

## Private Equity & Principal Investing



# Private equity Asia-Pacific

Rebounds, glocalization, and other tales

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James Ahn

Chinta Bhagat

Keiko Honda

Ivy Kwan

Fredrik Lind

Vivek Pandit

Jean-Marc Poulet

Bruno Roy

Timothy Ye

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# Private equity Asia-Pacific: Rebounds, glocalization, and other tales

*If there's one word I want to leave you with today, it's this: glocal.*

***Glocal?***

*Glocal. Our global must become local.*

— Natalie Keener, *Up in the Air*<sup>1</sup>

## Introduction

The past few years have confirmed what everyone has always known: private equity (PE) is a cyclical business. The biggest boom in the thirty-odd years since the asset class took off was followed by a bust of commensurate proportions in 2009–10. But while the industry was battered, it has survived, and has started to rebound—especially in Asia.

The global center of gravity is gradually shifting eastward. At the height of the pre-crisis boom, in 2007, Asia accounted for roughly 10 percent of global private equity deal making. By 2009, at the depth of the crisis, Asia had begun to take a bigger role; it claimed 25 percent of all global activity. To be sure, this rebalancing is in part a result of the sharp decline in PE activity in North America and Europe during the crisis. In 2010, with global deal flow picking up, Asia's share settled at about 17 percent. The stability of the higher share of global activity is a testimony to the resilience of Asia in the downturn.

Asia is now a priority for many global firms, drawn by the positive macroeconomic environments of the large economies of China and India, the restructuring potential of Japan and South Korea, and the freewheeling opportunities to be found in Southeast Asia. Indeed, Asia is now too big and too important for global firms to ignore. However, as investors have learned over the past several years, Asia also presents unique cultural, regulatory, and organizational risks. As more firms pursue the Asian opportunity, the PE industry in Asia appears to be at an inflection point. Global

funds in particular have reached a point where many are undertaking a serious shift in their thinking about Asia.

This white paper is a continuation of McKinsey's research effort that began in 2009, and presents the latest developments in the industry, updating the ideas and themes we presented last year.<sup>2</sup> We have again studied the six markets that together represent almost the entirety of PE investment in Asia: Australia/New Zealand, Greater China, India, Japan, South Korea, and Southeast Asia.<sup>3</sup> We gathered and verified data on fund-raising, deals, and exits—aggregating and reclassifying them so that investors can make sensible comparisons of size, growth, and potential among these very different economies. We articulate the findings of this effort in the first chapter, including detailed reviews of the widely divergent fortunes of these six markets (Exhibit 1).

This year we have also conducted an extensive set of interviews with top leaders from several PE firms, including both general partners (GPs) and limited partners (LPs) from Asia and around the world. We supplement this with the insights drawn from our extensive client work with both GPs and a range of LPs, including pension funds, sovereign-wealth funds, insurers, foundations, family offices, and others. The cross-cutting themes that emerged, including the furious competition between local and global firms to which *Up in the Air*'s “glocalization” refers, are discussed in the second chapter. Finally, in the third chapter, we indulge in a bit of prognostication, offering 11 headlines we may see emerging in 2011.

<sup>1</sup> From the 2009 film *Up in the Air*, based on the novel by Walter Kirn, New York: Doubleday, 2001.

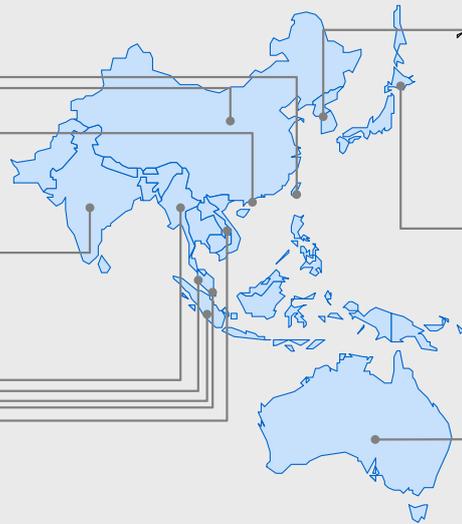
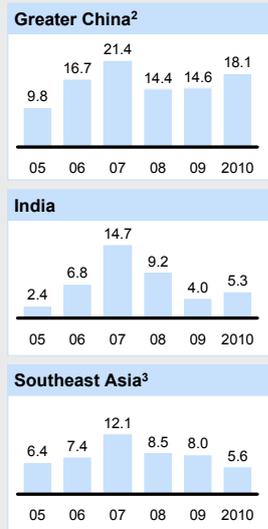
<sup>2</sup> James Ahn et al., “What we talk about when we talk about ... private equity in Asia,” January 2010.

