

Korean M&A: a budding market for PE and VC funds

Private equity and venture capital has become an important feature of the Korean M&A market. **Seungmin Jasmine Jung, Kwangbok Kim** and **Youngju Kim** of **LAB Partners** examine the evolving regulatory landscape and trends in transactions.

The Korean M&A market has diversified in recent years in terms of both the volume and types of transactions. This diversification is largely due to the increase in private equity (PE) funds and venture capital (VC) firms that have become dominant players in the Korean M&A market. With the increase in alternative investments by institutional investors such as pension funds and sovereign funds, PE and VC funds have grown exponentially during the past five years to become a fixture in the Korean M&A market.

As a result, the Korean market has matured beyond M&A ensuing from corporate reorganisations of Korean conglomerates. Large and mid-to-small cap transactions coexist, ranging from large cap transactions regarding the restructuring of Korean conglomerates or exits by PE funds derived from prior management buy-outs, to mid-to-small cap deals involving VC companies or mid-sized companies mainly in the ICT, biotech, healthcare or logistics industries.

As for large cap deals, acquirers tend to be PE funds managed by global investment management firms such as KKR or Blackstone or by major Korean PE management companies such as MBK, Hahn & Company, IMM or Stic Investments. On the other hand, players in mid-to-small cap deals are usually mid-sized PE funds owned by financial groups or VC groups, generally investing in growth funds involving venture or mid-sized companies, and independent PE funds with a relatively small AUM that engage in buy-outs. It is likely that these trends will continue for the time being.

Proposed regulatory amendments

The Financial Investment Services and Capital Markets Act distinguishes between two types of PE fund based on participation in management. The first type is the professional investment privately placed collective investment vehicle, commonly referred to as a hedge fund. The second type is the management participation privately placed collective investment vehicle commonly referred to as a PEF.

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Seungmin Jasmine Jung recently joined the partnership of LAB Partners. She has expertise in outbound and inbound corporate and finance transactions, representing clients in the finance, fintech, private equity, energy, real estate and technology sectors. She is considered one of the foremost experts on blockchain, cryptocurrency, cloud computing, data privacy and cybersecurity.

Jasmine has extensive experience ranging from law firms in NY and Seoul to multi-national corporations. She was previously head of legal for Amazon Web Services Korea, specialising in cloud computing and data privacy. Given her in-house experience, Jasmine is also well-versed in employment law, internal investigations, risk management and compliance.

She is also an adjunct professor at Yonsei University, lecturing in data privacy law and the legal issues surrounding the 4th industrial revolution.

Jasmine is highly regarded by clients for her transactional expertise and negotiation skills. She is a member of the New York Bar and has a JD from Columbia Law School and a BA in political science and international relations from Yonsei University.


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Kwangbok Kim is a founding partner of LAB Partners, a boutique firm recognised by media as the 'Avengers' of the Korean legal market.

Kwangbok specialises in domestic and cross-border private equity transactions, M&A and corporate governance. He has represented numerous institutional investors, private equity funds and corporations in a wide variety of transactions including M&A, joint-ventures, hostile takeovers and corporate restructurings in various industries. He also has expertise in the corporate governance of Korean conglomerates and post-merger corporate integration.

Kwangbok is highly sought after for his in-depth knowledge and ability to spearhead challenging transactions. He has been integral in growing the M&A practice at LAB Partners and in establishing the LAB Corporate Governance Centre, which provides advice dedicated to shareholder activism and corporate governance.

Prior to joining LAB Partners, Kwangbok was a partner at KL Partners and Shin & Kim in Seoul and worked as an international lawyer in the London Office of Travers Smith. Kwangbok is a member of the Korean Bar. He has a BS in materials science and engineering from Seoul National University and an LLM from University of Virginia School of Law.


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Youngju Kim is a founding partner of LAB Partners, a premier boutique firm in Korea that provides a one-stop service in a full range of practice areas.

Youngju specialises in corporate and finance transactions, both domestic and outbound. With his expertise in private equity, venture capital, M&A and corporate finance, Youngju has been named a leading lawyer by IFLR1000. He has extensive experience in fund formation, structuring private equity and venture capital investments, M&A, acquisition finance, energy and infrastructure and capital markets. Youngju is highly regarded by his clients for his business acumen in addition to his legal ability to resolve complex transactional issues.

