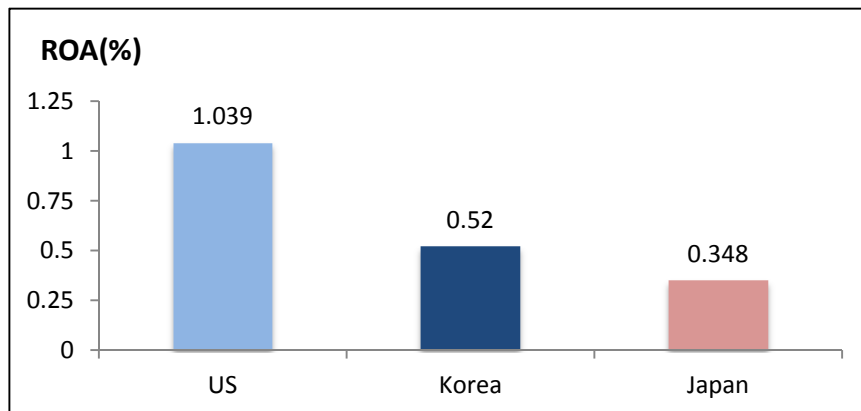
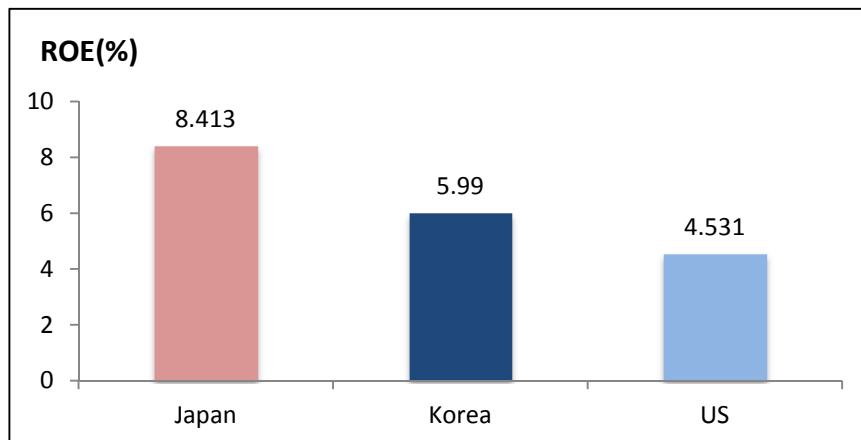




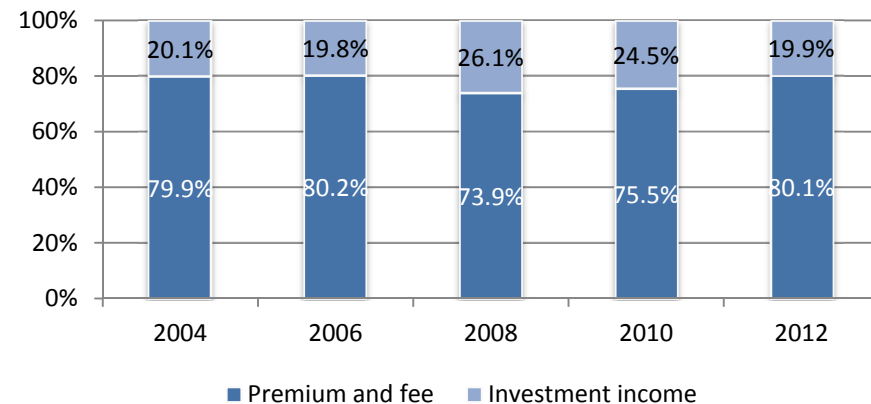
# Revenue Structure: Life Insurance Co.

- ❖ Compared to life insurance firms in the US and Japan, Korean companies' ROE and ROA rates are not bad
  - Korean life insurance firms depend heavily on insurance premiums

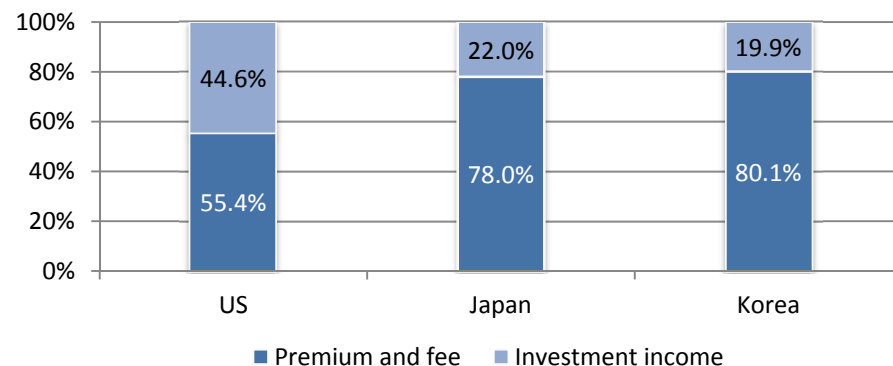
ROE and ROA of top 5 LICOs (2012)



Korean LICOs Revenue Structure



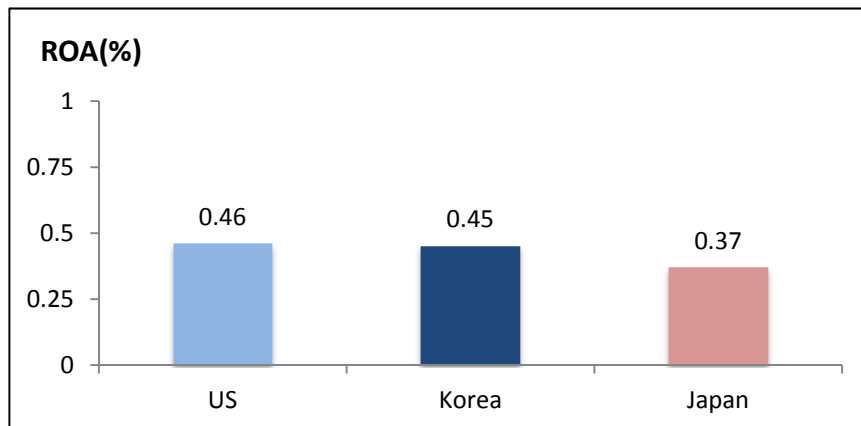
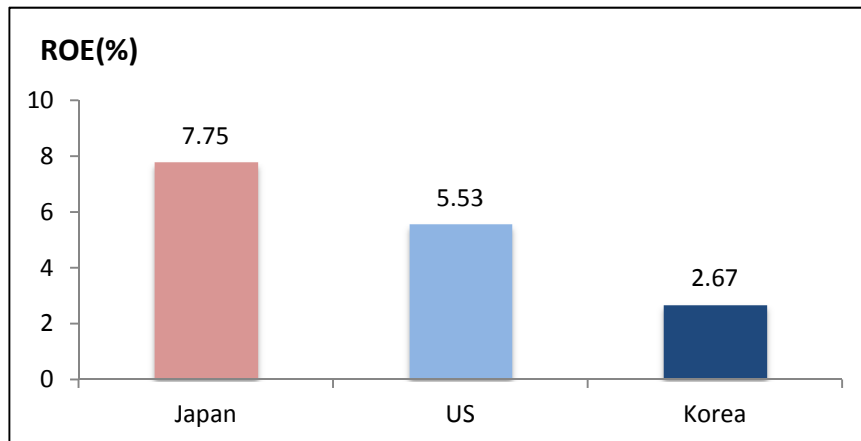
Revenue Structure of US and Japanese LICOs (2012)



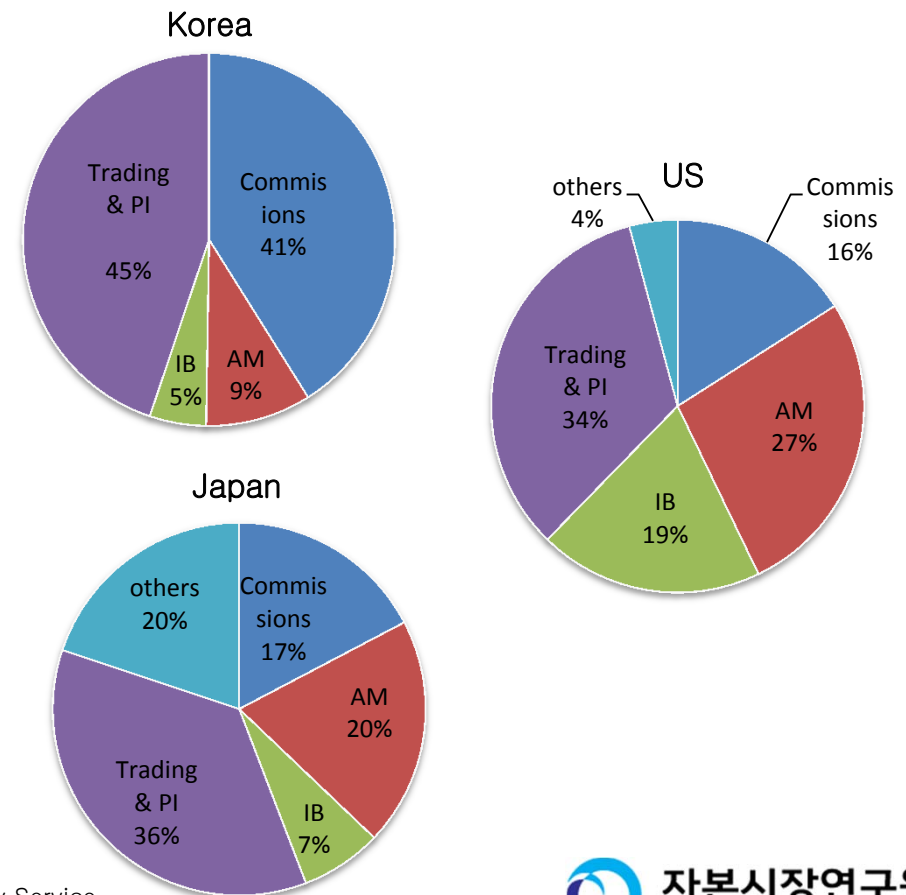
# Revenue Structure: Securities Co.

