



Asia: Lessons to be Learned

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Heterogeneous is not an adjective one would use to describe the private equity industries in the Asian region. Quite the opposite in fact; countries in the Asian region range from more developed markets such as Japan, Australia and Hong Kong and Singapore to up-and-coming countries such as China, India, Indonesia, Thailand and Vietnam. The diverse histories, political, regulatory and economic structures offer investors a plenitude of opportunities, but also mean association bodies play a vital role in transmitting education, training the next generation of private equity funds, and lobbying governments for conditions to encourage continued development of the industry not in just their own countries, but throughout the region.

Building from a Sound Base

Australia's comparatively mature private equity regime has flourished over the last decade because of structural and macro-economic features that encourage investment, says Katherine Woodthorpe, chief executive of the Australian Private Equity and Venture Capital Association Ltd (AVCAL).

"It's relatively well developed and mature, and it's demonstrated good returns over the last ten years," Woodthorpe said. "A lot of it is about Australia specifically; when you invest in a company, the corporate legal system is supportive, and Australia has a good tax system to encourage private equity. Those are the main things."

Because the market fundamentals already exist in Australia, AVCAL counts as one of its mission's public education. "Within Australia, our key delivery is to our members and our major aim is to foster an understanding of private equity and venture capital as part of the broad Australian economy," says Woodthorpe. "It is also to encourage entrepreneurship and to encourage investment in the venture capital/private equity asset classes. The things we do around that include advocacy with parliaments, governments, with the media, to inform and educate the way it operates and the benefits that it brings."

However, Woodthorpe also notes AVCAL has a role to play with its peers internationally and, among other things, works to set in place common standards. "In terms of association to association contacts, there is a network of associations worldwide which share information on a number of issues," she says. "We are members of an international private equity valuation forum, for example. We sign up to a global standard on valuation and reporting guidelines that encourage counterparts in the region to do the same. We have contacts with counterparts and we share issues, whatever they may be. I think we're a good example. Wherever possible we try to offer assistance elsewhere, but often there are issues that are not unique to private equity. There is nothing in terms of legal or reporting standards that applies strictly to private equity that doesn't apply to other areas of corporate law."

Importance of Affiliations

AVCAL isn't the only industry association that enjoys cross-border affiliations. The Indian Venture Capital Association (IVCA) has relationships with the European Private Equity & Venture Capital Association (EVCA) and the Emerging Markets Private Equity Association (EMPEA). As part of its mission, IVCA offers a foundation training course for potential venture capitalists, and the training modules come from the European Venture Capital Association, whose staff attend the courses to help with training, says Ranjit Shastri, executive director IVCA.

Learning Together

"We benefit because [EVCA] has an excellent training programme and we plug right into that," Shastri says. "The foundation course is a 3-day course. It brings in reps from EMPEA and EVCA. It teaches negotiations of terms, valuation, valuation guidelines for reporting purposes. We are also considering adding a module for limited partnerships."

This foundation course is vital to developing India's venture industry, which suffers from too few angel investors, a situation that stifles the success of entrepreneurs, Shastri says. "We have a very, very small venture capital industry community in India, and there are not enough angels to seed the future companies," Shastri said. "It is hard to reap if you don't sow. Start-ups in India have been backed by business families, traditionally. There is a business community of business families. Traditionally entrepreneurs born into a business family have a big advantage because they could get access to capital. The business families typically didn't back entrepreneurs outside of their families; immediate family or cousins only."



"In a way, it's undemocratic because there are a lot of worthy entrepreneurs out there who deserve to be funded because of the quality of the ideas. That's a constraint on the healthy evolution of the entrepreneurial ecosystem in India."

Addressing Different Challenges

By contrast, there are funds aplenty for Chinese businesses looking for private equity. Because China is a hot market for investment and is attracting attention from domestic and international players, companies are looking for private equity partners that will bring skills that can be imparted to the staff, says Graham Brant, CEO of Beyond Asia Capital. Beyond Asia Capital, founded by Brant, former-CEO of Microsoft Hong Kong, and Alfred Shi, a founder of Focus-Media, invests in small- and medium-sized firms with turnover of US\$50 million to US\$1 billion.