<sup>3</sup> Greater China consists of the People's Republic of China (mainland China), Taiwan, Hong Kong, Macau, and Mongolia. Southeast Asia consists of Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

**Exhibit 1**

Asia is not one market; it is six unique markets with different growth paths.

**Value of PE investments<sup>1</sup>**  
\$ billion



1 Includes buyouts, expansion, PIPE (private investment in public equity), pre-IPO, mezzanine, turnaround.  
 2 Greater China consists of China PRC, Taiwan, Hong Kong, and Macau.  
 3 Southeast Asia consists of Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

Source: AVCJ; Refco M&A; McKinsey analysis

# A look back at 2010

After the Great Recession of 2008–09, 2010 saw a rebound in global economic activity. Domestic economies are again growing, in both large developed markets such as the US (3 percent) and the UK (2 percent), and especially in emerging markets. Across Asia, GDP soared, growing by 15 percent in Singapore and returning to pre-crisis levels in the giant economies of Japan (4 percent), China (10 percent), and India (8 percent).<sup>4</sup>

The Asian corporate sector benefited from the more optimistic outlook. Banks have now improved their balance sheets and made more credit available. Corporations are recovering their risk appetite and putting cash to work in an improving M&A environment; recent weeks have seen several deals reminiscent of those from the 2002–07 heyday, such as the acquisitions of Gotransit Media by AMI Advertising for \$11 billion, Lihir Gold by Newcrest Mining for \$8.8 billion, and the proposed purchase of Cairn India by Vedanta Group for \$8.5 billion. Investors have noticed, and stock markets have bounced back.

All these improvements in the macroeconomic outlook have contributed to a rebound in Asian private equity. The sharp declines of 2007–09—in all metrics of core PE activity<sup>5</sup>—appear to have bottomed out and have begun to bounce back in 2010.

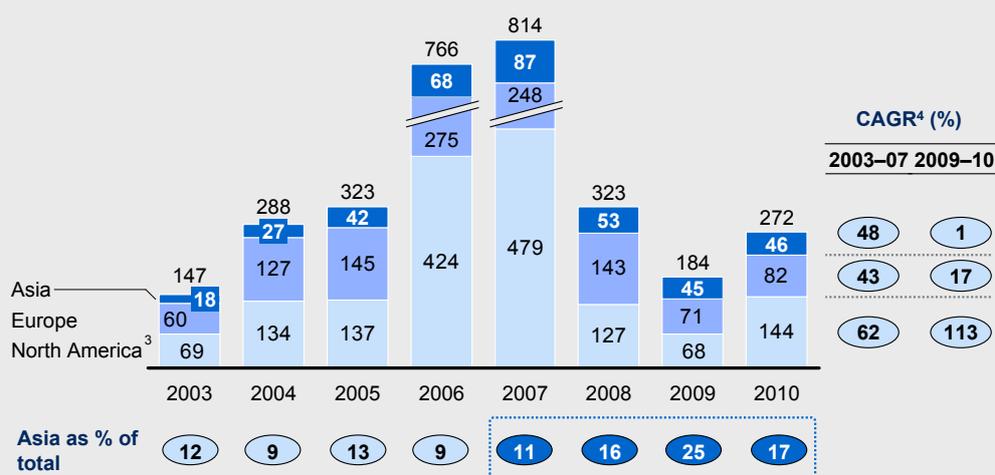
With that, the global center of gravity is gradually shifting toward Asia. With close to one-fifth of all PE activity, and great potential for the future, Asia now figures prominently on every PE firm’s strategic agenda (Exhibit 2).

As noted, some say that the rise in Asia’s share of global PE activity is merely a reflection of the decline in PE in Europe and North America—and to be sure, that is an important consideration. But on the other hand, Asia showed genuine resilience in the downturn. Indeed, by some measures, private equity in Asia is returning to its pre-crisis state of health. We discuss below four such metrics: fund-raising, deal volumes, deal values, and the number of exits. We also take a look at a fifth metric: the shifts in investor nationality

## Exhibit 2

Post-crisis, Asia’s share of global private-equity investments has grown.

