

China's \$70 billion opportunity: An interview with Cheng Hye Cheah, co-chairman of Value Partners

This asset-management company is leading the way in China.



A tectonic shift is occurring in global asset management as the world's largest fund managers seek to muscle in on China's long-shielded financial markets. In April last year, Chinese regulators gave the green light for overseas financial companies to establish wholly owned entities or take majority stakes in joint ventures, finally opening the door for multinational companies to compete on a level playing field with domestic incumbents.

Developed markets still account for the majority of global assets under management, but McKinsey research suggests that the sheer scale of opportunity in China is set to alter that balance. China's banking-asset-management sector alone is projected to exceed \$5 trillion by 2021, while the total market, which also includes fund houses, insurers, and trust companies, will surpass \$22 trillion by 2021.

By that time, China will be the world's second-largest financial market, leading an Asian asset-management industry that McKinsey forecasts will generate revenue of \$70 billion. In China, private funds will initially drive those revenues, but there are strong suggestions that regulators will open the public-fund market to overseas institutions as well. The world's largest fund managers are consequently clamoring to tap China's domestic financial market while offering Chinese clients global exposure and managing global inflows into China.

Meanwhile, in Hong Kong—China's traditional window to the financial world—regulators are embarking on reforms of their own. Since the turn of the year, the Hong Kong Monetary Authority has issued internet banking licenses to players seeking to challenge the long-held dominance of traditional banks in the distribution of financial products.

In these dynamic times for asset managers in Greater China, Dato' Seri Cheng Hye Cheah, co-chairman and co-chief investment officer of Value Partners, Hong Kong's longest-standing listed asset manager, offers a measured perspective on an industry he has been a part of for more than

30 years. Speaking with McKinsey Greater China managing partner Joe Ngai, Cheah assesses the depth of opportunity in China, explains why active investing will play a leading role as the market matures, and cautions that change is unlikely to happen overnight in Hong Kong. An edited version of their remarks follows.

Joe Ngai: What's the biggest asset-management opportunity or trend in Asia?

Cheng Hye Cheah: The biggest and most important opportunity is the opening of the mainland Chinese market. A recent report forecast China's asset-management industry to grow to be the world's second largest by 2023. Taken together with the forecast for China to become the world's largest economy by 2030, that's all the opportunity any fund manager—global or domestic—might need.

Joe Ngai: How do you compete against large-scale, global asset-management companies?

Cheng Hye Cheah: Western companies, especially from the US and UK, dominate global asset management because after World War II, the financial system was based on the dollar standard, and America led global economic development. Anglo-Saxon economies tended to have deeper levels of "financialization," which provided fertile ground for brands like BlackRock and Fidelity [FMR] to become global companies. On the other hand, there were no private companies in China at all until 1990 and no asset-management companies until the late 1990s. Value Partners was founded in 1993, which makes us an Asian pioneer, but that's still very late to arrive. It was tough to challenge those established players, even on a level playing field—like in Hong Kong.

Joe Ngai: But there were opportunities in Hong Kong that opened the door for you to be successful?

Cheng Hye Cheah: My partner V-Nee Yeh and I started as a hobby shop. We were young and passionate about value investing. We only had two

full-time employees—me and my secretary—and it didn't occur to us that we'd found a successful niche. In those days, asset management in Hong Kong was complacent. People bought index stocks, and fund managers had long lunches. Nobody rocked the boat.

We went in with no prior experience as professional fund managers. We didn't know the rules, so we broke them all. We bought nonindex stocks, insisted on bottom-up research, conducted company visits—I'm an ex-financial journalist, so I love getting involved. Pretty soon, we were outperforming the established industry. Otherwise, we were just lucky. The first companies in China were getting listed at the time, and we rode the Chinese economy miracle almost from the ground up. That's an incredible piece of luck.

Joe Ngai: How would you describe Value Partners' next ten years?

Cheng Hye Cheah: We have to make full use of the upcoming opportunity in China. We owe it to ourselves, our employees, and our shareholders. We were the first company listed as a full-time asset manager in Hong Kong, and our location on China's doorstep remains a primary advantage. We've got most of the necessary licenses to conduct business on the Chinese mainland, with the final major license—the retail license—likely to be granted within the next two to three years.

Joe Ngai: Chinese institutions are also developing asset-management capabilities. How does that influence your role?

