

Smart investing in Asia: The US perspective

Practitioners and advisors share their insights



Seen from the US, Asia Pacific may appear an amorphous geographical abstraction, even when its economies and markets are impacting American businesses directly. Comprising almost 30% of the world's land area and more than 60% of its population, the region embraces more than 35 nations and territories, with corresponding diversity of customs, languages, traditions, and jurisdictions. The US, in contrast, is a single commercial, legal, and linguistic whole. Private equity investors, and their supporting advisors and consultants, who work across the trans-Pacific divide have their own individual perspectives on this dichotomy, and the opportunities and pitfalls it creates. *AVCJ* heard from a diverse selection of them at the 2007 Asian Private Equity and Venture Forum Chicago, to gain a comprehensive view of the options to achieve success in all of the region's markets.

Asia's size and level of maturity

Market participants agree that Asia's great internal differences can still be grouped under certain norms. David Eich, Partner, Kirkland & Ellis, underscores both Asia's diversity and its relative immaturity. "Asia is a fragmented market: to call it a market is kind of a misnomer. It's effectively operating in an emerging legal culture, not a mature one, which influences every

aspect of a deal. Finally, there's a very scarce but increasing soft infrastructure in Asia."

[Richard Foyston](#), Founding Partner, Managing Director at [Navis Capital Partners](#), notes these phenomena in the context of investing across a fragmented region like Southeast Asia. "To get to anywhere near the market size of a China or even Korea, one has to be prepared to cover a number of individual markets. It raises all the complexities of different environments and regulations, hard and soft, different corporate cultures, different interactions with government, in some cases even different languages."



Richard Foyston

Notwithstanding Asia's diversity, there can be some surprising uniformity in key matters of concern for investors. Dane Chamorro, Regional General Manager for Greater China/North Asia with Control Risks, puts this simply: "A lot of the risks are the same across the markets." There is also a broad comparison to other formerly emerging markets that are now seen as signature successes in private equity's global expansion. "Can we learn from what Europe was like in 1995-96, as a fragmented market pre the Euro, or is in fact business different in Asia?" asks Eich.

Size matters in the macroeconomic debate

From an investor perspective, China and India dominate perceptions of the region – though perhaps not the top decile of returns from Asian funds. Foyston characterizes the entirety of emerging Asia as bracketed by "the giant populous bookends of China or India"

[Henry B. Nguyen](#), Managing General Partner at [IDG Ventures](#) in Vietnam, draws on the perspective of his pan-regional firm. "We occupy a very specific segment in terms of much earlier and middle stage companies. We try to develop scalable companies that have lower capital needs but huge market size and potential. That's why China and India are so attractive."

Foyston sees India as especially rewarding in terms of the returns on capital it can deliver compared to other Asian economies. "India is above everybody else. It reflects a lot of positives in the Indian economy: growth being one, but also governance and a lot of focus on return."

In contrast, [Vincent Chan](#), Managing Director, North Asia, at [JAFCO Asia](#), sees financial sponsors facing some raised barriers in China regarding regulatory oversight and resistance, particularly in the more sensitive sectors of the economy. "The Chinese are learning fast, particularly in the

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Vincent Chan



David Eich



Henry Nguyen

p7 >> continued government offices. They know who are the real strategic investors. Now they start to classify some of the big buyout firms as just financial investors. For these to get approvals is much more difficult than it used to be."

Brent C. Carlson, Vice President for Financial Advisory Services at AlixPartners, supports this view with various other challenges to investing in China, including lack of transparency, the imbalance of management teams, with "one strong CEO" controlling the entire firm. As a consequence, he sees private equity firms in China responding with "more guidance and active participation with their portfolio companies than originally anticipated." Such investments, he finds, are suffering pressure on returns in consequence.

Asia's other economies

Other countries in developing Asia may have suffered some neglect in comparison to the region's two highly populous and booming giants. Even a leading Southeast Asia investor like Foyston admits that, "the big money is in China and other markets." However, he points out one corollary of this. "Generally, Southeast Asia has a relatively competitive return to capital."

Nguyen draws similar conclusions, from a related perspective. "Obviously, India and China are the stories. They get all the attention. There are probably bigger market opportunities, but in terms of putting money to work, it's much more competitive in China or India than

Southeast Asia. You'll see that over long-term returns."

Competition for deals and raised valuations is significant in the more popular markets like China and India. This, Foyston, believes, benefits his preferred region. "It's a less competitive part of the private equity market. It is not easy for big firms to fly in and find, and develop, and close the kind of deals that we do."

Chan sees other North Asian economies as proxies for the China story. "Korea and Taiwan are a bit of a China play." However, he also finds that, "things can be done, even in a very closed market like Korea. That is a good trend, and we are very excited about North Asia."

Andy Ho, Managing Director and Head of Investment at VinaCapital Group in Vietnam, also sees first-mover advantage as a significant factor in avoiding the more well-trodden investment routes. "What we're trying to do here is invest in advance of the big boys coming in." Nguyen notes the incipient openings in Vietnam. "Despite the huge gains in the [public] market, there is still a lot of headroom. The big privatizations that will occur for SOEs in Vietnam, like banks, insurance companies, telecoms, petrochemicals industries, are still on the way. Those will happen over the next 18 to 24 months."

Issues and challenges in Asia investing

Wise investors into Asia learn to sidestep a number of traps in the region: some

obvious, some perhaps endemic to the private equity industry itself. Lack of service providers can be critical in some important areas, such as due diligence. Here, the impact is as much in cost and time spent on an investment as in risk. "There is not really a reliable secondary source for diligence," says Eich. "You actually have to go and do it yourself in a primary way." This is added to the fact that "there are not a lot of experienced intermediaries," especially in China.

Oversight of all kinds can be difficult in Asia. "Internal fraud and abuse happens everywhere," Carlson notes. But China in particular, he feels, is suffering from "a perfect storm" situation, created by a rapidly evolving economy, a transition from state-owned economy to a capitalist system, and an aggressive entrepreneurial culture that has percolated through all levels. And, Chamorro adds, "the concept of governance and compliance is extremely new." The culture of gifts and bribes can also be a hurdle. "This is just the way business is done. Most business owners and salesmen don't see anything wrong in this activity."

Commitment to honoring contracts is such that investors in Asia may have to rely on relationships instead. "There is no culture of contract," notes Eich. "Some of the contracts I see are just shocking." Allied to this is the problem of internal checks and accounting in Asian companies. "If you look at it from the point of view of a traditional Chinese, Indian, or Thai business operator, there

is no advantage in putting down figures on a piece of paper," Chamorro points out. "There will be several sets of books: one is for the tax people, one is typically for a foreign investor."

But legal ambiguities in these markets are a fact of life, he continues. "Chinese laws are always vague. They are written deliberately that way by the government. The reason that is done is because it is a big country, and they want to leave themselves as much room to interpret those laws as they possibly can."

Foyston finds one former consideration in the region no longer a challenge. He says that there is now no shortage of Asian companies where founders and management are ready to relinquish control to an external investor. "The acceptance level is high. The number of companies that can benefit from a change of owners, or of mandate, or an injection of capital, is so great that the constraint is no longer the number of such businesses." However, Chan notes that "a key trend in emerging markets, not just in China" is overinvestment in particular sectors or business models. "When the first mover makes money, there are so many guys who follow and want to do copy-cat."

Eich concludes with a warning. "There are some unique challenges in Asia." For him, the benchmark of success in the region will be, "critically, how can you mitigate these special risks of Asia in the short run"

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