Four Years of KONEX: Outcomes and Evaluations

Kang, Sohyun*

Four years have passed since Korea established KONEX aiming to create a marketplace for nurturing new venture companies. Despite skepticism about the success, KONEX has achieved remarkable outcomes in terms of size, growing over seven-fold for the past four years. It has also played an excellent role in providing a foothold for startups to climb up to the next level, by helping 27 KONEX-listed companies successfully move to the KOSDAQ market. However, doubt has been raised over the market's fundamental functions due to some issues. For example, an excessively large stake of major shareholders in quite a few KONEX-listed companies hinders active trading as well as proper valuation. Moreover, some KONEX companies have long business history, e.g., 10 year, to be labeled as a startup, while most of those moved to KOSDAQ entered the market in the first or second year of KONEX, which makes it hard for KONEX to take credit for the success. Expecting KONEX to make visible achievements in nurturing startups is certainly a far-fetched goal given the bourse's short history spanning only four years. Even so, multi-faceted plans are necessary to help KONEX to stand on its own and aggressively discover and nurture new venture companies with growth potential in order to facilitate the market's continuous development.

The Korea New Exchange (KONEX) was first established on July 1, 2013 with the aim of creating a stock market incubator for nurturing new venture companies. The bourse was purposed to provide a foothold based on which startup firms with financing difficulties raise capital easily in the stock market and achieve stable growth. Another expectation was a virtuous

* All opinions expressed in this paper represent the author's personal views and thus should not be interpreted as Korea Capital Market Institute's official position.

* Ph.D., Research Fellow, Capital Markets Department, Tel: 82-2-3771-0821, E-mail: sohyun.kang@kcmi.re.kr

circle of capital via which venture capital, angel investors, and others investing in venture companies exit their investments via KONEX for reinvestments in other growing startups.

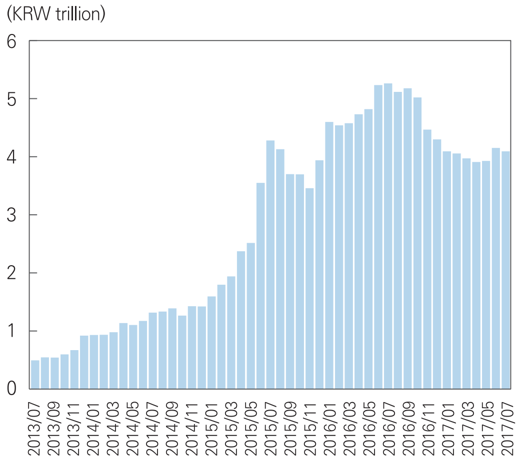
After four years since the launch of KONEX, the importance of venture development is ever growing compared to the pre-KONEX era. Discovering venture firms that will lead future industries based on excellent manpower and innovative ideas is the key to success in the Fourth Industrial Revolution. This will also constitute a key determinant of a nation's long-term development. In this regard, the KONEX market is becoming more and more important.

Current state and features of KONEX

Taking into account the special nature, the KONEX market and the design are quite different from other stock markets in many ways. Due to its high investment risks, the market limits market participants to the investors who have risk tolerance, meaning that ordinary investors have no access to the market. Furthermore, it uses differentiated listing requirements to prioritize future growth potential over sales, net profits, and other criteria to measure financial outcomes and visible achievements. Also different is its relaxed disclosure burden. Instead, the market's nominated advisor (Nomad) scheme enables Nomads to discover superb venture firms, examines listing eligibility, and provide post-listing advice as a guardian supporting venture firms in all areas.

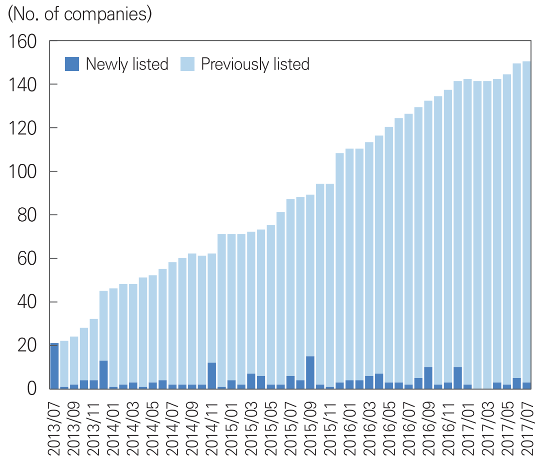
Such distinctive features of KONEX including the limited investor pools, reflection of growth potential, and Nomads are not only novel but also highly experimental. Admittedly, this raised expectations as well as concerns about the market's success.

