Around the region: Private equity's public face

Private equity is more entrenched and better understood in some Asian markets than others. What do the various stakeholders - entrepreneurs, government, media, public - make of the asset class?

AUSTRALIA

Katherine Woodthorpe, CEO, Australian Private Equity & Venture Capital Association

THREE TO FOUR TIMES A YEAR, A GROUP of journalists from an Australian newspaper sits down with a private equity executive and the CEO of one of his portfolio companies. The PE executive does very little of the talking, leaving it to the CEO to explain why he brought in private equity and what it's like working for them.

This is one of the Australian Private Equity & Venture Capital Association's (AVCAL) roundtables intended to improve media relations with the industry. "It is very frank and because the CEO is at the coal face, rather than a manager behind the scenes, they get a good response from the media," says Katherine Woodthorpe, CEO of AVCAL.

The public face of private equity in Australia has been tarnished in recent years. Although the Cooper Review placed the fees paid to PE managers under the spotlight – prompting a minority of investors to reconsider their allocations to the asset class – the fallout from some of the leveraged buyouts that took place prior to the global financial crisis has been much more damaging for the industry's profile.

In the last few weeks, embattled media giant Nine Entertainment underwent a debt restructuring that saw CVC Capital Partners lose all of the A$1.8 billion in equity it pumped into the company through several highly leveraged transactions between 2006 and 2008. Details of the protracted negotiations were leaked to the press, fueling a public perception of private equity that doesn't reflect the reality.

"They think everything is highly leveraged buyouts – people don't understand the shades of gray that the industry comes in," Woodthorpe says. "One of the problems is that these deals involved brand name, but the vast majority of transactions are smaller companies that no one has heard of because they make shipping containers or construction site toilets."


Australia

If a private equity-backed company goes into receivership it receives far more coverage than situations in which there is no PE involvement. At the same time, stories about investments generating a 6x return for LPs and helping move businesses forward get little traction.

While noting this disparity – which is not unique to Australia among developed markets – Woodthorpe believes private equity's public profile is far better than it was five years ago, partly because there is a general recognition among GPs that the world has changed and they must become more engaged.

AVCAL also runs events designed to facilitate a better understanding of private equity in government and corporate circles. A recent seminar saw corporate executives and PE professionals participate in panel discussions, attracting around 40 attendees from the business world.

"There is a perception among corporates that private equity investors are hostile bidders who come and kick the tires," says Woodthorpe. "It remains a challenge."

CHINA

James Wang, partner, Han Kun Law Offices, Beijing

PRIVATE EQUITY IS A BROAD TERM - IT might be used to refer to leveraged buyouts, pre-IPO financing, growth equity, venture capital, or perhaps all of the above. While in more mature markets such as the US and Europe, the leveraged buyout is a dominant force, with transaction sizes that dwarf the likes of venture capital, China is still very much a small-cap play. There are none of the negative connotations tied to leveraged buyouts because such deals don't exist. As such, private equity's public image differs from elsewhere.

In the West, the media is all too willing to brand private equity investors as locusts who acquire undervalued companies, sack workers and strip out and sell off assets to pay down the debt. The general public in China is largely oblivious to this kind of critique. At the same time, though, no consistent views are expressed – by the public or in the media – towards the asset class. Most people don't understand it as a function of asset allocation.

This is an important point because, regardless of the fact that they don't fully understand PE, people are investing in it. Among those who participate, there is a general preference to bet only areas with which they are familiar. An entrepreneur who has made his fortune in the technology sector, for example, is more likely to invest in funds targeting that sector – or even set up his own fund targeting that space.

The channels through which individuals participate in such vehicles are as informal as their grasp of the asset class might suggest. A group of like-minded entrepreneurs might be entrust capital to an acquaintance with some VC experience. The GP and LP roles, so clearly defined in Western private equity, are blurred; little if anything is set out in contract form.

In some extreme cases, these "investor clubs" reach a significant scale, at which point operations do become more professional. Yunfeng Capital, which was set up by David Yu and Jack Ma, founders of Focus Media and Alibaba Group, respectively, has a partner roster that reads like a who's who of CEOs who have


China

taken Chinese tech companies public in the US. The collective experience, resources, expertise and connections of these individuals makes for a powerful deal-sourcing tool.

High net worth individuals who don't belong to these clubs are typically approached by placement agents regarding PE commitments. Shanghai-based wealth management firm Noah is a case in point. It has established a wide network of wealthy clients and succeeded in raising capital for a number of funds.

However, the fundraising environment is a lot more challenging this year compared to the past two years. This is partly attributable to the sharp drop in public market valuations in China, which makes it more difficult for private equity and venture capital firms to exit their investments at short order and for high multiples.