- ❖ Domestic securities firms show relatively low ROE, and brokerage still remains as their major source of revenue

ROE and ROA of top 5 Securities Co. (2012)

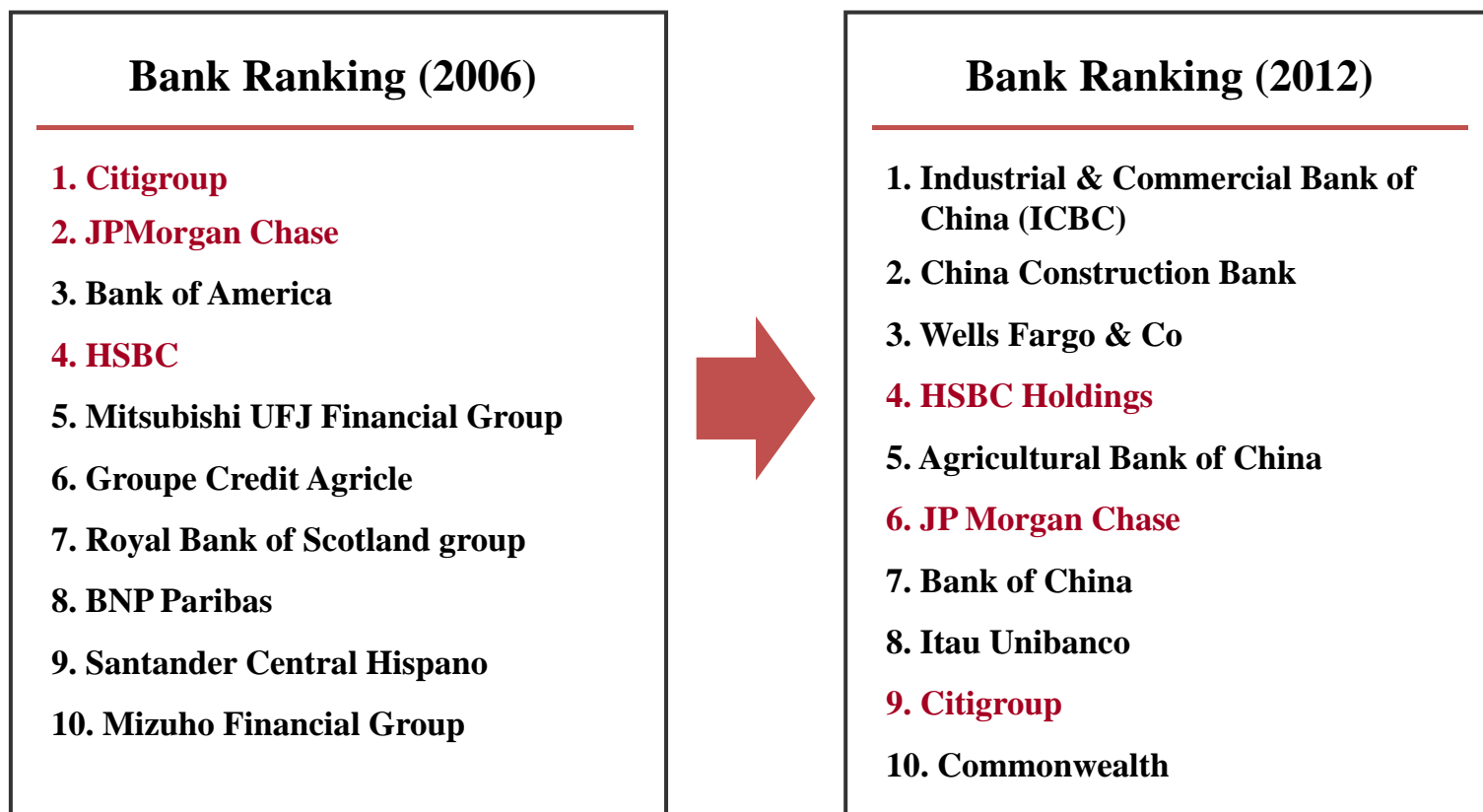


Revenue Structure of Securities Co. (2012)



# Change in Global Rankings: Commercial Banks

- ❖ The change in global banks ranking is attributed to the growth of Chinese commercial banks



Source: <http://www.relbanks.com>, EuroMagazine

# Change in U.S. Rankings: Commercial Banks

- ❖ Most top ten U.S. commercial banks maintained their top ten status

## U.S. Bank Ranking (2006)

1. Bank of America
2. JP Morgan Chase Bank
3. Citibank
4. Wachovia Bank
5. Wells Fargo Bank
6. Washington Mutual Bank
7. USBank
8. SunTrust Bank
9. HSBC Bank USA
10. West



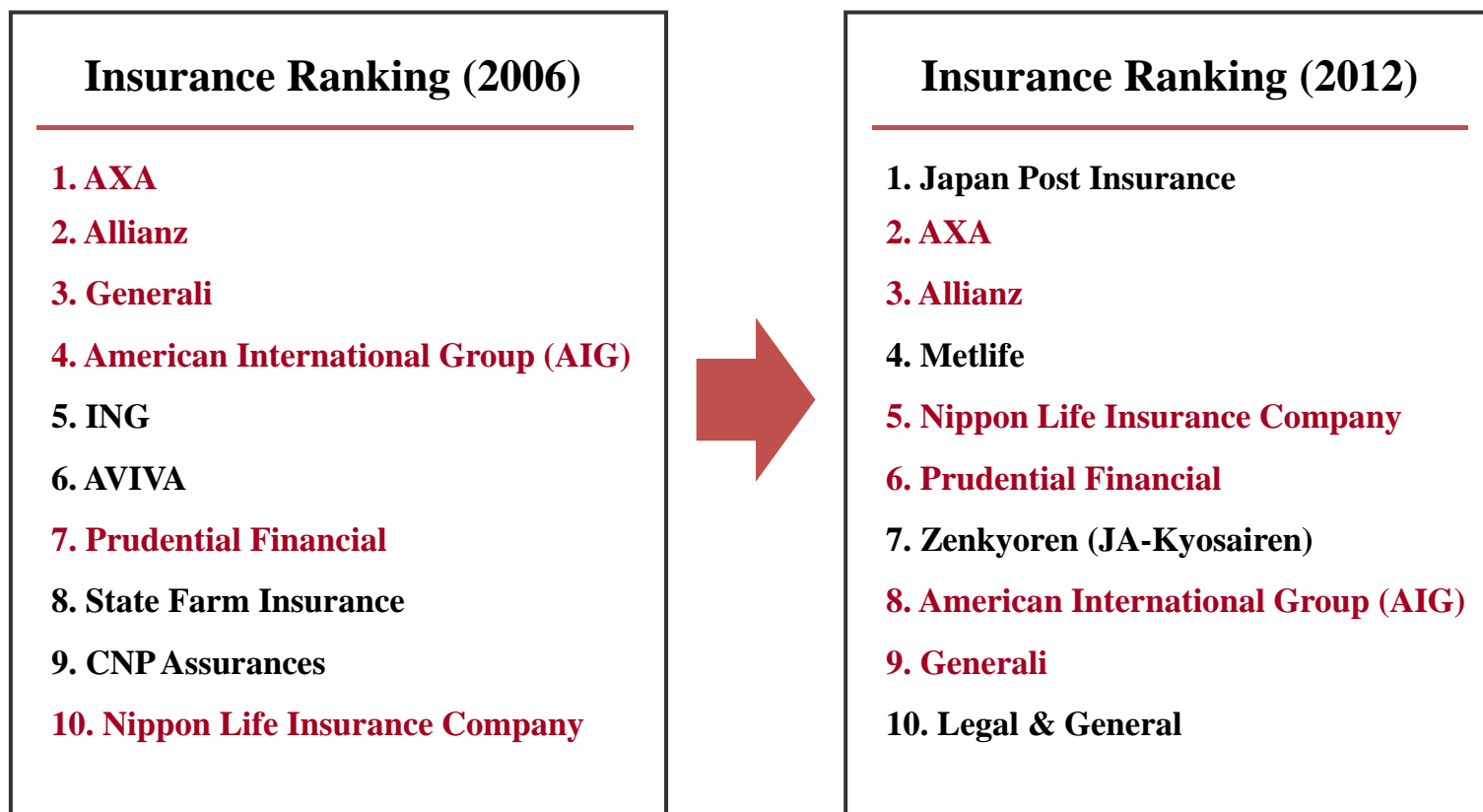
## U.S. Bank Ranking (2012)

1. JPMorgan Chase Bank
2. Bank of America
3. Citibank
4. Wells Fargo Bank
5. USBank
6. PNC Bank
7. The Bank of New York Mellon
8. HSBC Bank USA
9. FIA Card Services
10. TD Bank

Source: <http://www.relbanks.com>

# Change in Global Rankings: Insurance Co.

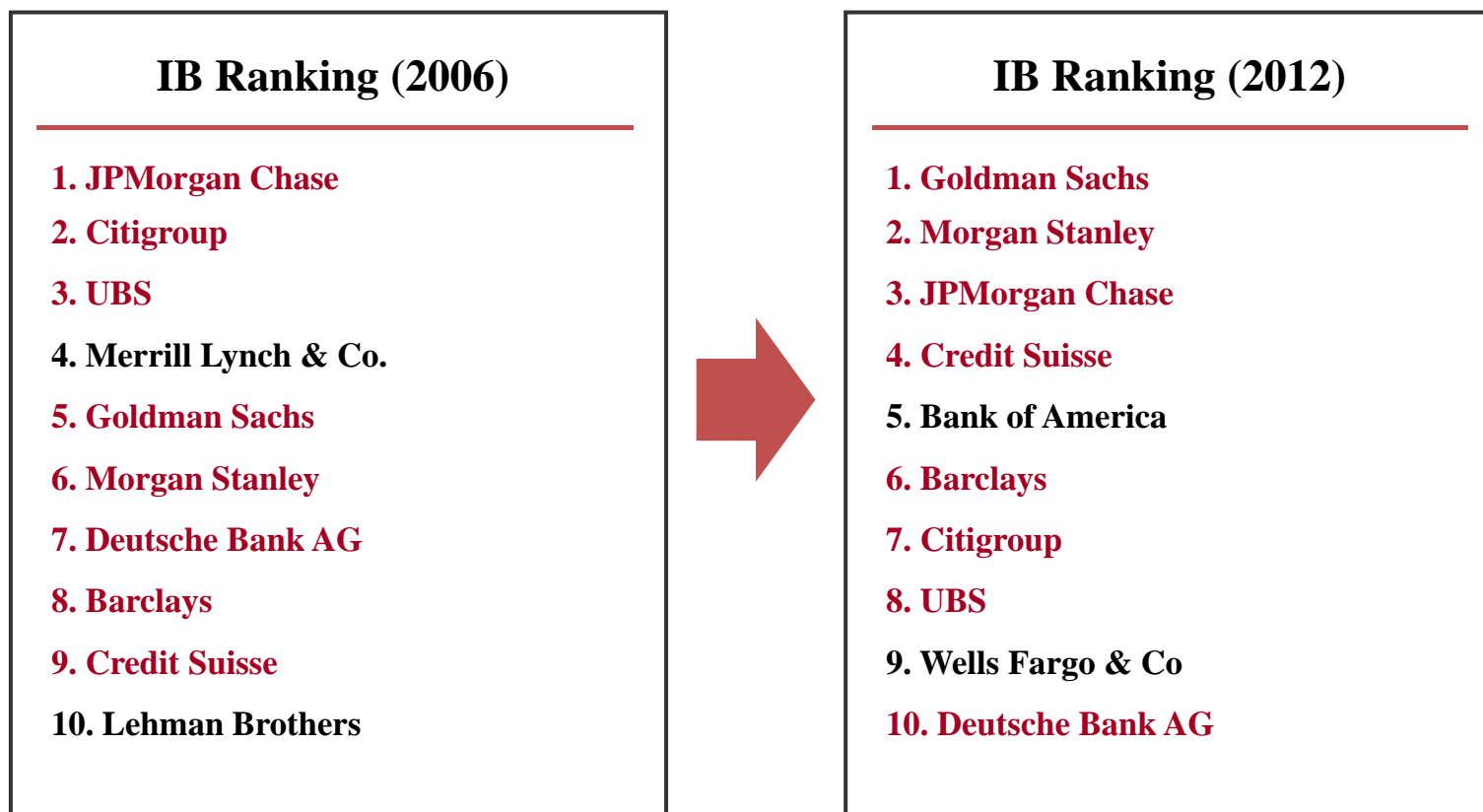
- ❖ Almost all top ten insurance companies remain in the top ten