Figure 1. KONEX market cap



Source: DataGuide

Figure 2. No. of KONEX-listed firms



Source: DataGuide

Despite concerns at the early stage, KONEX achieved remarkable growth in size. At the beginning in July 2013, KONEX's market cap hovered around only KRW 558 billion, but four years later in July 2017, it reached KRW 4.171 trillion, a 7.48-fold increase from the market's establishment. However, KONEX showed an abrupt decline once from KRW 5.3 trillion in mid-2016 to KRW 4.2 trillion in early 2017 because stocks representing a large portion of the market moved to KOSDAQ. Excluding those stocks, no substantial decline was observed in the KONEX market. Such a move to the larger market is one of the objectives of KONEX, and a decline over the past year is not all worrisome.

The number of listed stocks has been on the gradual increase since the KONEX began trading, suggesting a stable inflow of new companies to the market. After opening with two companies listed four years ago, KONEX listed 21 companies one month later. Thanks to a series of new listings, a total of 152 companies are listed at the end of August 2017. This shows a remarkable rate of growth in size compared to when KONEX was first established four years ago.

Transfers from KONEX to KOSDAQ

One of the indicators to measure the success of the KONEX market is KONEX-listed firm's transfer to another market. Helping a startup venture firm to grow into an SME or a middle market firms to eventually graduate KONEX to advance to a larger market is one of the key roles of the KONEX market. The Korea Exchange has given full support to help small venture firms to list their stocks on KONEX before growing enough to advance to the KOSDAQ market via diverse paths.

Table 1. No. of transferred firms by path

Year of Transfer	Technology growth companies	Fast track	Listing	SPAC merger	Total
2014	0	3	3	-	6
2015	2	2	4	-	8
2016	3	4	1	3	11
July 2017	0	0	1	1	2
Total	5	9	9	4	27

Source: DataGuide

As a result, a total of 27 companies successfully moved to the KOSDAQ market as of the end of June 2017. A KONEX-listed company can advance to KOSDAQ via four paths; the special provision for "technology growth companies", fast track, ordinary listing, and SPAC merger. Among them, the fast track and ordinary listing dwarf others at 9, whereas the special provision for technology growth companies and SPAC merger stood at 5 and 4, respectively. By year, the transfer to the KOSDAQ occurred most frequently in 2015 and 2016 at 8 and 11, respectively.

Table 2. % of transfers in initial listing

Year	No. of firms initially listed (A)	No. of firms transferred (B)	Ratio (B/A)
2013	45	13	28.9%
2014	34	8	23.5%
2015	49	6	12.2%
2016	50	0	-
2017	13	0	-
Total	**191**	**27**	-

Note: No. of firms transferred includes stocks that are transferred as well as delisted.
Source: DataGuide

However, it would be a far stretch to give credit to KONEX for all of the aforementioned outcomes. A close look at when transferred firms were initially listed on KONEX reveals that most of the transfers occurred at the early stage of the market. Out of 27 firms that left the market, 13 were initially listed in 2013, and 8 in 2014. Combined, they account for 26.5% of the firms listed in 2013 and 2014, meaning one in four firms advancing to the upper market. This implies that transfers from KONEX to KOSDAQ thus far have heavily relied on the outstanding firms among those listed during the first few years of KONEX. Hence, the transfers occurred not because the growth fueled by KONEX, but because solid venture companies came to cluster to list their stocks at the beginning of the KONEX market.

Liquidity conditions

The low liquidity issue that has been raised since the launch of the KONEX market appears to persist. Liquidity is one of the most important stock market indicators. The primary purpose of market formation is to enable sellers and buyers to trade seamlessly. A healthy level of trading volume is supposed to reveal a product's value, whereas trading in a persistent manner helps grasp the product's valuation trend. However, that function is not working properly in the KONEX market. The monthly trading volume reached only 1.25 million shares in 2013, and 4.8 million shares in 2017. The turnover ratio also hovered between 0.005 and 0.01, with no signs of improvement. Despite the steady increase in the number of listed companies, trading has not expanded significantly.

Korea's financial authorities and KRX have exerted multi-faceted efforts in tackling the liquidity issue. In 2014, KRX changed its trading method from periodic call auction system to the continuous auction system, and its trading unit from 100 shares to 1 share, both of which aim to provide easier market access. Slightly later in October 2014, it lowered the minimum deposit for the discretionary wrap account from KRW 300 million to KRW 100 million, which later in 2015 was extended to retail investors.

Such market-facilitating measures have paid off. The most visible outcome came from the cut in the minimum deposit for retail investors, which immediately led to positive effects of more market participants and higher market liquidity. It also pushed up the stock prices of the month, raising expectations for market facilitation, Unfortunately, the effect was fairly short-lived and the stock prices returned to the pre-measure level.