For many high net worth individuals that committed capital in more bullish times, the asset class has suddenly become much less attractive. They lose interest and default on capital calls. In this context, it's fair to say the public face of private equity in China isn't as rosy as it once was.

INDIA

Vikram Utamsingh, head of transactions and restructuring for KPMG India

A POSITIVE DEVELOPMENT IN INDIA'S private equity environment since the global financial crisis has been a better understanding and a stronger appreciation for the asset class. Business owners have begun to see private equity not only as just another source of capital but more as a partner for growth.

The weak primary market coupled with high interest rates over the past three years has meant that Indian firms have had to look at alternate sources of capital for their expansion plans. As a result, not only have better deals flowed to PE investors, but also entrepreneurs have become more appreciative of the value that a private equity firm brings along with its investment.

Our research indicates that more than 12 companies that raised money from private equity between November 2010 and April 2012 initially got regulatory approval for IPOs but subsequently changed their plans. For example, an ATM outsourcing and system integration company raised $33 million from TPG Capital in June 2011. An energy company received about $45 million from an international infrastructure fund, having recognized that this partner has a strong local knowledge of the industry as well as a global network of contacts and experience.

Large Indian business groups that previously would not have partnered with private equity firms are now approaching investors to support expansion in the overseas markets. The Tata Group and Mahindra & Mahindra group have each partnered with PE firms on specific opportunities.

KPMG research based on interviews with business owners has shown that PE investors are also playing a more active role in their portfolio companies despite being minority shareholders. They can attract management talent, help develop new business models, improve corporate governance and identify new partners and customers. In addition, PE firms are increasingly hiring specialists to add value to these companies.

As for the general public's view of private equity, it is quite different. This is because the Indian media only focus on deals and the challenges the industry faces in terms of exits and returns. Also, the regulators continue to have a difficult time distinguishing this asset class from financial institutional investors who target short-term public market deals. The recently issued Alternative Investment Fund (AIF) regulations impose unnecessary restrictions on fundraising and fund management.

The Industry is responding and has formed working groups under the Indian Venture Capital Association and the Confederation of Indian

Industry to interact with different regulators. This approach seems to be working. However, the general public perception is a much more difficult challenge to overcome.

JAPAN

Joji Takeuchi, CEO and co-founder, Brightrust PE Japan

VENTURE FUNDS? "GOOD GUYS." HEDGE funds? "Greedy and scary" Buyout funds? "What do they do? Are they vulture funds? This is what I think the "uninformed" public would say if asked about "funds." But, for most people, it is hard to distinguish between so many different types of funds and understand exactly what they do.

Broadly speaking, I believe the public image

of private equity has improved significantly in the last 10 years. The Shinsei Bank bailout in 1999-2000 painted a negative picture of the asset class due to the specific circumstances of the deal. In mid-2000s, Murakami Fund, an aggressive activist hedge fund, challenged public tolerance levels of "greed-driven capitalism."

In between them, a lot of corporate restructuring and turnarounds were executed by local private equity funds. Many involved well known domestic companies such as Kanebo and Daiei. As a result, the public image of private equity improved and it established itself in the Japanese economy and society. Nonetheless, "fund" still has negative connotations when used in conjunction with corporate acquisitions…

Small- and medium-sized enterprises (SMEs): SMEs account for more than 75% of Japanese buyouts, but a number of these companies still decline to meet with private equity firms, possibly due to the vulture image. Getting access to these deals is critical for GPs. While foreign investors inevitably find it tough, captive funds can leverage their ties to well-known institutions.

Large companies: Most large listed firms are happy to buy portfolio companies from Japanese and non-Japanese private equity players. Many will also sell subsidiaries to these same players. Problems only arise when PE investors try to acquire these firms in their entirety or make "difficult" requests, such management changes.

Investors: In the past 10 years, I have not met a single professional in the private equity department of a Japanese institution who said, "I do not like PE." Many have become fans of the asset class but regulatory developments in recent years – notably Basel III solvency requirements – mean this enthusiasm can no longer be replicated at the institutional level.

Government: The most earnest supporter of private equity – on a domestic level – is the Ministry of Economy, Trade & Industry (METI). It wants to see the industry develop and has supported numerous initiatives to promote foreign investments into Japanese PE funds. These include the 2009 tax reform that substantially eliminated tax liability for foreign investors in Japanese limited partnerships.

Politicians: The perception of private equity among politicians varies depending on the individual's knowledge. It would be fair to say the depth of understanding is quite modest.

Media: The mainstream media's stance on private equity also varies. The less transparent the fund, the more susceptible it is to criticism. There is also the expectation that private funds should play a major role in energizing Japanese economy.

SOUTH KOREA

Sunny Yi & Wonpyo Choi, partners, Bain & Company's Seoul office

WHILE THE MEMORY OF PRIVATE EQUITY'S tumultuous early years still lingers in Korea, public sentiment seems to have turned a corner. Foreign PE investors entered the country during the tough days of the Asian financial crisis and funds' healthy returns were met with strong resentmentby a nation struggling with massive unemployment.

