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Competition in Capital Markets – Note by Korea

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Korea

1. Introduction

1. Firms obtain funds through various channels, including bank loans, equity, and bonds. These different forms of financing have distinct characteristics and can affect one another in the course of firms' financing. Therefore, the financing conditions facing firms in capital markets can be affected not only by competition within capital markets but also by competition in other financial markets.

2. It is worth examining how competition among banks affects corporate financing, as firms in Korea rely heavily on bank loans. This paper examines the structure of corporate financing and the relationship between bank loans and capital markets. It analyzes how restrictions on non-price competition in the bank loan market can affect firms' financing conditions and capital markets, drawing on the case of four major commercial banks in Korea that exchanged information on their LTV (loan-to-value) ratios. Based on this case study, it draws implications for competition policy in capital markets.

2. Structure of Corporate Financing and Competition in Capital Markets

2.1. Functions of the Capital Markets and Corporate Financing Channels

3. Firms raise funds through traditional bank lending, as well as through other financing channels—including bonds, equity, venture capital (VC), private equity (PE), and angel investment. Capital markets support firms' investment and growth through private equity investment in unlisted firms, as well as through direct financing—i.e., the issuance of equity and bonds. Financing options available to SMEs can be classified into asset-based finance, alternative debt, hybrid instruments, and equity instruments. The risk and profitability characteristics of these financing options vary across these categories. Corporate bonds and equity instruments, in particular, allow firms to obtain financing beyond bank borrowing. However, the usefulness of these financing methods varies depending on factors such as firm size, credit history, return stability, and investment risk.[1]

4. Financing tools that suit firms' financing needs vary depending on their stage of growth and business risk characteristics. Conventional bank loans are suitable for firms with stable cash flows and sufficient collateral, whereas bank loans may be unavailable to startups or innovative firms due to their high business risks, uncertain future profits, and lack of collateral.[2] This is why VC and angel investment play an important role in providing funding for innovative firms in their early stages of growth and for firms with high growth potential. Hybrid financing can be useful for firms that need additional capital to grow and transition their business structures.[3]

[1] OECD (2015)

[2] OECD (2015)

[3] OECD (2015); OECD (2019).

5. The OECD (2019) explains that diversifying financing channels can help meet firms' various capital needs and enhance their ability to respond to changes in the credit market environment.[4]

2.2. Current Landscape of Capital Markets in Korea

6. One of the characteristics of corporate financing in Korea is firms' heavy reliance on loans. Looking at the financial debt of domestic non-financial firms as of late 2025, loan debt—including bank borrowings—accounted for 84.7%, while market-based debt—e.g., corporate bonds and commercial paper—accounted for 15.3%. In particular, the share of loan debt increased by 6.7 percentage points from late 2010, while that of market-based debt decreased by the same amount over the same period.[5] This indicates that loan financing continues to play a crucial role in the financing of domestic firms.

7. Comparing Korean firms with their foreign counterparts, it is notable that Korean firms rely more heavily on loan debt than U.S. firms do, and that their reliance on bank borrowings is even greater than that of German firms. As of late 2025, market debt accounted for more than 60% of the financial debt of non-financial firms in the U.S., while loan debt accounted for less than 40%. By comparison, loan debt accounted for 84.7% of financial debt in Korea. In Germany, loan debt accounted for approximately 95% of the financial debt of non-financial firms—a higher share than in Korea. However, bank loans accounted for only 30% of their total loan debt. One reason for this is that financing channels other than bank loans—including intra-group lending and cash pooling—are widely available in Germany. This suggests that corporate financing in Korea is relatively more concentrated in bank loans.[6]

8. The financing structure also differs significantly by firm size. Borrowings accounted for approximately 50% of the combined amount of loans and corporate bonds for large firms, while they accounted for more than 90% for mid-sized firms and SMEs. Furthermore, as of late 2025, loans from banks and other depository institutions accounted for 73.9% of non-financial firms' total loan debt, remaining a relatively high share despite declining from 82.6% in late 2010.[7]

9. Domestic market surveys also demonstrate SMEs' and startups' heavy reliance on loan-based financing. Bank borrowings accounted for 63.9% of newly raised external funds for general SMEs.[8] The shares of new financing obtained by startups from private financial institutions, policy financing, and VC and angel investment were 26.6%, 26.9%, and 16.8%, respectively.[9] This indicates that loan financing remains a major channel for securing funds for SMEs and startups, although they are also making use of various financing tools.

