The Globalization of Private Equity and Venture Capital

American Chamber of Commerce
Ho Chi Minh City
Eric L. Mais
Shidler College of Business
University of Hawaii-Manoa

What is Private Equity (P.E.)?
Partnerships specializing in:
• Venture Capital
• Growth Capital
• Leveraged Buyouts
• Mezzanine Investments
• Build-Ups
• Distressed Debt

Brief History
• Spectacular growth in the U.S. from 1980 ($4 billion) to today ($300 billion).
• Highly cyclical: large increases and decreases in annual fundraising.
• Primarily concentrated in the U.S. and U.K.
• P.E. has become much more global over last decade.

How does P.E. investing differ from “Public” investing?
• P.E. investors are Active investors.
• Builds companies in venture capital.
• Changes their direction in buyout funds.
• Distinct from the “active management” of hedge funds or mutual funds in the public markets.

Why is P.E. needed?
• Start-ups starved for capital or
• Large ailing firms that need to restructure
  – present risks and uncertainties that discourage other investors.

Risks
• Uncertainty and information gaps -difficult to assess these firms.
• Difficult for the typical investor to verify outcomes
• Difficult to write contingent contracts.
• This makes external financing costly.
Risks

• These information problems can be alleviated by P.E. firms.
• P.E. intensely scrutinizes companies prior to funding and carefully monitors afterward.

What Not Banks?

• Banks usually don’t have the skills to evaluate projects with few tangible assets and significant uncertainty.
• Banks unable to take equity positions.
• Banks unable to charge borrowers high enough rates to compensate for the firm’s riskiness.
• Banks are unable to replicate the high-powered compensation systems of P.E.

Globalization of Private Equity and Venture Capital

• Do governments welcome P.E. firms?
• Global P.E. is highly cyclical.

Private Equity Int’l Top 50 Global P.E. Firms (based on capital raised 2005 -10)

• 34 North America
• 9 London
• 2 Sweden
• 2 France
• 1 Holland
• 1 Greece
• 1 Dubai

Europe Experience

• Highly cyclical, early attempts largely failed.
• Buyout firms outperformed venture capital.
• Privatization efforts of national governments and deconstructing inefficient conglomerates. Ex. government owned telecoms.
• P.E. is well developed in the U.K., underdeveloped in Germany.

Why the differences?

• IPO market, labor market rigidities, accounting standards, private pension funds, government programs, tax and legal structures, strong university system.
• Civil law countries (France, Germany) tend to have less venture investing than Contract law countries (U.S. and U.K.).
Developed Asia Experience

• Australia: 13 billion $US in 2009, most all in buyout funds.

• Japan: peak of 10.6 billion $US in 2006 to less than 1 billion $US in 2010, struggles to become established. Management buyouts becoming more common.

PE. Emerging Markets

Difficulty in becoming established:
- underdeveloped business infrastructure,
- lack of deals of adequate size,
- management culture not focused on profits,
- inadequate legal systems,
- lack of accounting transparency,
- political instability,
- difficult to exit due to lack of IPO market and lack of potential purchasers,
- competition from subsidized state-run enterprises.

PE. Emerging Markets

• Strong growth rates in P.E. fund raising since year 2000.
• Most P.E. investment occurs in Growth capital – investing in a company that already has a market and a product reduces the intense hands-on supervision needed in a start-up.
• L.B.O.s may be difficult since government approval can be needed and due to lack of adequate debt financing.
• Emerging Asia investment mostly in China and India.

China:

• Still evolving – legal, regulatory, and administrative frameworks for the RMB funds and for joint ventures with foreign funds is not developed.
• Primarily investing in Growth capital.
• Carlyle Group most active P.E. firm from U.S.
• Challenges include finding management comfortable with Western style firms and lack of accounting transparency.

India:

• Continues deregulation of markets.
• Primarily investing in Growth capital.
• Carlyle, Blackstone, Sequoia, 3i, Bessemer Venture Partners, KKR have largest presence among overseas funds.
• Challenges include poor infrastructure and complicated regulatory system.

Vietnam:

Domestic Funds:
- VI Group (Vietnam Investments)
- Mekong Capital
- VinaCapital
- Indochina Capital
- Saigon Securities
- Dragon Capital
Vietnam:

- Overseas Funds:
- KKR (recently closed $200 million deal to invest in Masan Consumer Corp.)
- TPG Capital
- Navis Capital Partners (Malaysia)

Discussion questions:

- Will the P.E. model which evolved in the U.S. likely be successfully translated to other countries?
- Will only Buyout funds make the transition or will other types such as Venture Capital also make the leap?
- How can the tools of P.E. – Active monitoring by P.E. investors, compensation linked to results, and an emphasis on good governance be best adopted in emerging markets?

Discussion questions:

- How will P.E. groups deal with questions of scaling and institutionalization and the disruptive impact of market cycles?
- What makes a country or region more likely to adopt private equity as a funding mechanism?
- What conditions predispose P.E. transactions to success?