"The biggest difference you see, particularly in SMEs, is that companies need a lot more help because they are less developed," Brant said. "They have strong entrepreneurial skills, but have less in management orchestration and organisation. You'll have a strong, single-minded entrepreneur, but no delegated structure for work. Given that, what SMEs are looking from a funding organisation is more than cash. In China, there is a lot of cash floating around. What they want more than anything is smart money; the expertise and how to build brand, distribution channels; things that are second nature in Hong Kong and Singapore, for example."

As a result, Brant says Beyond Asia Capital helps "engineer change" in the businesses they take a stake in. Beyond Asia Capital will typically buy a stake of between 40% and 50%. "You have to get a balance. If you take a pure fund manager/investor approach to it, you're not going to get too far in China," Brant says. "For one, you're not adding enough value to a company with access to multiple sources of cash. You have to help engineer the change in the business. That's going to come with globalising the companies in one form or another... We're more like the conventional business re-engineering/business consulting, except we take a capital investment instead of charging a consultancy fee."

Sharing Knowledge

Other organisations are also bringing their experience to bear in mainland China, and transmitting information on mainland China to their members. The Hong Kong Venture Capital and Private Equity Association (HKVCPEA) holds an annual summit specifically on China, for example. "We do on a regular basis have an annual summit on China's rules and regulations," says Patricia Chiu, executive director of HKVCPEA. "It's an update of rules and regulations. We also try and cover up-and-coming countries like Vietnam to acquaint our members with the rules of each. The biggest market for the region is China, but also because the rules change constantly. It's an evolving country. It's essential that the practitioners have an update on those rules."

Hong Kong is also well placed to transmit information the other way as well. Hong Kong's venture capital and private equity industry has been directing attention to mainland China for at least a decade, Chiu says, and with outside professionals comes transmission of standards and other business practices. "Private equity professionals have been going into China for ten years or more and have been supporting the skills and the knowledge of China," Chiu says. "I would say that they have been helping a lot of the professionals, a lot of the firms have set up offices in Beijing and Shanghai, basically applying the standards, the international standards that Hong Kong uses, and helping raise levels in China. I think China is definitely trying to move up to more international standards, but I think it will take time to do it. I think private equity is just beginning to be recognised as an area of growth, internally, on [mainland China]. That will of course follow in the next few years."

With funds, entrepreneurs and investors looking to seed businesses, some emerging markets still don't attract attention because they lack structures that enable funds to enter into and exit asset purchases.

The Bigger Picture

"It's really about enabling environments," says Veronica John, CEO of IDFC Capital (Singapore). "You have to look at what steps these more developed markets took to create the enabling environment to establish a vibrant and robust private equity industry. For example, you have to have an environment where you can achieve exit, such as through capital markets. I've supported funds in Vietnam, for example, and there are managers who are investing in good companies with good fundamentals and good corporate governance, but whether they can achieve an exit is another story, unless it's as a trade sale."

John points to developments in both India and China that, in her estimation, have adequate liquidity to reassure private equity firms that there is ease in investing in as well as exiting a company in those countries. "You can see that in a country like India or China, you can achieve liquidity," she says. "They have volume, they have the quality/calibre of the



regulators and there are legal systems that ensure even the most fundamental things like ownership of property, very basic legal rights. You need those to support the private equity industry. You also need laws to support a decent commercial banking industry, because in a country that doesn't have good foreclosure laws, bankruptcy laws, etc, you're not going to see a banking sector that develops. With private equity you need that leverage as well."

As John notes, she has invested in businesses in Vietnam, but on the expectation that there will be a longer term time horizon for holding assets.

"With Vietnam, you have to think longer than five years, depending on how the markets develop," she said. "The other thing is you have to look at the management. There's one fund that I committed to in Vietnam; their fundamentals are all sound, with one set of books, clean corporate governance, and they're ready for public listing. There are companies with revenues that are growing at a clip of 50-80% pa, good company, good scalability, but no exit plan. You can't do it."

The Work Has Only Just Begun

Even as the developing markets in Asia are evolving and industry associations are making noise about domestic opportunities, Asia's more mature markets are not sitting back. Promoting a country's benefits is not the parvenu of developing countries only; AVCAL participates in international conferences as a way of raising the country's profile. "Private equity investment needs to be both from your own country and the global market; you need global investors as well," says Woodthorpe of AVCAL. "Persuading people to invest in Australia, when it's so far away and little known, is a problem.

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