10. Although the domestic capital markets have recently expanded, particularly in the stock and bond markets, access to capital markets and the availability of financing vary significantly depending on firm size. The Korea Capital Market Institute (2026) pointed

[4] OECD (2019)

[5] Lee, Seong-bok (2026)

[6] Lee, Seong-bok (2026)

[7] Lee, Seong-bok (2026)

[8] Industrial Bank of Korea (2026)

[9] Ministry of SMEs and Startups (2025)

out that the growth of the Korean stock market was concentrated in a few large IT and semiconductor firms in 2025, and that financing conditions for SMEs and firms in their early stages of growth could become more constrained if this concentration continues. It emphasized the need for policy support for innovative firms with growth potential and institutional improvements to increase SMEs' and early-stage firms' access to capital markets.

11. These features of domestic corporate financing indicate the need to examine the relationship between bank loans and financing through capital markets. Given the heavy reliance on loan-based financing among domestic firms, particularly SMEs, the competitive landscape in the bank loan market can significantly affect firms' availability of financing. The availability of bank loans and capital-market-based financing, however, varies depending on firm size, creditworthiness, and stage of growth. Therefore, the relationship between these two financing channels should be examined in light of corporate characteristics.

2.3. Relationship between Bank Loans and Capital Markets

12. As bank loans and capital-market financing are two different financing channels with distinct characteristics, they typically play complementary roles in corporate financing. The OECD (2019) explains that capital market financing tends to supplement bank loans rather than replace them. Holmström and Tirole (1997) demonstrated that financial intermediaries' monitoring helps firms obtain funds from external investors who lack sufficient information about them, and that firms' ability to secure funding and invest may be limited when financial intermediaries' capital decreases—particularly in the case of firms with insufficient net worth. Robb and Robinson (2014) found that newly established firms relied heavily on bank loans and other debt financing from external sources. Schmalz, Sraer and Thesmar (2017) conducted an empirical analysis showing that an increase in the value of real estate collateral positively affects the probability of starting a business and its subsequent growth. These studies suggest that bank financing can complement other financing methods and that financing based on bank loans and collateral can play an important role in firms' investment activities.

13. Depending on firms' creditworthiness, business risks, and access to capital markets, bank loans and capital-market financing can substitute for one another. Diamond (1991) theoretically explained that firms' choice between bank loans and direct financing depends on their creditworthiness and the need for monitoring by financial intermediaries. Bolton and Freixas (2000) also demonstrated that firms choose between bank loans and the issuance of corporate bonds or equity based on their business risks. de Bettignies and Brander (2007) and Winton and Yerramilli (2008) theoretically analyzed how firms choose between bank loans and VC based on business risks, management control, and monitoring by financial intermediaries. These findings suggest that bank loans and other financing methods can substitute for one another under certain circumstances, despite their different characteristics.

14. More specifically, bank loans can serve as an outside option for firms seeking financing in capital markets. Even if firms decline investor offers, being able to obtain the funds they need from banks can help firms secure a more favorable bargaining position and more favorable investment terms. Renucci (2014) theoretically analyzed how access to bank financing affects negotiations with VCs over the division of investment returns between firms and VCs. Similarly, Inderst and Müller (2004) suggested that the possibility of raising funds from other VCs can affect firms' bargaining power and investment terms. Bienz and Hirsch (2012) analyzed how access to financing from external sources is related to the detailed terms of investment contracts through an empirical study. Given these

findings, outside options available to firms can influence their bargaining power and the terms and conditions of investment contracts.