Source: <http://www.relbanks.com>, Business Insight

# Change in Global Rankings: Investment Banks

❖ Same story, almost no change in the rankings



Source: <http://www.relbanks.com>, annual report, 10-K

# Change in Global Rankings: Asset Management Co.

- ❖ Most asset management firms stayed in the top ten

## Asset Manager Ranking (2006)

1. UBS
2. Barclays Global Investors
3. State Street Global
4. AXA Group
5. Allianz Group
6. Fidelity Investments
7. Capital Group
8. Deutsche Bank
9. Vanguard Group
10. BlackRock



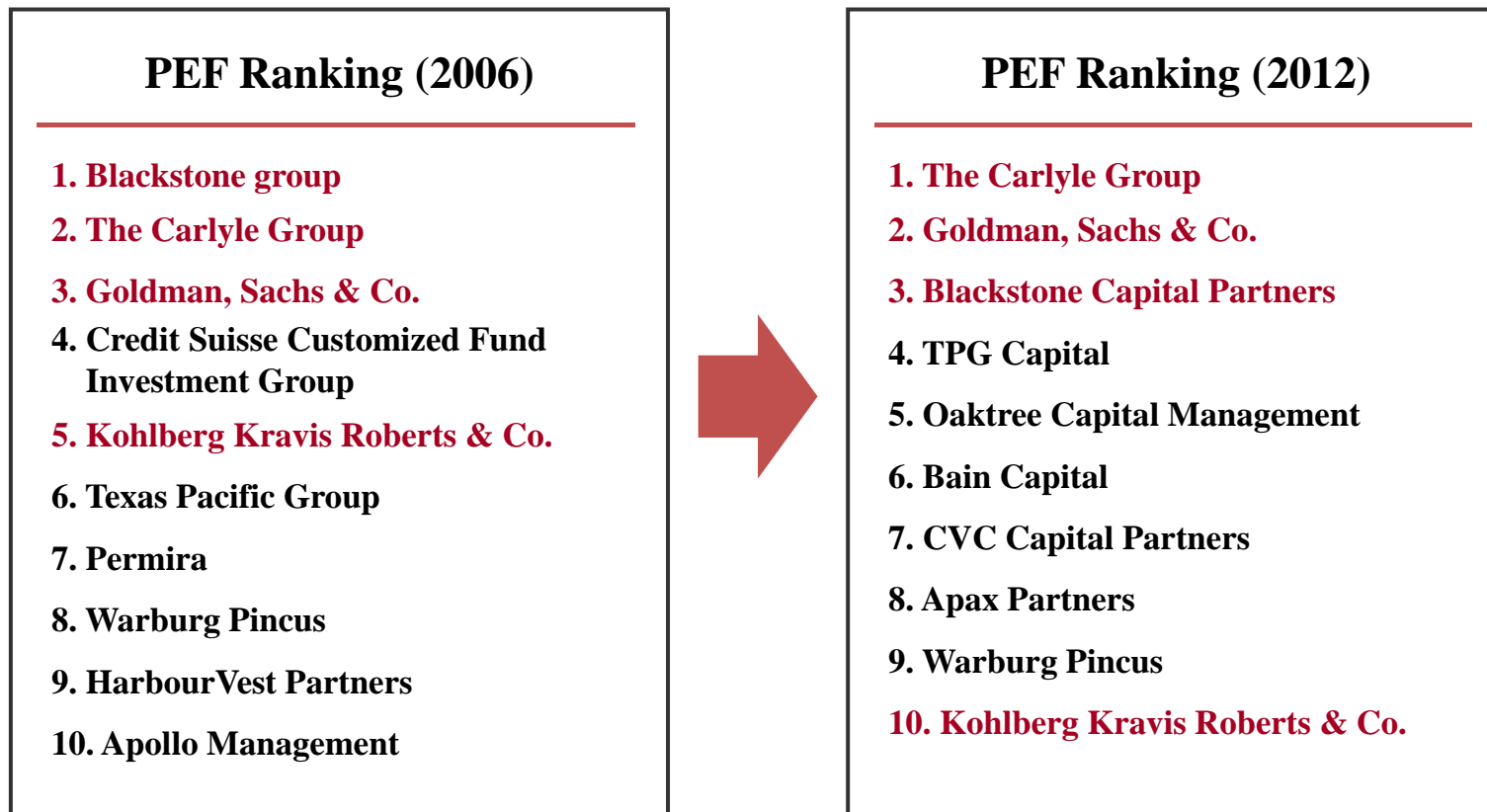
## Asset Manager Ranking (2012)

1. BlackRock
2. Allianz Group
3. State Street Global
4. Vanguard Group
5. Fidelity Investments
6. J.P. Morgan Chase
7. Bank of New York Mellon
8. BNP Paribas
9. Capital Group
10. UBS

Source: TowersWatson

# Change in Global Rankings: PEFs

- ❖ PEFs have shown significant change in their global rankings. The degree of change is second only to that of the hedge fund industry

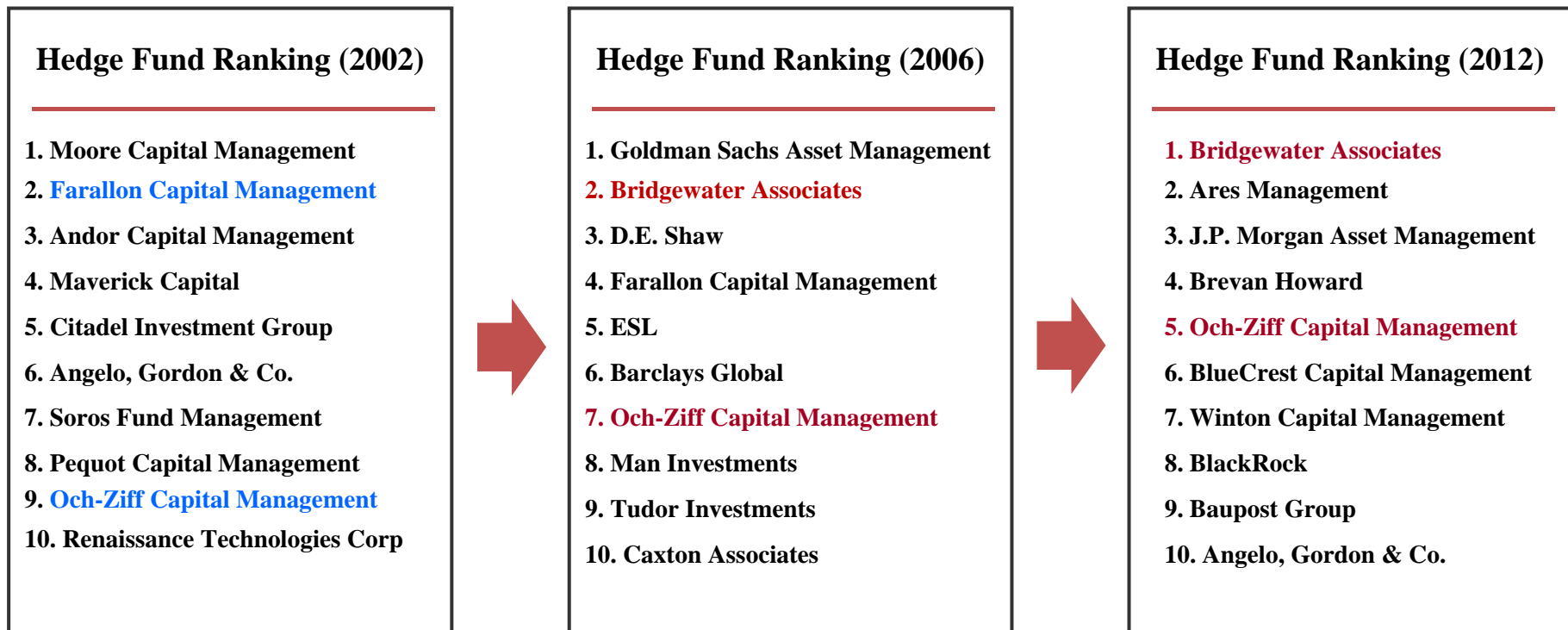


Source: TowersWatson



# Change in Global Rankings: Hedge Funds

❖ We can see tremendous shifts in the rankings of hedge funds



Source: TowersWatson

# Why isn't there an Equivalent of Samsung in the Financial Industry?

- ❖ As opposed to being an independent industry, Korea's financial industry has been regarded as a secondary industry that exists mainly to support the real sector industries
- ❖ Since domestic firms can survive in the domestic market, they have no sense of urgency about going abroad and looking for opportunities elsewhere
- ❖ We need to change the concept of the financial company in terms of global competitiveness
- ❖ We need to create strategies that will better utilize the “superpower” NPS

## Properties and Future Direction of Korea's Capital Markets

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# What are the Fundamental Problems in the Korean Capital Markets?

