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Fostering Innovation with Patient Capital

Long-term patient capital can help finance innovations that require substantial investment in research and development.

Photo credit: KIF.

Policies should encourage private sector participation in building long-term patient capital to support innovative start-ups.

Introduction

Long-term patient capital is needed to support and enable innovative start-ups to grow. In the Republic of Korea, funding for companies in a seed or start-up stage remains meager, and even venture capital is heavily biased toward later stages of business growth. To increase the supply of patient capital, it is necessary to establish a dedicated investment vehicle. The government also needs to formulate policies to encourage private sector participation, while serving as a liquidity supplier and post-investment manager.

Analysis

There is growing attention given to the role of patient capital in promoting innovations. *Stakeholderism* advocates the broadest sense of patient/dedicated capital as stable, long-term capital, contrasted with short-term, profit-seeking capital of *shareholderism*. More narrowly, it indicates a social venture that supports the independence of social enterprises through long-term investment and financing.

More recently, patient capital is widely used to indicate capital provided with a long-term investment horizon that supports all stages of the business life cycle, and its importance is growing in promoting industrial policies that pursue innovation. The United Kingdom provides a good reference in this regard. In 2017, public opinion was solicited on “Building our Industrial Strategy,” the same was done for “Patient Capital Review” later in the year, and subsequently, British Patient Capital was launched in early 2018 as a fully owned subsidiary of the British Business Bank.

The Republic of Korea’s financial authority has also emphasized the role of patient capital in a financial ecosystem to support businesses throughout their stages of development: from start-up to trial-and-error stage and rehabilitation.

Innovations require substantial investment in research and development (R&D). More patient capital is needed to support innovative start-ups from early stage to business expansion. In terms of the amount of private R&D investment relative to the gross development product (GDP), the Republic of Korea ranked second among OECD countries (4.09%), behind Israel (4.25%). It should be noted that corporate R&D statistics data include R&D investment for both large corporations’ sustaining innovation and start-ups’ disruptive innovation. As of 2016, small and medium-sized enterprises and venture businesses represented 24.4% of corporate R&D; the share of start-ups was estimated to be smaller.

In terms of the amount of venture capital relative to GDP, the Republic of Korea ranked fourth among OECD countries (0.08%), behind the United States (0.40%), Israel (0.38%), and Canada (0.18%). Furthermore, funding support is said to be insufficient for early-stage start-ups. Meanwhile, the *Global Entrepreneurship Monitor* scored the Republic of Korea’s Entrepreneurial Finance at 2.38 in 2017, below the world average of 2.60. These indicate that policies are needed to mitigate the supply-and-demand mismatch for venture capital and to supply patient capital for starting and expanding a business.

New Venture Investment by the Number of Years in Business
In million won

Years	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018** November
3 or less	3,192 (29.3)	3,722 (29.6)	3,696 (30.0)	3,699 (26.7)	5,045 (30.8)	6,472 (31.0)	7,909 (36.8)	7,796 (32.8)	8,972 (28.7)

3 to 7	2,904 (26.6)	3,296 (26.1)	3,137 (25.4)	3,259 (23.5)	4,069 (24.8)	5,828 (27.9)	6,156 (28.6)	6,641 (27.9)	10,805 (34.6)
Over 7	4,814 (44.1)	5,590 (44.3)	5,500 (44.6)	6,887 (49.7)	7,279 (44.4)	8,558 (41.0)	7,438 (34.6)	9,366 (39.3)	11,441 (36.6)
Total	10,910	12,608	12,333	13,845	16,393	20,858	21,503	23,803	31,217

Note: Figures in ( ) are percentages.
Source: Korea Venture Capital Association's Venture Capital Market Brief.

Implications

The government's role is essential because of the high level of uncertainty in the recovery of investment and insufficient liquidity of patient capital. Based on cases from the United Kingdom, the probability of loss was 66.2% in the seed stage, 53.0% at startup, 33.7% in the second stage, 20.1% in the third stage, and 20.9% in the pre-IPO stage.[1]

One way to facilitate patient capital in the Republic of Korea is to establish an investment vehicle with the government providing liquidity and in charge of post-investment evaluation while enlisting the private sector's screening capacity. Eligible industries, companies, and innovative ideas will be explored and selected based on their merits and market potential. Meanwhile, the government needs to facilitate this effort with consistent support and a long-term perspective. As for private sector participation, it might start with efforts such as accommodating insurers' demand for long-term assets, and cautiously decide whether to allow the participation of retail investors.

[1] M Mazzucato. 2015. Growth Stage and Probability of Loss (Table 2). *The Entrepreneurial State: Debunking Public vs. Private Sector Myths,.* p. 55. Anthem Press. US Paperback Edition.

Resources

Korea Institute of Finance website

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