To identify the root cause of the low-liquidity requires a renewed look at the supply side, setting aside the previous attempts exploring the market design and investment demand. Simply put, a test should be conducted on whether a sufficient number of stocks out of KONEX-listed stocks are available for trading or not.

Table 3. Shareholding ratios of KONEX-listed companies

(Unit: No. of firms, %)

		2013	2014	2015	2016
Largest shareholder and specially related persons	No. of firms	45	77	116	149
	Average	59.48	56.54	54.12	53.89
	Mean	56.81	54.61	53.77	50.59
	Maximum	99.98	99.98	99.88	100
	Minimum	21.14	19.92	15.76	15.77
Largest shareholder and specially related persons, shareholders with a 5% or higher stake, treasury stocks	No. of firms	21	41	70	89
	Average	72.54	70.41	68.25	67.90
	Mean	71.68	70.92	69.86	67.98
	Maximum	99.98	99.98	100	100
	Minimum	21.14	19.92	15.76	15.77

Note: 1) The data are for KONEX-listed firms whose shareholder information is available.
2) For the companies that moved to the KOSDAQ market, the quarter-end data right before the move were used.
Source: DataGuide, KCMI

A look at the shareholding ratios in KONEX-listed companies reveals that a small number of shareholders including the largest shareholder are holding excessively large stakes. The table shows that over 50% of the shares are owned by the largest shareholder and the specially related persons. In 2016 when the shareholding ratio was the lowest, the median value reached 50.59%. The problem becomes even more serious if the data include shareholders with a 5% or higher stake are included. If combined, they are holding about 68% to 72% of KONEX-listed stocks, meaning that only 30% of the stocks are available for trading.

Notably, there are some companies whose stocks are 100% owned by the largest shareholder. From the perspective of the secondary market, the listing of those stocks is meaningless. In principle, it is impossible for a company whose largest shareholder owns all of the shares to trade in a stock market. Even if the largest shareholder’s stake is slightly less than 100% in a company, trading is impossible in practice. The primary purpose of listing stocks on a market is to help the shares to get fair valuation and improve the corporate value via trading, which is not the case for these stocks.

When listing a company, the KONEX market places no requirement for ownership distribution, unlike the KOSPI and KOSDAQ markets mandating the ownership distribution requirements, e.g., the ratio and number of ordinary shareholders, the ratio of publicly traded shares, etc. Any company must meet the requirements to list its stocks on those markets, whereas KONEX places no such requirement. Furthermore, KONEX-listed companies' efforts to distribute their shares have been lukewarm at best. Over the past four years, the market has seen active private placements, whereas public offerings have been sluggish. Since the launch, only four public offering deals took place to raise only KRW 2.24 billion, which could hardly invite active trading and investment.

Implications

Over the past four years, the KONEX market has achieved substantial outcomes in terms of size. Backed by the persistent flow of new issuers into the market, the market size and market cap increased seven-fold compared to the beginning of the market. Furthermore, aggressive support and diverse paths to move to the higher market helped KONEX companies to move to the KOSDAQ market. Taking into account the grave concerns about the market's survival during the early stage, all of the outcomes are truly remarkable.

However, there are lingering worries about whether the market can keep delivering such outcomes going forward or not. Most of the firms moving to the higher market are strong and have entered the market right after the market opened, and therefore, the market cannot just take all the credit. Admittedly, such a phenomenon could be inevitable given the market's short history spanning only four years. Regardless of the level of the impact, however, it seems only obvious for the effect created by the entrants in the early-stage market to be short-lived.

For the KONEX market to advance going forward, it must gain confidence in its ability to give the listed companies diverse support for further development. Toward that end, aggressive efforts are needed for addressing the liquidity issue. Given that previous market-facilitating attempts were nothing more than a stopgap policy, a bolder measure must be taken for better distribution of shares. At the individual level, a founder or major shareholders of a company can possibly choose to maximize their investment returns by holding as many shares as possible even after the company goes public. However, investors will turn their back on a market that fails to facilitate trading.

Also necessary are continuous endeavors to discover good companies and help them enter the market. The average history of KONEX-listed companies stands at 11.7 years, and it is hard to label them as a startup. More needs to be done for the KONEX market to achieve its initial purpose of discovering and incubating outstanding startups. Especially notable is a possible overlap between KONEX and KOSDAQ. As KOSDAQ has continued to relax its listing requirements, some startups may want to go directly to KOSDAQ, instead of via KONEX. The KONEX market should put in more efforts to find more promising startups, e.g., by working with investors who have better knowledge and information on newly established venture firms.