## ❖ Financing dimension

- IPO, seasoned equity financing, corporate bonds, ABS

## ❖ Investment rate of return dimension

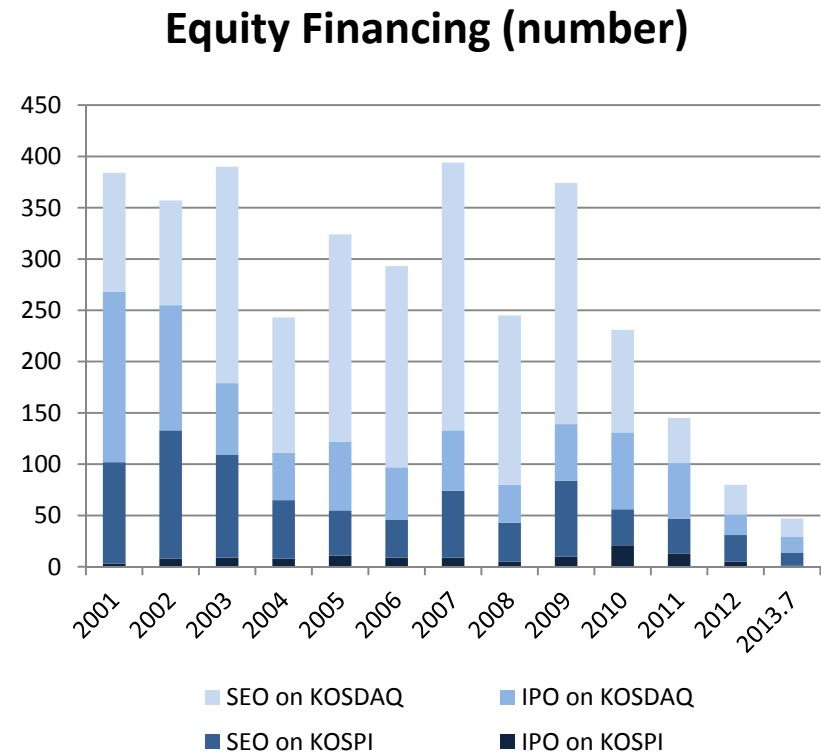
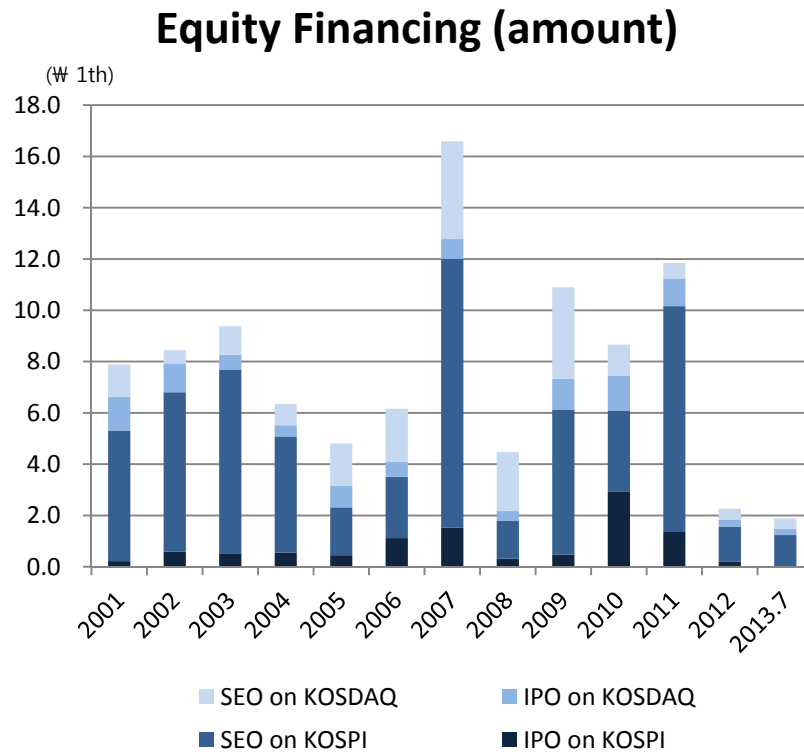
- Rate of returns of Equity, bonds, funds vs. rate of returns of savings (deposits),

## ❖ Future direction

- Financing dimension
- Investment rate of return dimension

# Changes in Equity Financing

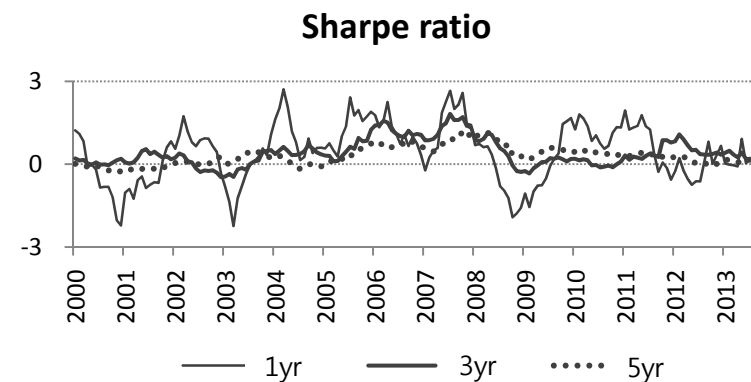
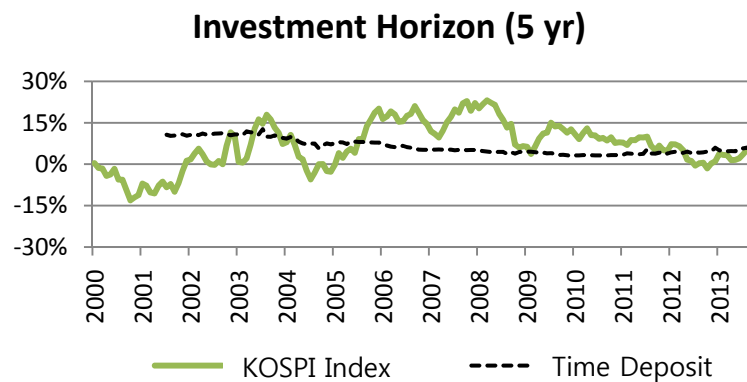
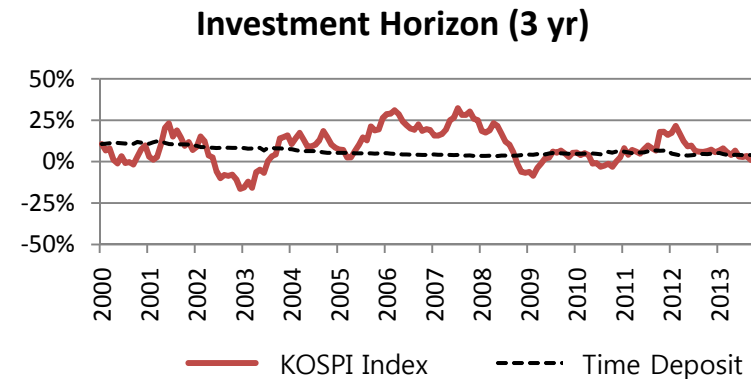
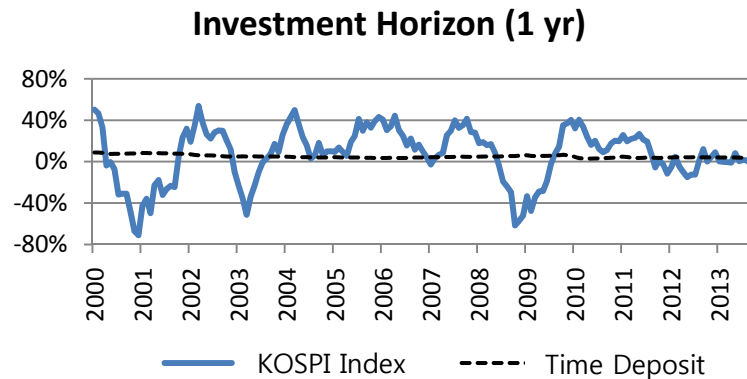
- ❖ The amount of equity financing has significantly shrunk
  - Large companies are increasingly using internal financing



Source: Financial Supervisory Service

# Equity Rate of Returns

- ❖ Until 2011 equity investments showed superior returns compared to deposit savings. However since 2012 there is almost no difference in returns

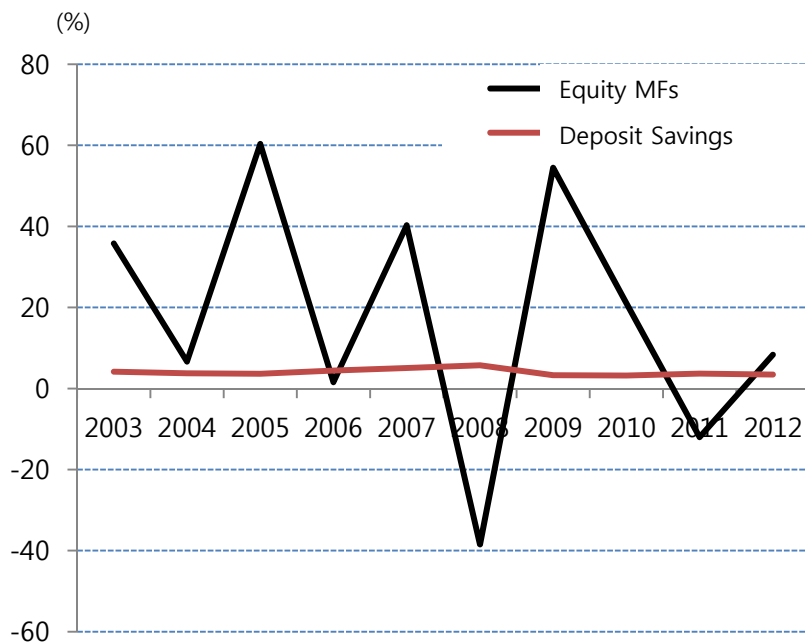


Source: DataGuide, Bank of Korea

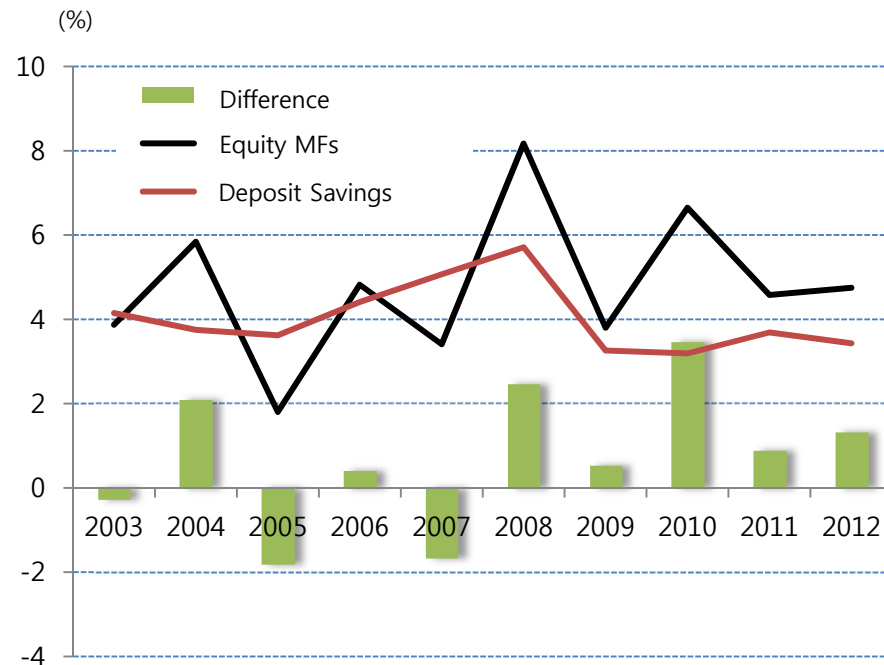
# Mutual Funds Rate of Returns

- ❖ Equity-type mutual funds: high volatility
- ❖ Bond-type mutual funds: consistent returns