**Global<sup>1</sup> private-equity investments<sup>2</sup>**  
 \$ billion



1 Includes Asia, Europe, and North America.  
 2 Includes buyouts, turnaround, PIPE (private investment in public equity), expansion, pre-IPO, and mezzanine.  
 3 US and Canada.  
 4 Compound annual growth rate.

Source: Capital IQ; AVCJ; Refcof M&A; McKinsey analysis

4 Except where otherwise noted, macroeconomic data such as GDP have been supplied by Global Insight; information on private-equity activity has been supplied by Capital IQ, *The Asian Venture Capital Journal*, Refcof M&A, and Preqin.  
 5 Including investments for buyout, turnaround, private investment in public equity (PIPE), growth or expansion, pre-IPO, and mezzanine.

that emerged in 2010. On all metrics, Asia has distinguished itself from other regions. Does this mean that an increasing shift in focus by global funds to Asia is warranted? Should these firms give considered thought to the challenges of going about it? We think so.

#### Fund-raising: Coming back but still difficult

Unsurprisingly, raising new funds was difficult during the crisis, and the difficulties persisted in 2010. Globally, outside Asia, fund-raising fell by 67 percent from 2008 to 2009, and a further 22 percent in 2010.

Asia did relatively better. Funds raised by both foreign GPs for their Asia-focused funds and by local Asian GPs declined by 62 percent from 2008 to 2009 but increased by 22 percent in 2010. China in particular has seen strong growth; the emergence of RMB-denominated funds has brought fund-raising to an unprecedented level of RMB 83.7 billion (\$12.3 billion) for 2010, up 82 percent from just a year ago. Three large funds raised in China in 2010 were CDH<sup>6</sup> China Fund IV (\$1.5 billion), SAIF Partners<sup>7</sup> IV (\$1.3 billion), and CITIC Mianyang Private Equity Fund (\$1.3 billion).<sup>8</sup>

Breaking down Asian fund-raising by size of fund, we see that the number of \$1 billion-plus funds grew at a 63 percent compound annual growth rate (CAGR) from 2004 to 2008. Funds of \$500 million to \$1 billion grew at 19 percent. In the crisis, the number of \$1 billion-plus funds fell by 86 percent—but in 2010, GPs renewed their optimism, and new \$1 billion-plus funds grew by 400 percent. The number of midsize funds<sup>9</sup> dropped 86 percent in 2010 after growing 75 percent in 2009.

Fund-raising in Asia also held up well when assessed by expectations met. In the crisis, several funds had trouble reaching their announced target, with half coming up short in 2008 and 2009. The situation improved markedly in 2010, when only 12 percent of funds failed to reach their intended fund-raising levels.

Fund-raising is only part of the picture; access to debt financing is also essential. Here, too, the tide is turning. At

the time of this writing, one of the largest buyouts in Asia in recent memory, and the largest buyout deal in Australia since 2006, is in the making: Healthscope accepted a consortium bid of A\$2.7 billion (\$2.3 billion); some 17 banks provided the financing.

Indeed, across Asia, banks are again getting comfortable with leveraged finance. Increasingly, large deals such as the Matahari department store deal in Indonesia in January 2010 are again being financed by syndicated loans. That deal is thought to pay 600 basis points over the rupiah<sup>10</sup> benchmark with a 6.75-year tenor.<sup>11</sup>

#### Deal volumes: Still down, but large deals return

In the rest of the world, PE deal volumes (which we define as the number of PE deals concluded during a given year) slumped drastically from 2007 to 2008, and again in 2009. Global ex-Asia PE deal volume fell 22 percent between 2007 and 2008 and by another 25 percent from 2008 to 2009. In 2010, volumes improved but remained low: PE deal volume increased 30 percent in 2010 but is still 24 percent off its high in 2007.

In Asia, volumes also slid from 2007 to 2010, though not as sharply as elsewhere. PE deal volumes fell 21 percent from 2007 to 2008 and another 38 percent from 2008 to 2009. And in 2010, deal volumes further decreased by 29 percent.

The story is different for the larger deals—those over \$1 billion. Global volumes outside Asia fell sharply, by 62 percent from 2007 to 2008. Since then volumes have continued to fall, dropping 21 percent between 2008 and 2010. But Asia has not followed the global trend. Larger deals fell 90 percent from 2007 to 2008 but recovered in 2009 (six deals) and 2010 (nine deals). The 2010 deals included the pre-IPO sale of stakes in Agricultural Bank of China to a consortium led by Temasek; China International Capital Corp. to a consortium led by KKR and TPG; and Taiwan's Taikang Life Insurance to Goldman Sachs, Government of Singapore Investment Corporation, and China Guardian Auction.

