

Internationalization of Korea's Asset Management Companies

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Korea's fund industry has stagnated and suffered from low profitability since the financial crisis of 2008 and finds it difficult to expect a rebound for long-term growth. It's time to look at the bigger Asian fund market which shows a robust growth path amid the prolonged financial crisis. Considering that Korea's funds are in the early stages of internationalization, we need a national strategy to further develop the internationalization of domestic asset managers. Domestic asset managers should go abroad with more proactive strategies such as acquiring overseas asset management companies. At the same time, Korea needs a stronger national initiative to use the country's large sovereign wealth fund and pension fund as leverage when Korean asset managers advance into overseas markets.

I. Introduction

The Korean fund industry has stagnated and suffered from lower profitability since the financial crisis, compared to other Asian rival countries. Total asset under management (AUM) remains around KRW 300 trillion and more than one third of asset managers have suffered from deficits in net income. It's fortunate that there are some innovations in products and services in addition to reinforced regulations for investor protection. This is rebuilding investors' trust and hopes for long-term growth momentum.

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

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However, these efforts and policy steps do not fully address the fundamental fact that Korea's fund market has reached its growth limit due to the small size of the capital markets, which is approximately 2% of worldwide equity market capitalization. That's why Korea's asset management industry should be internationalized.

The reasons why the asset management industry should advance into overseas markets can be viewed from three perspectives. First, from investors' perspective, investments should be diversified in destination and asset class. This depends entirely on the global competence of asset managers. And in order to build up global competence in portfolio management, internationalization is absolutely necessary. Second, from asset managers' perspective, Korean asset management firms need to expand overseas investments to alleviate concentration risk stemming from cyclical fluctuation of the domestic economy, and also to make a leap forward to become global players who can overcome the limit of Korea's narrow market. Last, from the nation's perspective, internationalization is necessary to nurture the asset management industry to become a leading financial sector in the era of an aging population. Korea has a great deal of financial resources such as its public pensions fund and sovereign wealth fund, enough to have an influence on the global asset management market.

This article reviews the current status of domestic asset managers in terms of internationalization, and discusses the development of global strategies.

II. Current Status of Internationalization in the Asset Management Industry

1. Outbound internationalization of domestic asset managers

a. The status of overseas operations by domestic asset managers

At the end of 2011, only 12 domestic asset managers went abroad to attract portfolio management business. They established a total of 27 overseas operations, which is a significant increase from 21 in 2008. The legal forms of overseas operations vary:

overseas subsidiary, overseas branch, or overseas office. Most overseas operations, 17 out of 27, took the form of overseas subsidiaries while 10 of them were established as overseas offices.

In terms of revenue generation, the subsidiary type is the most advanced form compared to other types of overseas operations. The office type is legally prohibited from any profit making business, so the only role it can play is gathering local business information.

The overall status of overseas operations is as follows. Their capital combined stands at about \$1.7 billion with 409 total staff members including local residents. Their primary business is to provide portfolio management services by investing in overseas assets for clients in Korea. According to the statistics, this is the business purpose of 19 of the 27 overseas operations.

Table 1. Legal status of overseas operations established by domestic asset managers (2011)				
	2008	2009	2010	2011
Subsidiary	14	15	16	17
Branch	-	0	0	0
Office	7	7	9	10
Total	21	22	25	27

b. Overseas investment funds

We define overseas investment funds as funds domiciled in Korea, established by domestic asset managers to invest in foreign assets (foreign stocks, bonds, etc.), and denominated in foreign currencies. Overseas investment funds can show how globalized asset managers are. The larger the size of a fund, the more competitive the asset manager is, and the more globalized the fund industry is.

There are two types of overseas investment funds in Korea. One is the pure overseas fund whose portfolio is fully composed of foreign assets, and the other is

the hybrid overseas fund whose portfolio has both domestic and overseas assets. The overall balance of overseas investment funds was about KRW 51 trillion, 16% of total mutual funds domiciled in Korea as of November 2012. Pure overseas investment funds amount to KRW 10 trillion, showing an increasing trend since the financial crisis of 2008. Meanwhile, hybrid overseas investment funds have gone down, recording KRW 10 trillion in November 2012 from KRW 66 trillion in 2007.

Table 2. Trend in overseas investment funds in Korea

(Unit: KRW 100 million)

	Pure overseas funds			Hybrid overseas funds		
	Number of funds	Subscription	NAV	Number of funds	Subscription	NAV
2007	335	169,834	187,654	700	560,565	659,683
2008	519	390,769	218,747	885	378,811	212,784
2009	761	417,709	350,075	697	314,695	258,264
2010	892	389,033	350,049	689	248,815	223,021
2011	1,049	409,872	316,912	733	156,503	124,029
2012*	1,145	471,152	405,850	765	109,041	101,415

Note: * As of November 2012.

c. Offshore sales

Offshore funds sales of Korean asset management companies is the selling of Korea-domiciled mutual funds to retail investors in other nations outside Korea's financial authority. This is widely viewed as an important indicator for the level of internationalization because those retail investors have a home bias and foreign players are required to overcome the bias with a stronger reputation than domestic players. Most global asset managers, such as Blackrock, Fidelity, and Vanguard, have a broad customer base, including retail investors with a variety of nationalities.

Unfortunately, Korean asset managers operating overseas have so far been unsuccessful in offshore sales. As mentioned above, most Korean asset managers with overseas operations are not selling their Korean-domiciled products to overseas clients,

but primarily focusing on managing overseas investment funds for asset managers in Korea. This implies that Korea's asset management industry is still in its infancy of business internationalization.