Returns: Equity MFs vs. Deposit Savings



Returns: Bond-type MFs vs. Deposit Savings

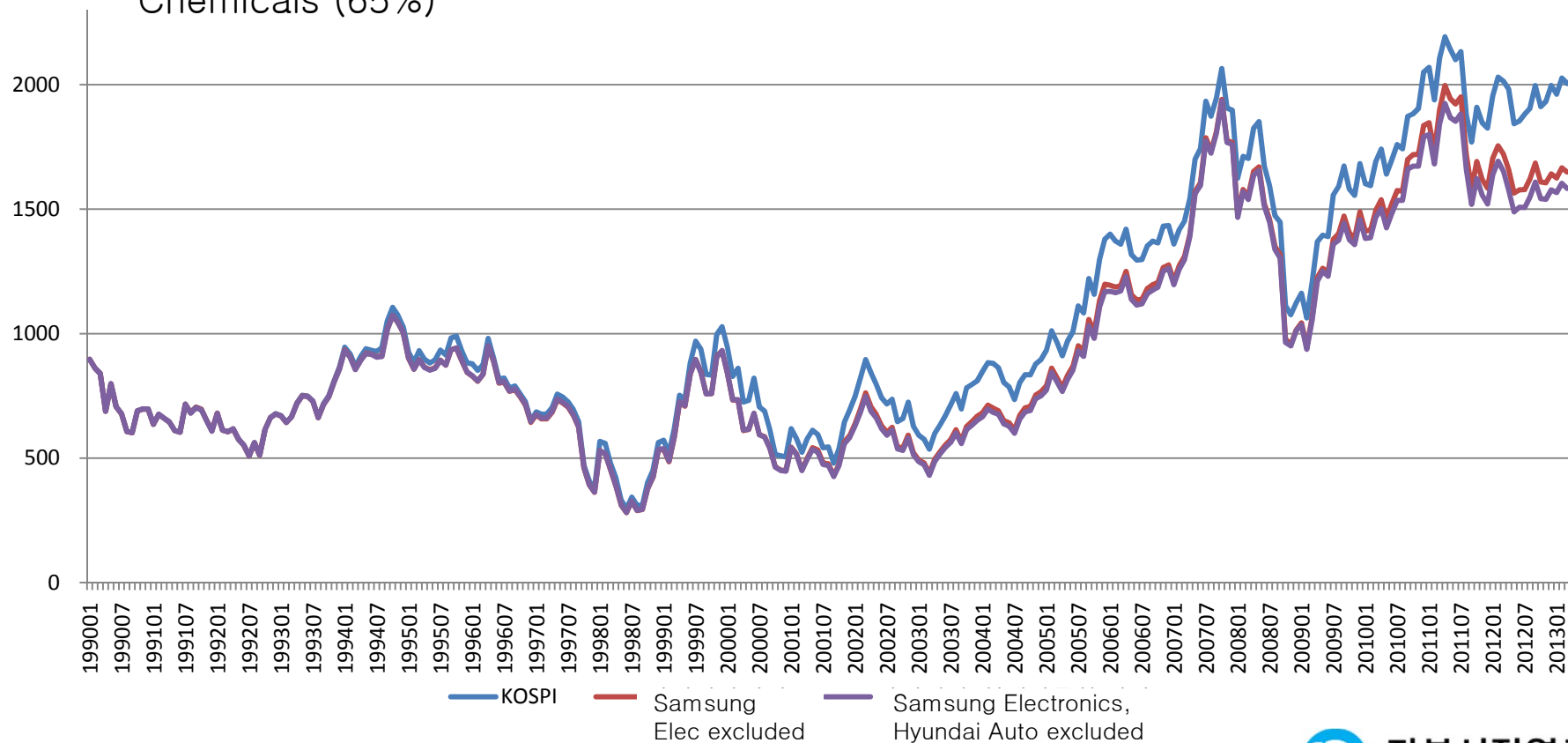


Source: Zeroin, Bank of Korea

# The Gap between the Stock Index and the Real Economy

❖ The determinants of the stock market are now different from those of the real economy

- Large corporations rely on overseas sales
- Foreign sales: Samsung Electronics (85%), Hyundai Motors (70%), LG Chemicals (65%)

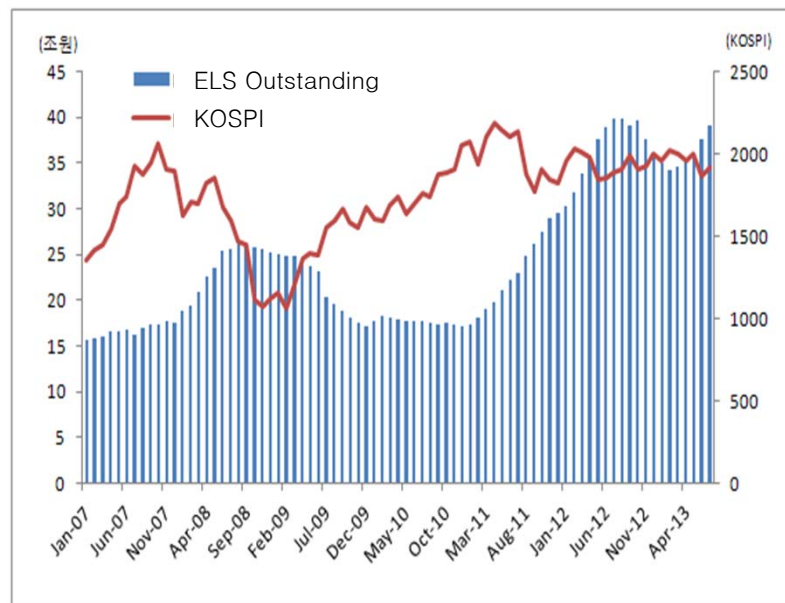




# ELS/DLS: The Most “IB-esque” Product

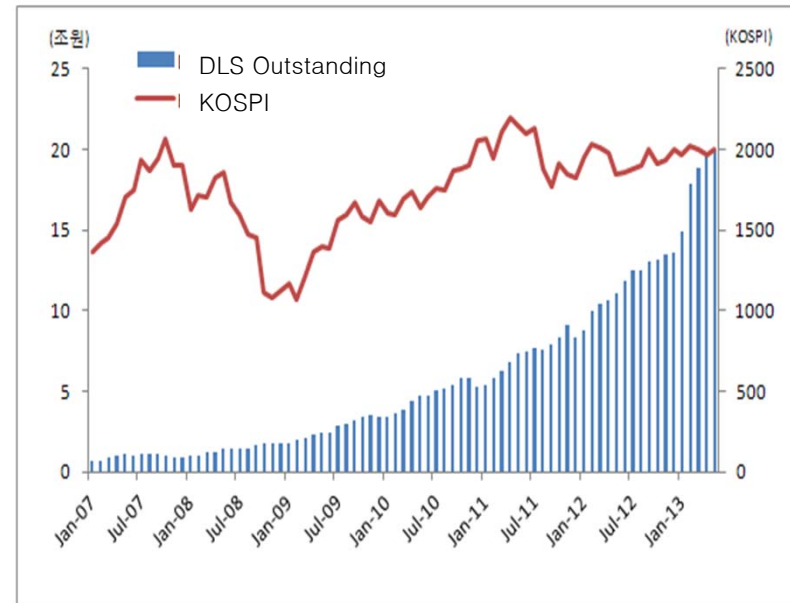
- ❖ Under low growth, low interest rate economy, ELS/DLS has grown and evolved as a middle risk middle return product

ELS Outstanding



Source: KOFIA

DLS Outstanding



Source: KOFIA

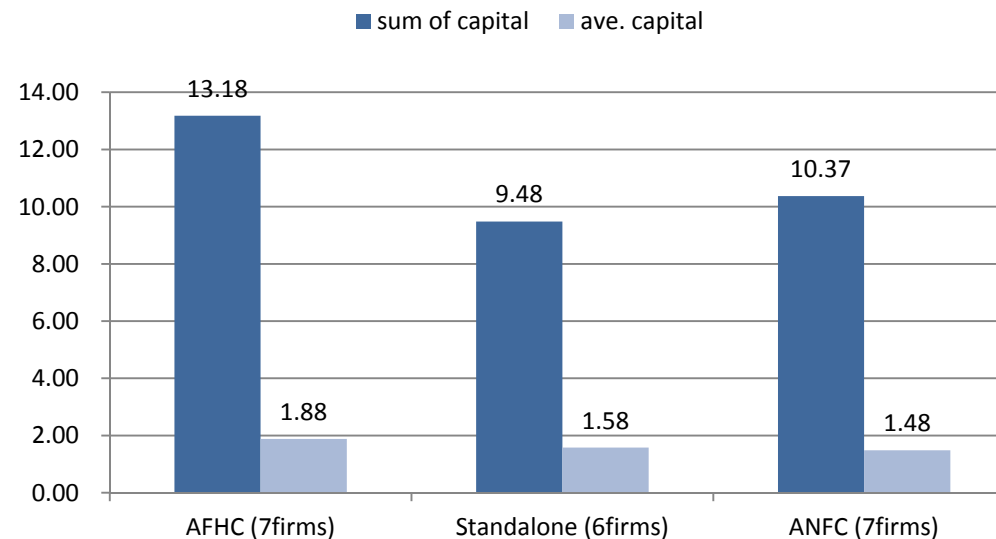
## A Closer Look at the Korean Securities Industry

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# Tripartite Market

- ❖ Korea's securities firms are divided into three groups
  - depending on affiliate types, each of which accounts for roughly one third of the industry's total capital
    - AFHC: Affiliates of financial holding company
    - ANFC: Affiliates of Non-financial conglomerates