6 CDH China Holdings Management Company is a private-equity firm based in Beijing that specializes in growth-capital, middle-market, and buyout investments.

7 SAIF Partners is a PE firm based in Beijing that provides growth capital to companies in Asia.

8 All currency figures in this paper are US dollars unless otherwise noted.

9 Funds between \$500 million and \$1 billion.

10 The official currency of Indonesia.

11 "CVC's Matahari LBO loan launched into syndication," *EuroWeek*, April 22, 2010.

### Deal values: Coming back

From 2007 to 2008, deal values (defined as the total value of all PE transactions in a given country over a year) in global ex-Asia fell considerably, by 63 percent. The trend has continued; from 2008 to 2010, PE deal values fell a further 32 percent.

The total value of PE deals in Asia also fell, by 39 percent from 2007 and 2008. Since then, however, Asia has done better than other parts of the globe. Over the course of 2010, total PE deal value improved by 14 percent.

This growth in Asian deal values, at a time when they were shrinking elsewhere, has prompted a change in a secondary metric, PE “penetration”—that is, the size of PE activity in relation to the national economy, as measured by the ratio of new PE investments to GDP. In the US and UK, PE investments in 2004 accounted for about 1 percent of GDP, while in Asia the figure was between 0.2 and 0.4 percent. At the crest of the wave, in 2007, developed-market penetration was about 4 percent in the US and 3 percent in the UK, but just between 0.4 and 2 percent in Asia. In the depths of the trough, in 2009, penetration was roughly equivalent between Asia

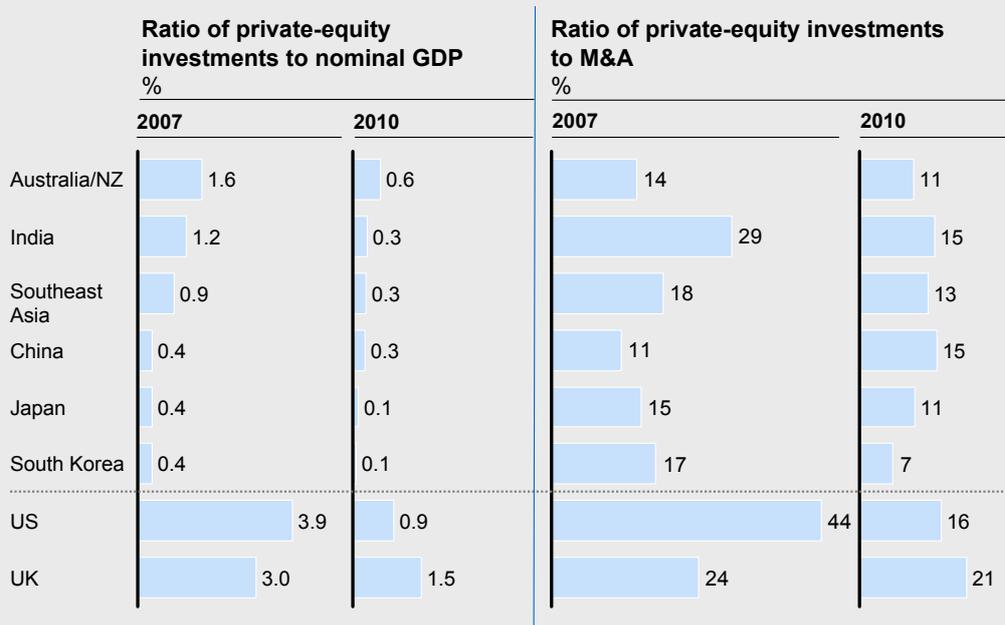
and the developed markets. But in 2010, once again, we see that Asian penetration lags behind the more mature markets, demonstrating potential for further growth (Exhibit 3).

Exhibit 3 also shows another form of penetration: the percentage of all M&A activity that is driven by private equity. This form of penetration is, we think, even more revealing of private equity’s health—for example, if M&A is growing and private equity is increasing its share of M&A, it is not merely benefiting from the secular trend but is growing on its own. The data show that in traditional buyout markets such as Japan and Australia, PE is maintaining, or nearly so, its share of M&A. In some growth-oriented markets such as China, PE is increasing its share—that is, it is gaining favor in the marketplace of corporate transactions. It would appear that the perception that “Asian markets do not like private equity” has been disproved, if these metrics are any indication.