2. Inbound internationalization of domestic asset managers

a. Entrance of foreign asset managers

As Korea's asset management market has rapidly liberalized since the end of the Asian financial crisis, overseas asset managers started to enter the domestic fund market in the mid-2000s, which then was at an early phase of development. The entrance of foreign players was the most active in 2008, when five foreign asset managers began operating in Korea. As of September 2012, there were 22 foreign asset managers operating in Korea, accounting for 27% of all asset managers licensed in Korea.

Table 3. Trend in domestic entries of foreign asset managers

(Unit: number of entities)									
	2004	2005	2006	2007	2008	2009	2010	2011	2012.9
Foreign asset managers (A)	11	12	14	15	20	23	22	23	22
Asset managers total (B)	47	46	46	49	51	63	71	81	82
A/B	23%	26%	30%	31%	39%	37%	31%	28%	27%

Note: Foreign players here means an asset management firm whose foreign stake is over 50%.

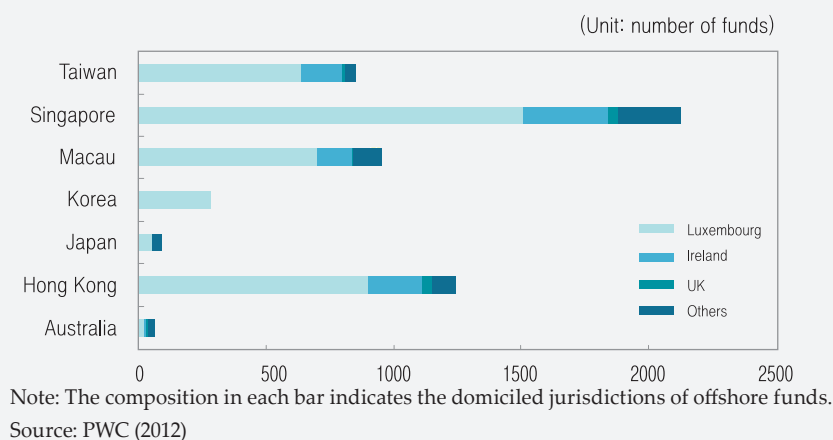
Source: Financial Supervisory Service

b. Offshore funds

Offshore funds here refer to funds that are domiciled in foreign jurisdictions to invest in any investable asset. Most offshore funds are usually domiciled and managed by foreign asset managers. However, a small number of offshore funds, such as SICAV, are domiciled and managed by foreign subsidiaries of domestic asset managers.

Offshore funds are still negligible in terms of their size. As the end of 2011, 280 offshore funds were sold to domestic investors. The offshore fund market is active in several major Asian countries, including Singapore, Hong Kong, and Taiwan. In particular, Singapore has over 2,000 offshore funds which are mostly domiciled in Luxembourg.

Figure 1. Offshore fund market: cross-country comparison



3. Assessment

So far, this paper reviewed the current status of internationalization of the Korean asset management industry in terms of commercial presence and fund products that asset managers provide to their clients. In short, we briefly assess the current status of the asset management industry. Above all, the outbound internationalization of domestic asset managers is at the early stage and lags behind that of inbound entrance of foreign asset managers. Simply put, the number of foreign asset managers operating in Korea exceeds that of overseas operations established by Korean asset managers. This reflects domestic asset managers' passive position in terms of internationalization.

As for the customer base, domestic asset managers have made no progress in internationalization since the early 2000s. In contrast, foreign asset managers licensed

in Korea have widened their domestic customer base including retail customers as well as institutional ones.

III. Future Directions for Internationalization

1. M&A vs. organic growth

As mentioned earlier, domestic asset managers began to advance into overseas markets in the early 2000s. They preferred to go abroad by establishing new subsidiaries or opening new overseas branches, rather than by acquiring overseas local asset managers. This is the organic growth strategy, maximizing the use of their internal resources. But this internationalization strategy is effective only if domestic asset managers have a competitive edge over local players in overseas markets in terms of asset management skills and information. Otherwise, this approach can be regarded as naïve and passive.

Of course, not every attempt for organic growth is viewed as passive. This strategy was used by the US when it entered into the European market in the 1990s. At that time, the US had the world's most advanced and competitive asset management industry. On the contrary, European asset managers employed the M&A strategy when they began operating in the US because they believed that acquitting existing US players would help them improve management skills and build a strong reputation in the US market.

The case of European asset managers demonstrates that it is time for Korean asset managers to revisit their internationalization strategy in terms of portfolio management and product innovation. For markets that are more competitive than Korea, the M&A strategy is a better option.

2. Widening customer base: role of domestic public pension

As implied in the above analysis, Korean asset managers are at the early stage of internationalization and thus have a very shallow foreign customer base. This is why the domestic investor base is critically important for internationalization of Korean asset managers. Korea has strong institutional investor pools including the National Pension Service (NPS), the fourth largest pension fund in the world. Those institutional investors can help Korean asset managers to internationalize proactively. Furthermore, the strong presence of institutional investors will help NPS play its public role under its fiduciary duty. Ultimately, the collaboration between public and private institutional investors will benefit both of them.

Table 4. Medium-term projection for NPS's AUM

(Unit: KRW trillion, %)				
By type	2011		2017	
	Amount	Composition	Composition	Estimates (Net increase) *
Equity	81.9	23.5	Over 30%	104
Domestic	62.1	17.8	Over 20%	63
Overseas	19.7	5.7	Over 10%	41
Bond	239.4	68.7	Below 60%	135
Domestic	224.9	64.5	Below 60%	-
Overseas	14.6	4.2	Below 10%	-
Alternatives	27.2	7.8	Over 10%	35
Total AUM	348.5	100	623.0	274

Note: * means a net increase in AUM at the threshold, compared to AUM in 2011.

Source: Ministry of Health & Welfare

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