As a testament to his efforts, LAB Partners was ranked sixth for M&A, among all Korean law firms, in the first quarter of 2019 by Invest Chosun. Prior to joining LAB Partners, Youngju was a partner at KL Partners and Shin & Kim in Seoul and worked as an international visiting associate in the Hong Kong office of Latham & Watkins.

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Under the current regime, a PEF must hold 10% or more of the shares of an investment target to ensure participation in management; must retain such an equity interest for more than six months; and cannot

take out loans. In contrast, hedge funds are not subject to such investment restrictions but are restricted from exercising voting rights for shares held in excess of 10%.

Recognising that the above regulations

hardly contribute to the growth of corporations and jobs but rather inhibit the competitiveness of Korean PE funds against global funds, the Financial Services Commission (FSC) has announced a proposal

to amend the Financial Investment Services and Capital Markets Act. The amendment proposal, which was announced in September 2018, is pending in the National Assembly. It attempts to merge the two types of PE funds into one and remove the investment restrictions as follows:

- The distinction between hedge funds and PEFs based on management participation will be abolished. Instead, PE funds will be divided into 'institutional PE funds' and 'general PE funds', based on the nature of the investor. Institutional PE funds will only allow investments by institutional investors and will be subject to the provisions currently applicable to PEFs. General PE funds will allow investments by individuals as well but will be subject to the provisions currently applicable to hedge funds.
- The investment restrictions applicable only to PEFs, such as equity retention and prohibition of loans, will be abolished along with the restrictions applicable only to hedge funds, such as voting restrictions, in order to converge the asset management rules applicable to PE funds into one.
- PE funds will be allowed to take out loans.

However, the lending of the fund's assets to an individual, either directly or through a lending company, will be prohibited.

Activist funds and corporate governance

Activist funds have become very vocal in advocating changes in the corporate governance of Korean conglomerates. This trend has been increasing, emboldened by the social climate in Korea which is seeking changes and transparency in the corporate governance of Korean conglomerates. In the first half of 2019 alone, several activist funds raised their voices in relation to corporate restructuring, director appointments or executive compensation schemes.

In early 2019, Elliott Management Corporation, one of the largest activist funds in the world, objected to the spin-off and merger between Hyundai Mobis and

Hyundai Glovis. In the annual shareholders meeting of Hyundai Motors and Hyundai Mobis, Elliott raised multiple agendas, including over cash dividends and the nomination of an external director. Unable to secure enough votes, these agendas were not adopted but sparked a continuous debate on the state of corporate governance in Korean conglomerates.

Additionally, 2019 marks the emergence of the first Korean activist fund: Korea Corporate Government Improvement Fund (KCGI). Since the beginning of the year, KCGI has urged Hanjin Group, the operator of Korean Air, to improve its corporate governance. Management disputes between KCGI and Hanjin Group are ongoing. Specifically, in January 2019, KCGI filed for a preliminary injunction requesting access to

Hanjin Group's shareholder registry in order to gather minority shareholder votes. The court granted access to KCGI. Thereafter, KCGI filed a suit against Hanjin Kal to include the appointment of an auditor and external director and a director compensation ceiling as shareholder meeting agendas. KCGI won in the trial court. Although KCGI lost the suit in the appellate court, Hanjin Group announced a mid-to-long term initiative and a management improvement plan for Hanjin Kal, accepting some of the proposals raised by KCGI, such as increasing the number of external directors and the sale of unused assets.

It is expected that shareholder activism will continue given the recent positive perception of PE funds and the public's scrutiny of the corporate governance of Korean conglomerates. From a global perspective, the activities of activist funds could help improve the corporate governance of Korean conglomerates and raise the value of Korean corporations, which are relatively underestimated.

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LAB Partners is a premier boutique law firm in Korea established by partners from the leading law firms in Korea.

LAB Partners provides a one stop service in all major practice areas. These range from traditional practice areas such as general corporate, finance, M&A, private equity, litigation, labour and employment, compliance and risk management, internal investigations, trade secrets, Japan practice, TMT and data privacy to newly emerging practice areas such as shareholder activism and blockchain/cryptocurrencies. Such full range of services is made possible by the diverse expertise and high calibre of the partners at LAB Partners who all have over decades of experience and are regarded as the top experts in their field.