Looking more closely at the nature of 2010’s deals, it seems that the mix is shifting. We distinguish among several investment types: buyout, turnaround, mezzanine, pre-IPO, private investment in public equity (PIPE), and expansion. The value of PIPE deals decreased 59 percent in 2010, as

#### Exhibit 3

Asian private-equity penetration shows room for growth.

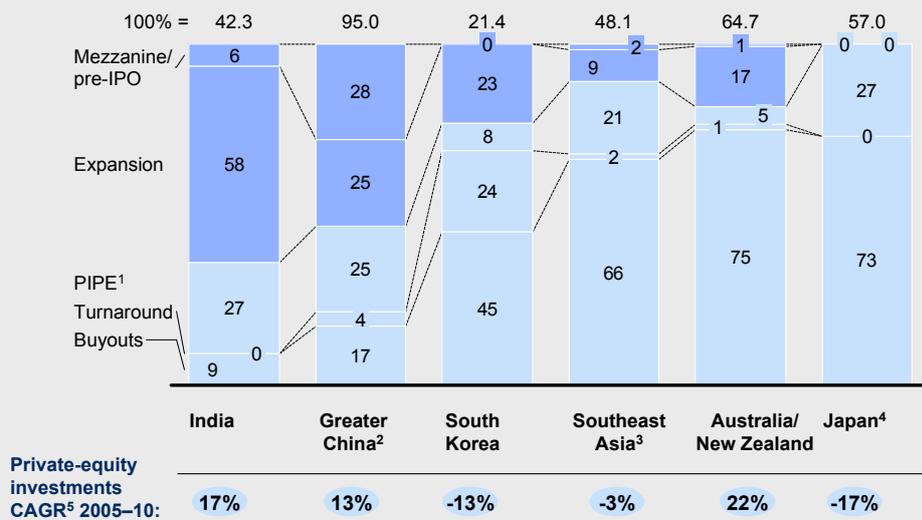


Source: AVCJ; Recof M&A; Capital IQ; EIU; McKinsey analysis

#### Exhibit 4

Deal types differ across Asia.

#### Value of private-equity investments by financing stage, 2005–10 %, \$ billion



1 Private investment in public equity.

2 Greater China consists of China, Taiwan, Hong Kong, and Macau.

3 Southeast Asia consists of Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

4 For Japan, only buyout and PIPE data are available.

5 Compound annual growth rate.

Source: AVCJ; Recof M&A; McKinsey analysis

public-market valuations rose, making PIPEs less attractive. However, the value of buyouts increased by 19 percent. The value of growth/expansion deals grew 88 percent in 2010 after declining 46 percent in 2009. China and India were the main focus of growth investments in 2010. Buyouts continue to be the focus of more mature markets such as Japan and Australia/New Zealand (Exhibit 4).

#### Exits: IPOs come roaring back

Worldwide ex-Asia, private-equity exits (via both IPOs and trade sales) as measured by volume fell 45 percent between 2007 and 2009, driven primarily by the biggest markets: Europe, the US, and Canada were all down by 42 percent. Africa fell by 33 percent and the Middle East fell by 100 percent; exits in Latin America remained the same.

Asia did better than other regions over the same period (2007–09) (Exhibit 5); the number of PE exits fell by only 36 percent. The number of IPOs decreased by 46 percent, while trade sales declined by 23 percent.

In 2010, exits were back in style. IPOs in particular made a comeback, as public-market valuations improved. IPO

exits rose 176 percent to \$84.3 billion from the previous year—eclipsing the previous high in 2007. Trade sales totaled \$29 billion, an increase of 75 percent over the same period. Average sale size in 2010 also increased, by 92 percent, to \$154.9 million.