Top 20 Securities Firms' Capital Size by Their Affiliate Type

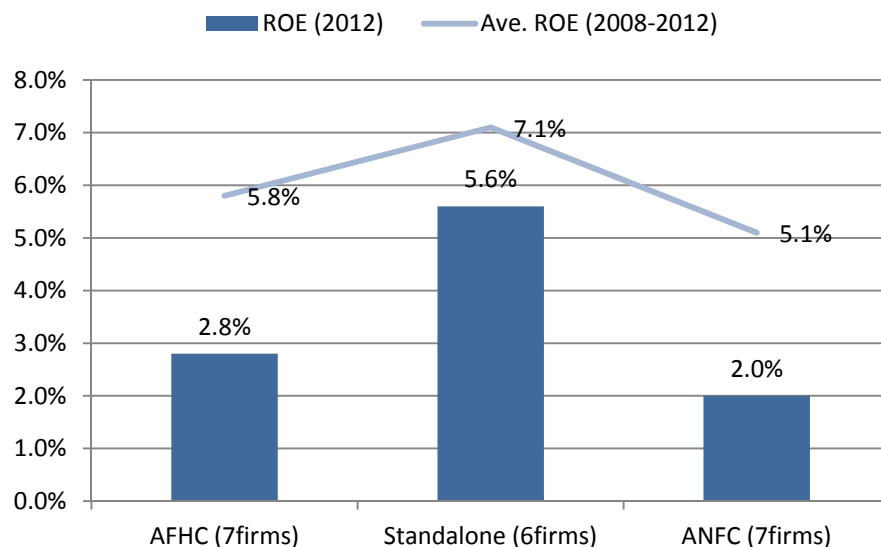


- a) Top 20 securities firms are selected based on their capital size in 2012. They take 85.5% of capital in the securities industry.  
b) Source: Financial Supervisory Service, DART

# Comparison by Affiliate Type: ROE

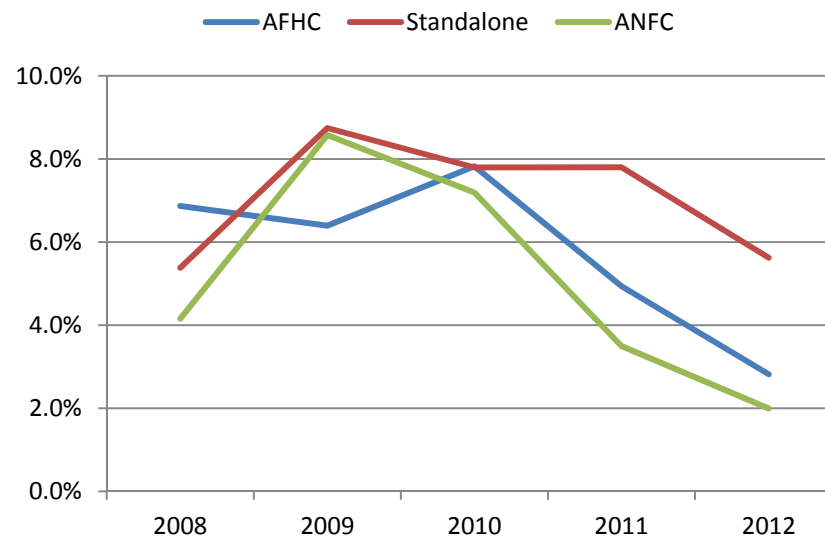
- ❖ Not only in 2012, but also over the last 5 years, standalones showed the best performance with highest ROEs

ROE comparisons by affiliate type



Source: Financial Supervisory Service, DART

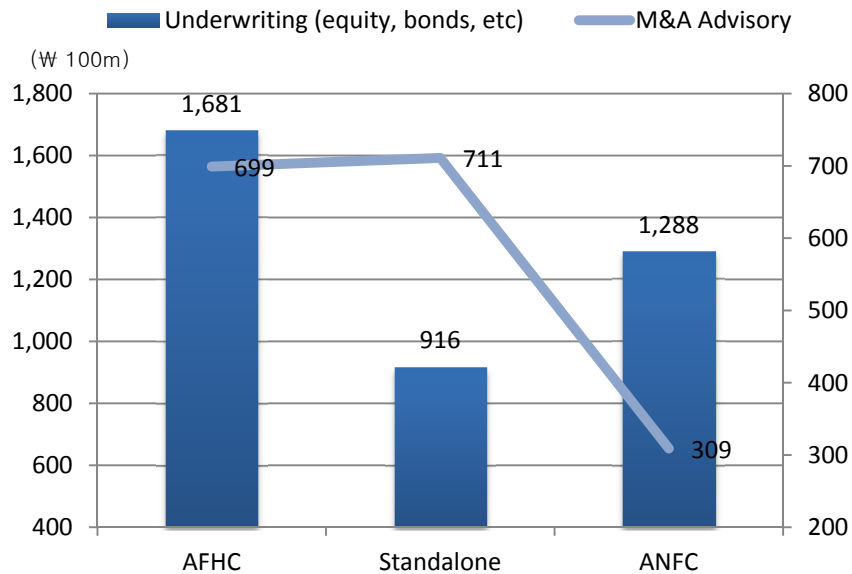
Recent ROE trends by affiliate type



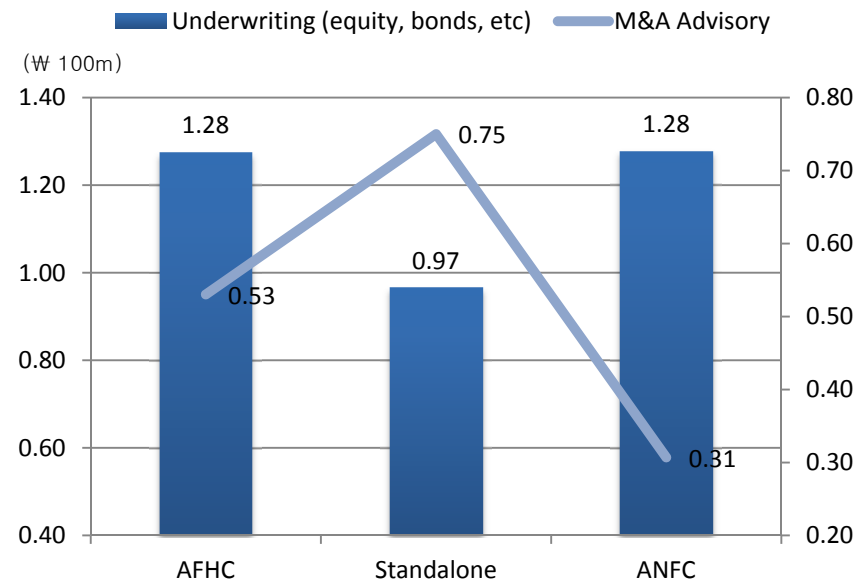
# Comparison by Affiliate Type: IB [1]

- ❖ Standalone players had high revenue in M&A advisory, while the others, AFHC and ANFC, had relatively high revenue in underwriting

IB revenues by affiliate type (2012)



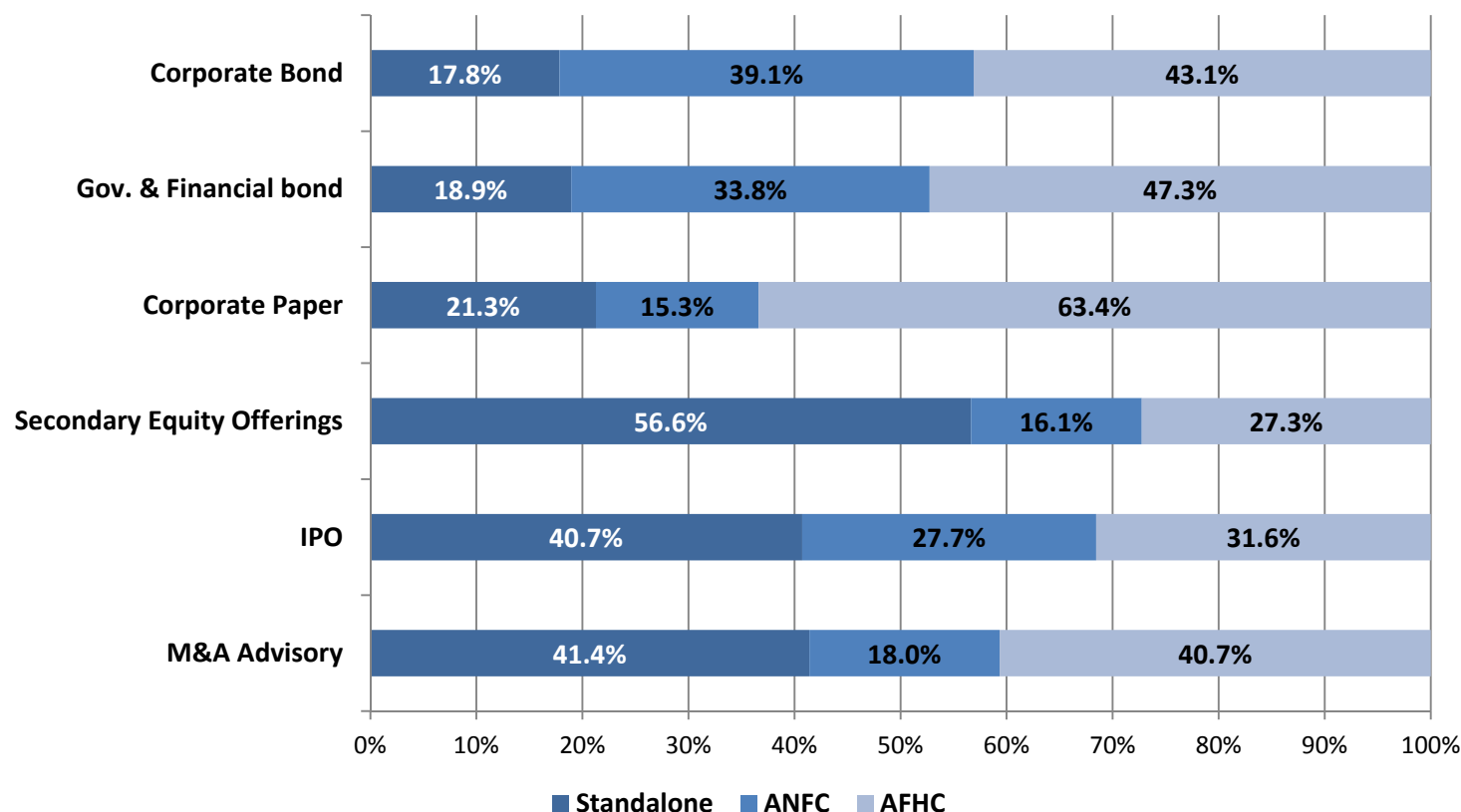
IB revenues per capital by affiliate type (2012)