Some deals, like Newbridge Capital's acquisition and turnaround of Korea First Bank, were viewed more for the dramatic returns reaped by foreign investors than for the significant improvements made to the business. Others, like Lone Star's purchase of Korea Exchange Bank, ended in scandal and fueled a continuing controversy about the wisdom of foreigners buying assets in financial services and other sensitive industries.

While a degree of sensitivity remains, it is softening. And there are signs that Koreans as the government offers more vocal support and as more companies, investors and individuals feel its positive effects. It's only been eight years since the government allowed local PE funds to operate.

Among Korea's business leaders, those who have used private equity as a vehicle for growth or capability building tend to be more positive than those who have not. Doosan wisely relied on PE to carve out its non-core businesses and de-leverage its capital structure. Fila bought Acushnet, a leading golf brand, with the help of PE investors. Many owners of mid-cap companies are now using PE as tools for growth capital or to cash-out. Some are working with global or regional funds to expand overseas.

Actions speak louder than words, so each successful PE deal in Korea serves to quiet the skepticism that once raged so strongly.

Private equity still has its share of detractors. For example, conflicts frequently arise when PE funds take board seats and exercise their rights – angering owners who are accustomed to making all the important decisions themselves. There is also resistance when funds structure deals to gain favorable downside protection. And because many PE players lack years of experience working with major firms, they also lack the insights and knowledge that helps improve companies.

However, such challenges are now being balanced – and outweighed – by visible evidence that PE has much to contribute to Korea's economy. The government and regulators are positive towards the asset class provided


South Korea

deals don't involve over-leveraging, massive restructuring or leakage of core technology.

The days of bottom-feeding are giving way to tangible portfolio value creation. PE funds are becoming more actively involved in management and operations, upgrading portfolio companies' management infrastructure to make them more scalable, finding new customers, suppliers and partners. These are not only requirements for private equity to flourish, but also the best way to improve the industry's once notorious image.

SOUTHEAST ASIA

Dean Collins, partner, O'Melveny & Myers, Singapore

GAUGING PERCEPTIONS OF PRIVATE equity amongst the public and various stakeholders in Southeast Asia is challenging for a number of reasons, most obviously because its constituent countries do not think as one. Cultural, social, lingual and economic disparities confound generalizations.

At one end of the scale sits Singapore: modern, transparent, user-friendly regulation and making a concerted effort to attract more foreign private equity firms. Public views on the asset class are generally positive because the government is pushing all the right buttons.

Myanmar is at the other end of scale. "Some governments haven't addressed their minds to private equity yet," says Dean Collins, a Singapore-based partner with O'Melveny & Myers. "Myanmar has just passed new rules on foreign investment. It's not about PE; it's about recognizing this is a poor country that needs foreign capital. They are not discriminating between PE and corporations."

Looking at the region as a whole, economies are not as penetrated by PE as elsewhere in Asia.

"For years, there were only four local GPs in Indonesia – plus a few international guys above them looking for deals – and now there are 5-6," says Collins. "In Thailand there are only two established private equity firms, and although Vietnam saw a sharp increase in GPs a few years ago, most have since faded to the margins."

Given the growth-oriented nature of many transactions, together with the strong consumer sector focus in countries such as Indonesia, wherever the public and business communities actually have reasonably informed views on private equity, they tend to be positive.

Collins cites Indonesian movie theater chain Blitz Megaplex as an example. The entrepreneur who started the business wouldn't have been able to do so without support from local GP Quvat Management. From a pure consumer point of view, before Blitz came along, Indonesia only had one movie theater chain, so there is a sense that PE has made a positive contribution.

"What you don't have yet in Southeast Asia are the millionaires you find in China who got rich thanks to private equity-backed IPOs," Collins adds. "People are influenced by their friends and contacts – if one person received PE capital then the others want investment as well – but there aren't a lot of stories about this guy or that guy getting his money from CDH Investments."

There are, however, a couple of private equity professionals who enjoy a reasonably high public profile. Gita Wirjawan, founder of Ancora Capital, is now Indonesia's trade minister, while Sandiaga Uno, co-founder of Saratoga Capital, is a regular contributor to local media.

Last month, Uno used his column in The Jakarta Post to criticize media coverage of tensions between Indonesian family conglomerate Bakrie Group and UK financier Nathaniel Rothschild, who together control Bumi,


Southeast Asia

an Indonesian coal producer. The public response was, to say the least, mixed.

It serves as a reminder that Southeast Asia is characterized by an asset ownership model under which a lot of power lies in the hands of a few families. Private equity firms need to do business with these families and so the public perception of one will inevitably rub off on the public perception of the other.