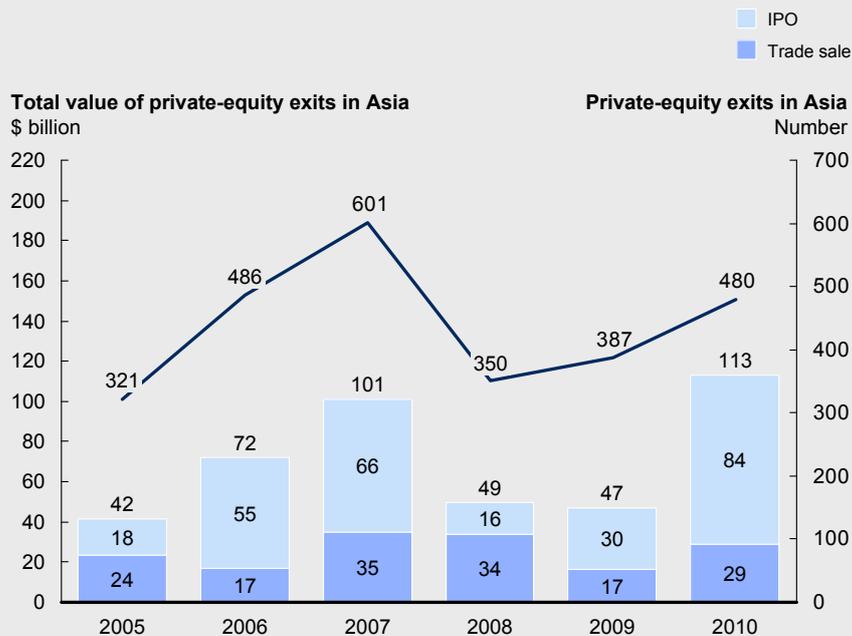
Prominent exits in 2010 included the sale of Lonestar's stake in Korea Exchange Bank to Hana Financial Group for \$4.1 billion (announced exit, closing in 2011); and Temasek's stake in Fraser & Neave to Kirin Holdings for \$974 million. Prominent IPOs in 2010 included the listing of Agricultural Bank of China in Hong Kong and Shanghai, raising a total of \$19.2 billion; and the listing of Huatai Securities in Shanghai, which raised \$2.3 billion.

#### Investor nationality: Some countries see a rise in local firms

The first four core metrics—fund-raising, deal volumes, deal values, and exits—all point to a return of strength for Asian private equity. Another measure, investor nationality, attests to the changing balance of foreign and local investors in Asia. Local players were responsible for 18 percent of all investments by deal value in 2010, down from 29 percent in 2009. Local

**Exhibit 5**

Exits picked up again post-crisis.



Source: AVCJ; McKinsey analysis

firms' deals tend to be smaller (\$62 million versus \$138 million, on average). That was up by 26 percent in 2010 for local firms, while average deal size for foreign players increased by 67 percent. Exhibit 6 shows the changing balance of local and foreign firms in several Asian economies.

## A closer look at six markets

As in previous years, private equity in Asia is very much a story of individual markets. A pan-Asian perspective is useful to distinguish the region's broad trends from the rest of the world. But pragmatic insights only emerge from a thorough understanding of local details.

Our research tackles six key Asian markets: Greater China, India, Southeast Asia, Japan, South Korea, and Australia/New Zealand. For each, we have analyzed four of the same key metrics as above: deal volumes, deal values (including prominent deals, changes in deal nature, and changes in market leadership), exits, and investor nationality.<sup>12</sup>

### Greater China: Surging ahead

Mainland China and Taiwan have both been surging ahead in 2010.

On the mainland, capital raised by firms for the express purpose of domestic investment increased by 82 percent in 2010. As mentioned, a surge in RMB-denominated funds was responsible (Exhibit 7).

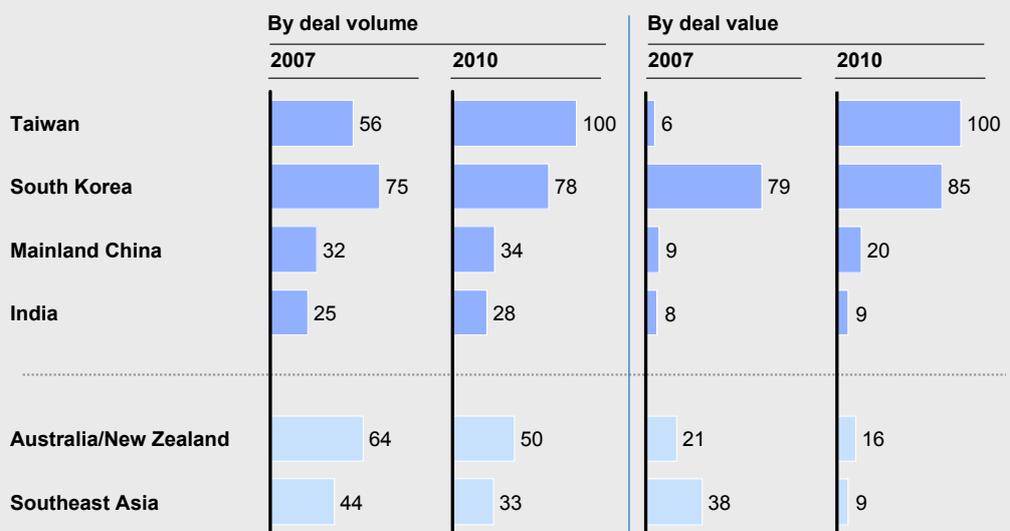
Recent measures instituted by China's National Development and Reform Commission (NDRC) require PE firms with assets under management of over RMB 500 million (\$76 million) to register with the NDRC. The intent is to protect retail investors. And the new rules could also help to increase commitments to Chinese funds. While the jury is still out, the new rules will likely translate into a broader investable universe for China's National Social Security Fund (NaSSF), which can only commit to NDRC-approved firms.