LAB Partners has been praised by clients for their ability to provide expert advice in an agile and efficient manner, without regard to factors extrinsic to clients' interest. As a testament to such efforts, in the first quarter of 2019, LAB Partners was ranked sixth among all Korean law firms for M&A by Invest Chosun. The Law Times also named LAB Partners as the "Avengers" of the Korean legal market.

Recently, LAB Partners has established the 'LAB Corporate Governance Centre', which provides advice dedicated to shareholder activism and corporate governance improvement.

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Secondary market

In the context of PE, the 'secondary market' refers to additional capital raising by existing

investors pre-IPO or the sale of equity in venture companies by initial investors to gain a return on investment. Secondary transactions, in the narrow sense, refer to transactions involving the sale of: shares of target companies owned by PE or VC funds to other PE or VC funds; or limited partnership (LP) interests owned in PE or VC funds to other investors.

The growth of the secondary market and in secondary transactions is a global trend yet to mature in Korea. In Korea, it takes at least

12 years before an IPO can occur, whereas the lifecycle of PE or VC funds that invest in mid-to-small/venture companies is generally five to seven years, shorter than the time period required for IPOs. Because of this, when secondary markets are not active, PE or VC funds tend to focus their investments in venture capital companies whose IPO schedule is not too far away. This strategy ensures a return on their investment but makes it difficult for start-ups to secure investments from PE or CV funds. To resolve such a market distortion, the government has made efforts to launch secondary funds but with little success.

In terms of large-cap companies, secondary transactions involving the resale of target company shares between PE funds have started to occur in the Korean market.

Management buy-outs

Management buy-outs (MBOs) refer to the buy-out of all or part of a company by the existing management of that company. One of the most notable MBOs in the Korean market was the buy-out of the global FILA group by the representative director of FILA Korea in 2005. However, since then, there have not been many MBOs in Korea. One of the reasons for the lack of MBOs could be found in court precedents that have ruled

against using company assets as collateral for acquisition financing in the context of MBOs. Under the court precedent, such acquisition financing is a criminal offense, due to the management's breach of fiduciary duty owed to the company.

Recently, the market has been seeing a resurgence of MBOs where the existing management in venture companies or mid-to-small companies acquires its company's equity in partnership with PE funds or by investing in the LP interests of PE funds. Such MBOs

allow the PE funds to retain the experience and capabilities of the existing management while motivating the management to work towards increasing the value of the company.

Notwithstanding such synergy, liability and reward for management executives can become a tricky issue. For example, any breach of representations and warranties in the share purchase agreement can be a double edge sword, given that the management in such case could be viewed as both the provider and recipient of the representations and warranties. Likewise, the structuring of compensation and incentives for existing management and the structuring, drafting and negotiation of MBOs requires careful review from expert attorneys.

Outbound transactions

Another trend over recent years has been the focus on outbound transactions by PE funds, partnering with conglomerates, that have turned their eyes overseas to find a new driver

for growth. The types, industries and geographical regions of these outbound transactions have diversified and Korean funds and corporations have grown into sophisticated players in the global M&A market. In terms of industry, conglomerates tend to focus on energy and technology industries whereas Korean PE or VC funds tend to invest in technology, IT related services, online commerce and sharing economy platforms. As to geographical regions, Korean PE funds have spread their reach to emerging economies with rapid growth potential.

The constant challenge in outbound transactions is ensuring the protection of the interests of Korean investors throughout the entire phase of the transaction and devising a transaction structure that not only enables optimum investment but also a strategic sale and exit plan. It is essential to engage both Korean and foreign counsel to ensure proper documentation and negotiation, taking into account the laws of both Korea and the target's jurisdiction.

The next phase

Once the amendments to the Financial Investment Services and Capital Markets Act are adopted, domestic PE funds will be able to structure transactions in a more flexible manner. This could allow further investment into mid-to-long term growth capital and enable PE funds with minority shareholdings to influence corporate governance changes in large conglomerates.

These regulatory changes mark a departure from the previous government-induced growth of PE funds and embrace the global trend in regulation that displays a reluctance to restrict the investment activities of PE funds. It is anticipated that these changes will enhance the competitiveness of domestic PE funds vis-à-vis global PE firms.

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