Cheng Hye Cheah: As the Hong Kong brand, we have a certain cachet—as well as a terrific compliance and performance track record. Most Chinese competitors only started in the last 18 to 20 years, and many are less than a decade old. Moreover, we've never benefited from protectionism: from day one, we've competed on a level playing field with multinationals.

We've learned to survive by offering genuine value to our clients. We also had the opportunity,

over 26 years, to make lots of mistakes and learn from them accordingly. That puts us in prime position to serve the Chinese consumer. China has had restrictions in place to nurture homegrown industry, but that may have allowed a certain degree of complacency to creep in.

Joe Ngai: In mature markets, active investors have started to lose a bit of their value add, and ETFs [exchange-traded funds] and passive funds are on the rise. How long before we see a similar shift in Asia?

Cheng Hye Cheah: Active investing still outperforms in China and is likely to continue to do so for a long time. One reason is that 80 percent of investors in Chinese domestic markets are retail investors. They're trend followers, day traders, shotgun traders, so they tend to buy at the top and sell at the bottom. As such, professional managers armed with research on the fundamentals tend to outperform.

I agree that, in more developed markets, active fund managers are struggling—though I'm not totally pessimistic, even here. In the US, passives now are responsible for more than half the buying and selling. That can be quite dangerous because everyone will run for the exit more or less at the same time: it could create a stampede. But that's the West. Here in the East and Southeast Asian region, active fund managers that do their homework still have an edge, and that should be sustainable for quite a while.

Joe Ngai: That opportunity is motivating new entrants. What advice would you have for start-up asset managers in the region?

Cheng Hye Cheah: I have personally invested in some of those start-ups, but the failure rate is extremely high. Start-up fees, the high cost of doing business in Hong Kong, vigorous compliance restrictions, and the near impossibility of obtaining licenses in protective markets—like Malaysia or China—make the odds formidable for a start-up. Success factors include having an excellent “cook” who, despite these adversities, can develop strong



Cheng Hye Cheah

Age: 64

Career highlights

Serves as Value Partners co-chairman, co-chief investment officer, and executive director, leading one of Asia's largest homegrown asset managers across offices in Hong Kong, Shanghai,

Shenzhen, Singapore, London, and Kuala Lumpur, advising on growth strategy, operations, marketing, and M&A

Cofounded Value Partners in February 1993 and led investment strategy and portfolio management as the company became the first asset manager to list on Stock Exchange of Hong Kong, in 2007

Served as an independent, nonexecutive director of Hong Kong-listed JCG Holdings, a leading microfinance company, from 1993 to 2002

Founded Morgan Grenfell's Hong Kong/China equities-research department as head of research in 1989

Worked as a financial journalist at Asia edition of the *Wall Street Journal* and the *Far Eastern Economic Review*, covering business and financial news across East Asia and Southeast Asia

performance funds. It's a very uphill struggle now, unlike during my time.

Joe Ngai: What changes might make it easier for start-ups to compete?

Cheng Hye Cheah: We would need to democratize the marketplace, by which I mean having fewer restrictions, streamlining licensing, and encouraging internet-based distribution. These are the kinds of reforms required, but right now, the industry is structured so that newcomers are not welcome.

Joe Ngai: What does the future hold in terms of technology for the industry?

Cheng Hye Cheah: On my side, which is very evidence and research driven, we are already making heavy use of data. We subscribe to data streams for China sales of headphones or cosmetics, for example.

On the distribution side, the biggest event in a generation just occurred in Hong Kong, with the issue of internet-banking licenses. We're trying to analyze what that may mean for our system of distributing financial products. It's an interesting experiment that will take time to play out, but the likelihood is that this will change Hong Kong's distribution system.

Joe Ngai: How much impact will the new licenses have on established banks in Hong Kong?

Cheng Hye Cheah: Judging from other countries, particularly China, there will be a certain amount of cost cutting. The internet promises to reduce distribution costs, but in markets like Hong Kong, wealth-management- and financial-product

distribution employs tens of thousands of young men and women in the sales channel. What's going to happen to them if you disrupt the business too quickly? We have to ease into it. If you disrupt them too much, it will be difficult for society.

Cheng Hye Cheah is co-chairman and co-chief investment officer of Value Partners. **Joe Ngai** is a senior partner in McKinsey's Hong Kong office.

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