Source: Financial Supervisory Service, DART

## Comparison by Affiliate Type: IB [2]

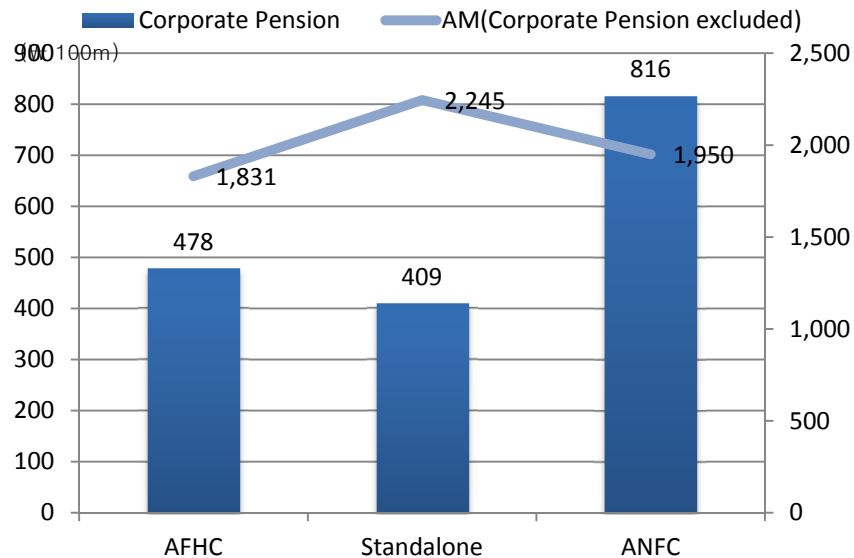
- ❖ Standalone had relatively high market share in M&A advisory and equity offerings, while the others showed strength in CP and bond underwriting



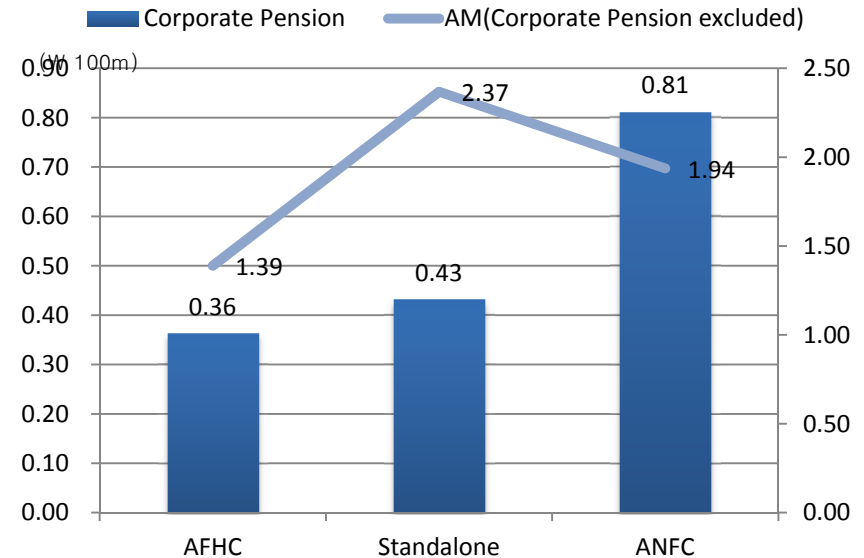
# Comparison by Affiliate Type: Asset Management

- ❖ Standalones have demonstrated a competitive edge in asset management except corporate pension
  - As for corporate pension, affiliates of non-financial conglomerates have shown the highest performance both in total revenues and in per-capital revenues

AM revenues by Affiliate type (2012)



AM revenues per capital by Affiliate type (2012)



a) Source: Financial Supervisory Service, DART

# Comparison by Affiliate Type: Implications

- ❖ Recently, standalones have shown relatively good performance and have been widening the competitive gap
- ❖ Standalones stand out in equity underwriting, M&A advisory, asset management (corporate pension excluded), and online brokerage
- ❖ Non-financial conglomerates affiliates have edges in CP, bonds, and M&A advisory
- ❖ Affiliates of financial holding companies are relatively good at government and corporate bond
- ❖ Implications for the way to strengthen investment banking firms



# Why aren't Korea's IBs advanced yet?

- ❖ In the IB market, there isn't even a clear domestic market leader, and obviously no regional leader
- ❖ IBs can only grow in an IB-friendly environment
- ❖ Products like ELS and DLS have been successful in depth and diversity and are potentially competitive strengths in the global markets
- ❖ In the low growth, low interest rate era, Korea's IBs need to extend their investment universe to the global market to provide excess returns to investors
  - FX business for hedging purposes
  - Double Decker Fund (Nomura Securities)

# Why have most Korean financial companies not been successful in their overseas businesses?

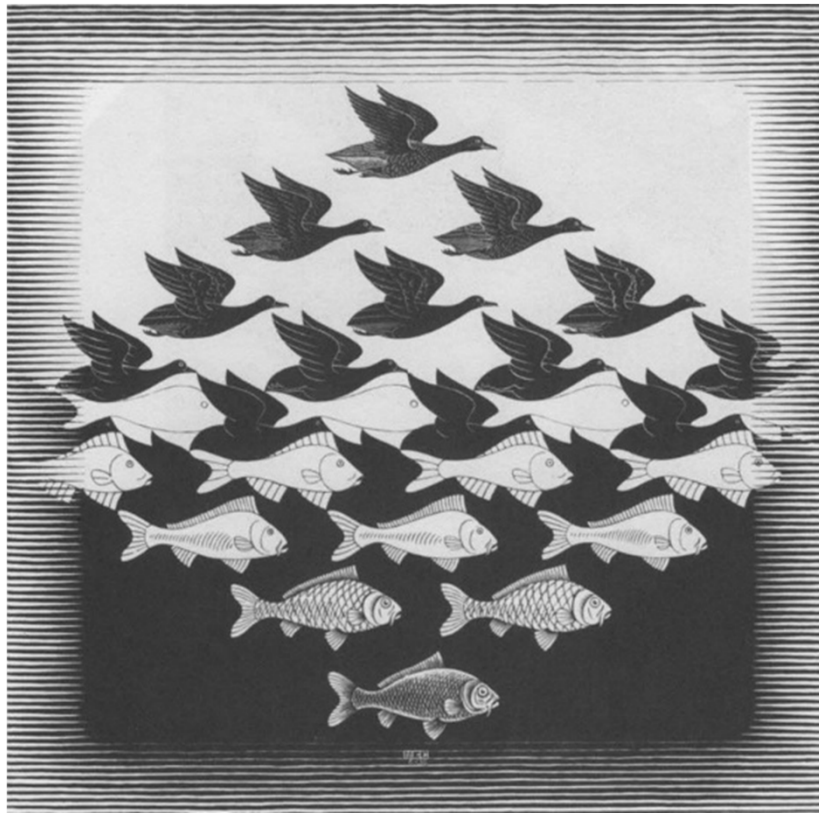
- ❖ Overseas expansion requires foreign talent and human resources. However, many Asian firms have had a difficult time retaining their foreign talent.
- ❖ Korean firms should consider acquiring IT platforms and trading systems in foreign markets
- ❖ The most powerful players (e.g., private equity, mutual funds) should move first, and financial intermediaries (e.g., securities firms) will eventually follow
- ❖ Take advantage of the global “superpower” National Pension Service (NPS)

# Financial Markets and Public Finance/taxes: Friends or Enemies?

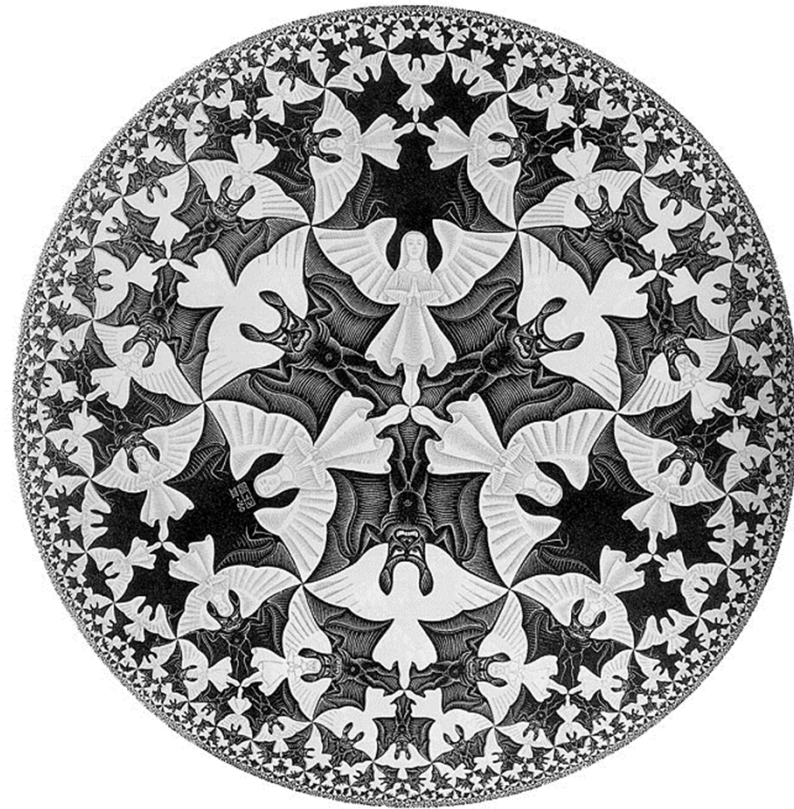
- ❖ “Total Risk Conservation Law”
  - Risk absorption capacity: financial markets vs government
- ❖ Financial policy is not just a tool for public finance and tax policy
- ❖ In financial markets, liquidity is essential
- ❖ An appropriate level of good risk taking should be supported

# Financial Markets and Public Finance/taxes: Escher's Angels and Devils

<Sky and Water>(1938)



