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GLOBAL MARKET COMMENT: AFTER THE CRISIS: ASIAN PRIVATE EQUITY INVESTING

October 2002

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After the Crisis:
Asian Private Equity Investing [1]

If private equity investing were a soccer game, the score over the past decade would be the United States 12, Europe 6, Asia 0. Hardly anyone has made money in Asia—or, more accurately, hardly any third-party financial investors have made money in Asia. This is due in part, of course, to the wealth destruction of the Asian financial crisis of 1997-98, but also because most Asian countries lacked the socio-economic conditions conducive to institutional quality, third-party private equity investing.

The crisis precipitated some changes in those conditions—albeit unevenly and incompletely—and private equity investment opportunities have expanded accordingly. Investors have earned good returns from funds invested in Japanese distressed assets,[2] and Korea has afforded some opportunities in distressed assets and buyouts, but on the whole the level of activity is less than one would have expected and Western investors remain suitably cautious and selective.

Historically, one of the distinguishing characteristics of private equity investing in Asia has been the issue of control. Even when keen to raise expansion capital from private investors, Asian families, corporations, and governments have all been unwilling to cede any control to outside investors, whose rights as minority investors have often proved both tenuous and unenforceable. Pre-crisis, the most common forms of private equity investing were the provision of expansion capital as a minority investor—with the problems just mentioned—and pre-IPO speculation; that is, buying into a private company about to go public in the hope of reaping quick gains from a post-IPO pop. For obvious reasons, that game is now dead.

Looking forward, Asia should provide an abundance of buyout opportunities, since risk-taking buyout investors are expert in the triage wrecked economies need to help bury the dead, shoot the hopeless, and nurse the wounded back to life. Unfortunately, only Korea has accepted this necessity, and even there political considerations limit the scope of such clean-up operations. In contrast, Japan has still not accepted that the route back to economic health is through the liquidation of excess capacity and uneconomic enterprises, but continues to nurse hopeless cases, diverting capital and resources from potentially sound companies, and depressing profits for all competing businesses. Buyout investors are

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[1] We exclude from this comment both venture investing in China, on which we have a paper impending, and Australia, whose economy runs along Western lines (with a small, but thriving, private equity market). A detailed paper on Asian buyout investing is also imminent.

[2] See our recent report *Japanese Distressed Investing*.

massing on the sidelines of the Japanese economy, just waiting for some catalyst to send them into the game—but they have been there for years, stamping their feet to keep their enthusiasm warm, and still the signal has not come.

Finally, generalizations about Asia are fraught with risk, since conditions vary so much from one country to another across the region. However, one can say that although many countries have enacted or amended bankruptcy laws and have liberalized regulations governing such issues as foreign investment in domestic companies, minority shareholder rights, and so on, the playing field is still far from level and foreign investors should never take for granted that laws and regulations in their favor will always be enforced.

Asia remains a region of greater potential than of actual opportunities for private equity investors, but that potential is gradually becoming more tangible, less will-o'-the-wisp, and merits close attention in light of Asia's dynamic growth prospects. In the meantime, however, *caveat emptor* are the watchwords on this frontier, and will stay so until private equity funds invested in Asia demonstrate a consistent record of returns commensurate with the risks investors incur.