15. Changes in the availability of bank loans can influence not only firms' bargaining power but also the actual financing choices they make. According to Becker and Ivashina (2014), firms that have access to the corporate bond market tend to choose corporate bond issuance over bank loans when bank credit supply is constrained. Leary (2009) also demonstrated that the availability of bank loans affects firms' capital structure and their choice of financing methods. Meanwhile, Bergbrant, Bradley and Hunter (2017) found that tighter bank lending standards can lead to a decline in the number of IPOs and an increase in IPO withdrawals. This implies that tighter bank lending standards do not necessarily lead firms to switch to capital-market financing, and that firms' overall access to financing may be constrained depending on their access to alternative sources of financing.

16. In conclusion, competition in the bank loan market can affect not only loan terms in that market but also the availability of financing through capital markets. When the amount of loans that firms take out decreases or loan terms become tighter due to less competition between banks, the value of the outside options available to firms may decline, and their bargaining position vis-à-vis capital market investors may also weaken.

3. Key Aspects of the LTV Information Exchange Cartel Involving Four Commercial Banks

3.1. Overview of the Case and LTV as a Competition Variable

17. The LTV information exchange case involves four major commercial banks with the largest market shares in terms of loan value in Korea. They regularly exchanged information on LTV ratios over a long period and used this information to determine their own LTV ratios. The banks involved in the cartel adjusted their internal standards for setting LTV ratios taking into account their respective ratio rankings and competitors' average ratios. The Korea Fair Trade Commission (KFTC) concluded that this information exchange had restricted competition in the mortgage loan market and imposed remedies and administrative monetary penalties.

18. The LTV ratio is the percentage of a loan amount relative to the value of the real estate property used as collateral, and is therefore an important factor that determines the amount of credit available to a borrower based on the collateral they own. Banks are likely to attract more customers by raising their LTV ratios, as borrowers can obtain larger loans against the same collateral. At the same time, however, the risk of loan default increases. If banks, on the other hand, lower their LTV ratios, the risk of default decreases, but they are likely to lose customers to competitors that offer larger loans. That is why banks determine their LTV ratios by considering the trade-off between their competitiveness in attracting potential borrowers and the risk of loan default, with LTV ratios serving as a crucial factor in competition for customers.

19. However, if banks are aware of the loan terms offered by competitors through the exchange of LTV ratio information, competition to attract customers by offering larger loans may be weakened. Specifically, the banks involved in the information exchange cartel adjusted their own ratios to narrow the gap with the average LTV ratios of the other banks in the cartel, taking into account their own ratios relative to those of competitors. The KFTC's economic analysis also confirmed that these adjustments were made to reduce the differences between their ratios and those of their competitors. Such information exchange

can restrict competition for customers by influencing banks' independent decision-making on loan terms and conditions.

20. In fact, the average LTV ratio among these cartel participants was made at a lower level than that of banks outside the cartel. This indicates that harmonizing LTV ratios can limit the size of loans available to borrowers. Therefore, this case is significant in showing that competition in the bank loan market can be restricted due to non-price factors—i.e., LTV ratios—as well as by price factors such as interest rates.

3.2. Impact of LTV Ratio Information Exchange on Firms' Financing Conditions

21. Borrowers are likely to have difficulty choosing larger loan offers in a market where multiple banks apply similar LTV ratios. Such constraints on loan availability can affect firms' financing through capital markets. Firms that regard bank loans as a viable outside option may have greater incentives to seek funding from external investors when the amount of credit available to them decreases. At the same time, the value of that outside option in negotiations with investors may also decline.

22. However, this impact can be observed when bank loans serve as viable outside options for firms. Changes in LTV ratios would have different impacts on firms with sufficient real estate collateral and on startups whose businesses are built primarily on intangible assets, given the differences in their access to bank loans.

23. In this case, the analysis examined whether the exchange of LTV ratio information restricted competition in the mortgage loan market, but did not extend to its impact on firms' investment terms in capital markets or their total financing. This case, nevertheless, can serve as a case study illustrating the mechanism through which restricted competition among banks for customers may limit the financing options available to firms. In particular, restrictions on competition arising outside capital markets may affect firms' outside options and their negotiations with investors, making this issue closely connected to competition in capital markets.