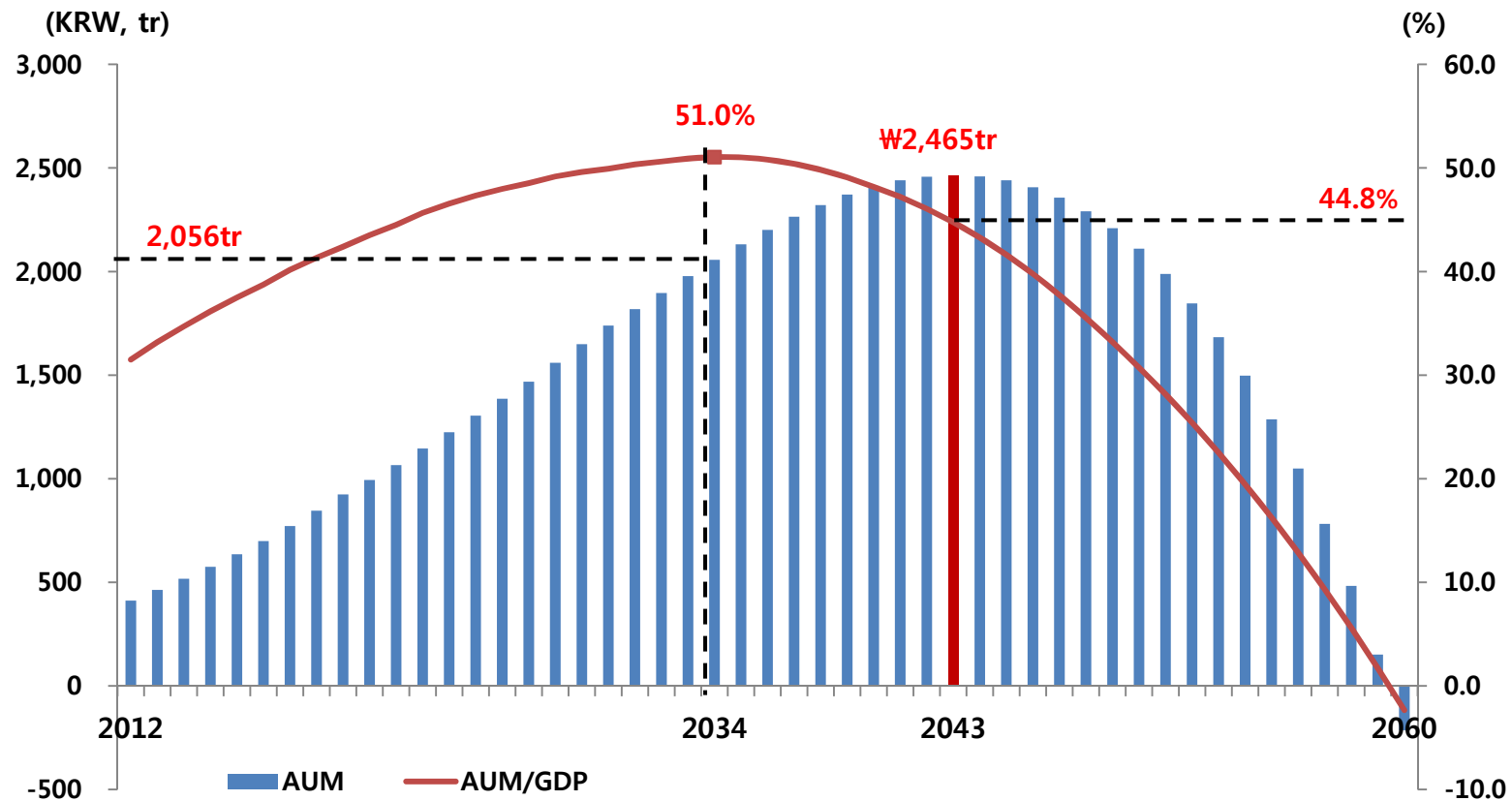
<Angels and Devils>(1960)



## Capital Markets and National Pension Service(NPS)

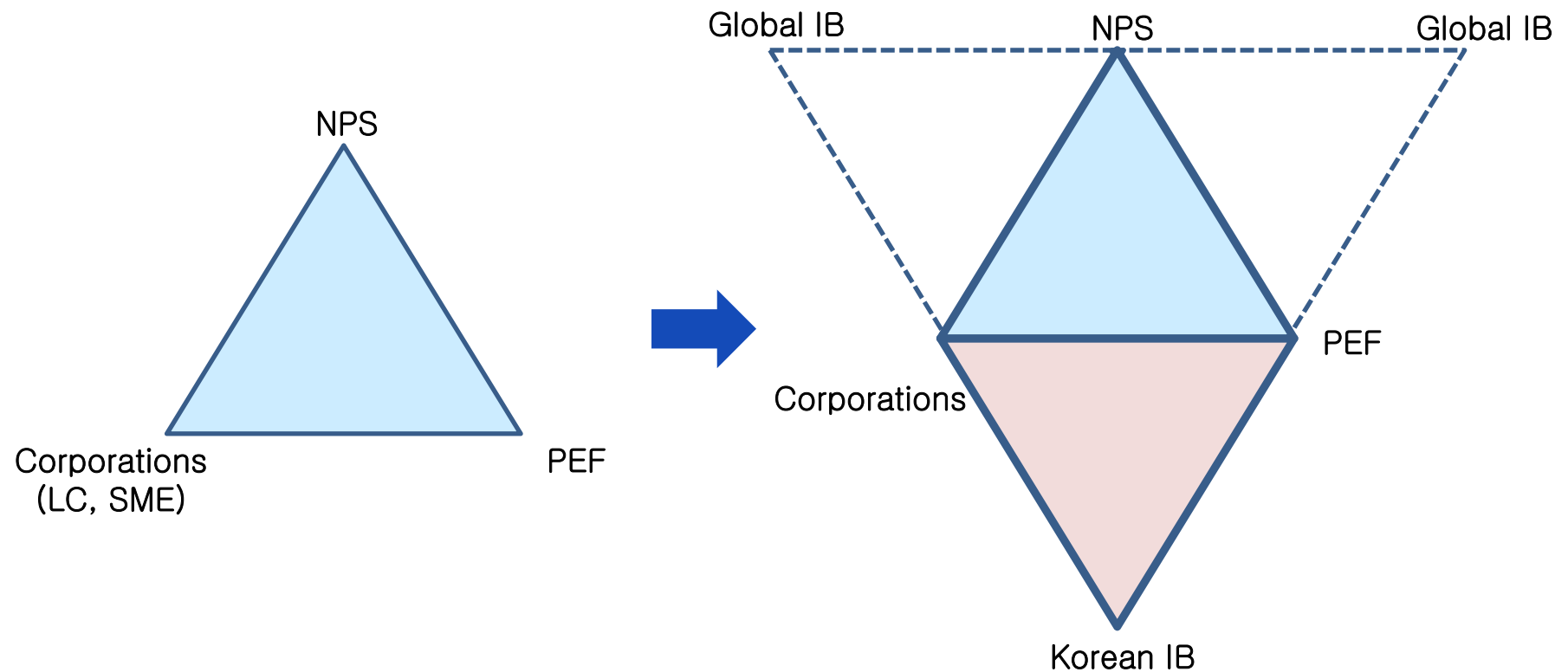
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# How Long Will NPS Remain a “Superpower”?



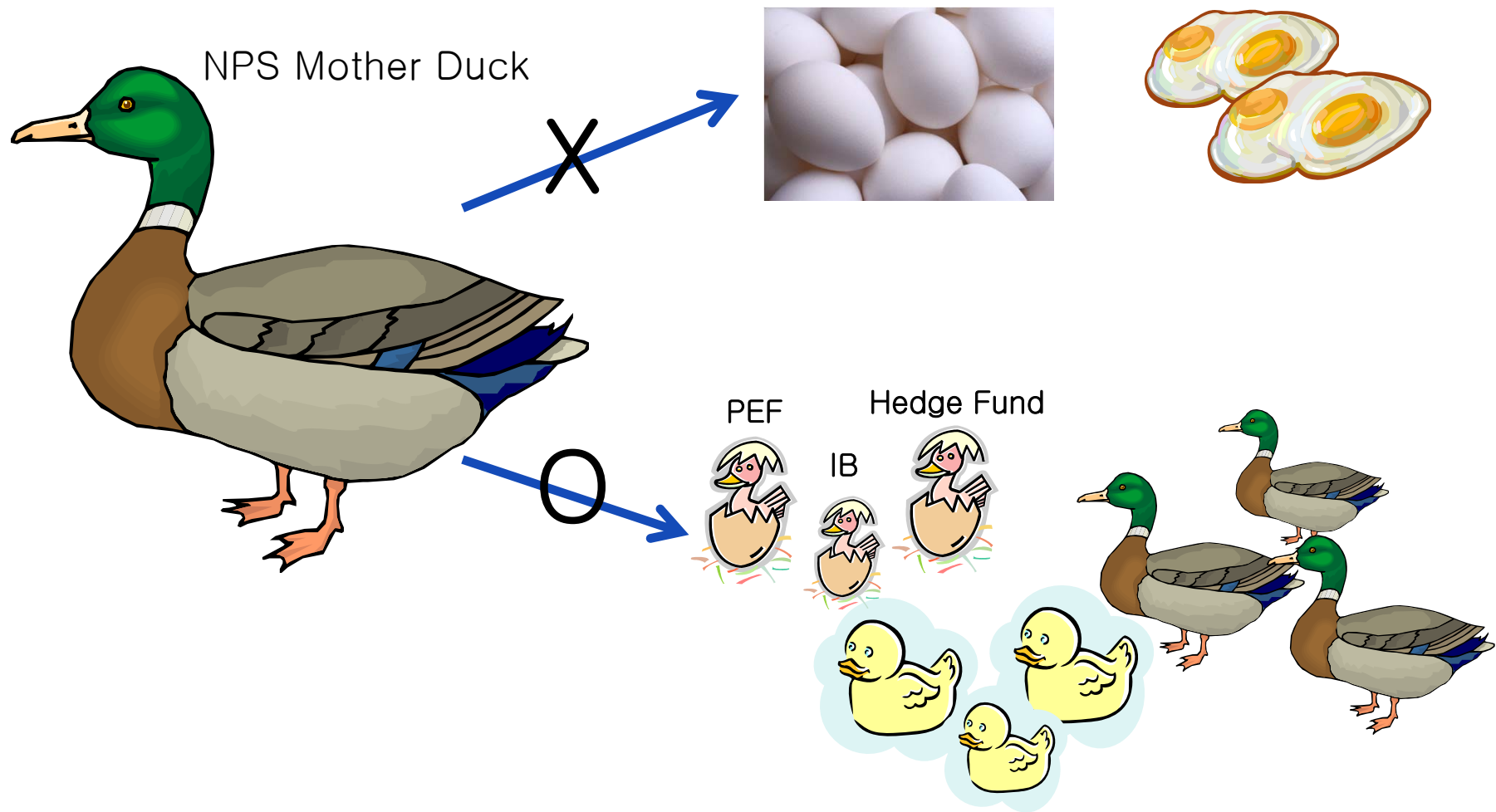
Source: NPS

# Corporate Partnership Program (CPP): Implications for IBs





# NPS and the Future of Korean Finance





# Concluding Remarks

- ❖ Do it our own way!
  - If we can fight the enemy when we want, where we want, how we want, then we can win the battle (Sultan Saladin)
  - For the advancement of IBs, do it IB's way!
- ❖ Korean economy and finance will always lose the “average vs. average” battle, but have a chance to win when it comes to the “#1 vs. #1” game
- ❖ Future directions of Korea's IB industry
  - Speed, structured & evolutionary products(e.g. ELS, DLS, ABS etc)
  - Foreign market business(e.g. IT platform-based strategy)
  - Develop players with different business model
  - Capitalize on superpower of NPS