4. Implications for Competition Policy

4.1. Considerations Regarding Restrictions on Competition Outside Capital Markets

24. To assess competition in capital markets, it is necessary to examine not only the competitive landscape among fund providers in those markets but also the competitive landscape in other financing markets. This is because the actual investment terms that firms can accept may vary depending on competitive conditions in other forms of external financing, including bank loans, even when the number of fund providers and levels of market concentration remain unchanged.

25. Specifically, competition between fund providers and the financing options available to firms need to be examined separately. Even if competition among fund providers within capital markets remains strong, firms' financing may be constrained when their financing options are limited. On the other hand, firms with access to alternative sources of financing can negotiate financing terms without relying solely on their existing sources of funding.

26. When bank loans and capital-market financing are complementary, a reduction in bank lending may also affect firms' ability to raise funds through capital markets. In assessing the impact of restrictions on competition in the bank loan market on capital

markets, it is therefore necessary to consider both how bank loans, as an outside option, affect firms' bargaining terms with investors and how a reduction in bank lending may affect capital-market financing through this complementary relationship.

27. Yet, it does not mean that the bank loan market and capital markets need to be defined as a single market. Rather, the availability and terms of bank loans may affect firms' negotiations with investors and their access to alternative financing options, while the two markets remain distinct.

4.2. Potential Impact on Firms' Financing and Innovative Activities

28. Weakening competition in the bank loan market may impede investment and innovative activities. When loan amounts shrink or borrowing terms deteriorate due to less competition among banks, firms without sufficient alternative financing options may fail to secure the funds necessary for investment. In such cases, firms may forgo or scale back investment despite the existence of profitable opportunities, thereby constraining R&D and new business projects.

29. Such a relationship between financing constraints and innovative activities has been examined in previous research as well. Giebel and Kraft (2020) empirically analyzed how a decrease in the supply of bank credit constrains existing and new innovative activities. Tian, Han and Mi (2020), on the other hand, found that intensifying competition among banks tends to improve firms' innovation outcomes and the efficiency of R&D investment. These studies show that firms' innovative activities can be influenced not only by the availability of bank credit but also by competition among banks.

30. However, these tendencies can vary depending on firms' growth stages and access to alternative financing options. The more heavily firms rely on bank loans and the less access they have to alternative financing, the less likely they are to pursue investment and innovative activities.

31. Accordingly, this LTV ratio information exchange case holds significance as it illustrates how the weakening of non-price competition in the bank loan market can constrain investment and innovative activities, in addition to limiting firms' access to financing.[10]

5. Conclusion

32. Firms obtain funds through bank loans, capital-market financing, and various other channels, and competitive conditions in the bank loan market can also affect firms' financing through capital markets. Bank loans, in particular, can serve as outside options for firms seeking financing in capital markets, and the availability and terms of bank loans can indirectly affect firms' bargaining positions and the terms offered by fund providers.

33. The case involving the cartel formed by the four major commercial banks through the exchange of LTV ratios provides an example of how this relationship can be examined in the context of non-price competition in the bank loan market. If loan amounts and financing options are limited due to less competition among banks for customers, the effects may extend beyond the bank loan market, influencing firms' financing decisions and their negotiations over financing terms with fund providers in capital markets.

[10] However, these potential ripple effects on capital markets and innovation have not been examined directly in this case.

Specifically, when bank loans are complementary to other financing options, constraints on bank lending may also constrain firms' access to other forms of financing. These financing constraints may impede firms' investment activities, further adversely affecting R&D and innovation.

34. To assess competition in capital markets, therefore, competition in external markets where firms can seek financing needs to be examined in addition to competition among fund providers within capital markets. In particular, assessing how non-price factors—e.g., LTV ratios—affect both the financing options firms choose and the availability of other options will help us understand more comprehensively how restricted competition within the bank loan market affects other financial markets.

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