<sup>12</sup> The available country-specific data on fund-raising, the fifth metric, is inconsistent, and as such, we have not included it in our country-specific analysis. Figures for mainland China are, however, reliable and worth noting and are included in the section on Greater China.

**Exhibit 6**

The rise of the local GPs is prominent in several countries.

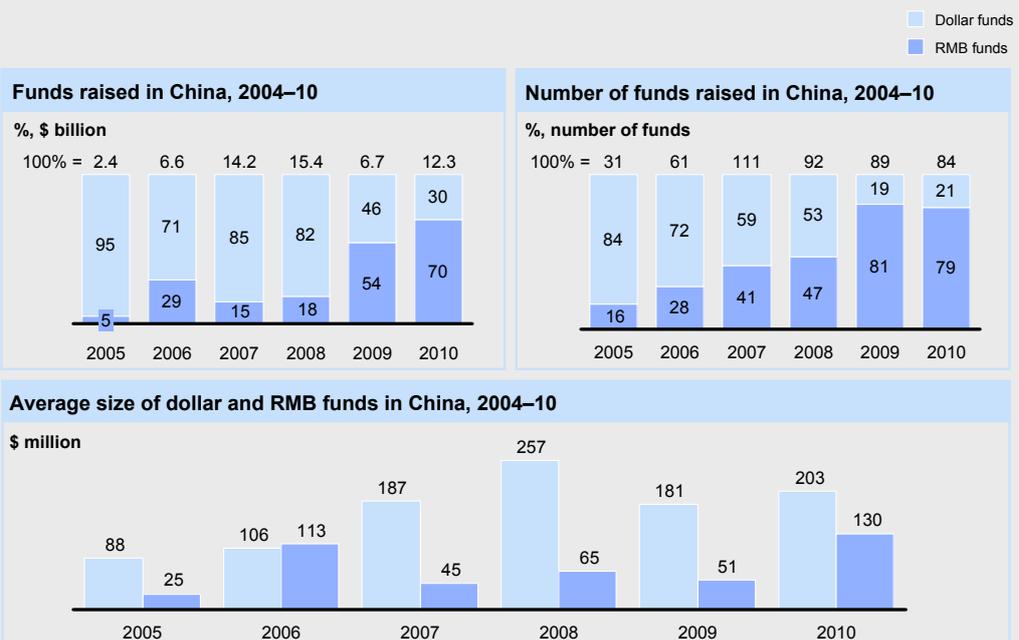
**Share of deals involving local general partners (GPs)**  
%



Source: AVCJ; McKinsey analysis

**Exhibit 7**

Strong growth in RMB funds exists.



Source: AVCJ; McKinsey analysis

For more discussion of the rise of China-specific funds, see page 19.

Total PE investments as measured by volume fell by 52 percent in 2010. However, total deal values increased by 21 percent. Average deal values increased by 149 percent, from \$66 million in 2009 to \$164 million in 2010. Penetration of GDP is still low, at 0.3 percent; compared with rates in developed markets, such as the US (1 percent) and the UK (2 percent), it appears that PE in China has room for growth.

Most deals in China in 2010 (61 percent) were done to provide companies with expansion capital. As to sectors, 2010 was another big year for the financial-services sector; financial institutions attracted about 54 percent of all PE investments (by value). Another 17 percent went to the transport sector. As mentioned, some of the biggest deals in Asia in 2010 were for Chinese companies: the \$2.3 billion direct investment in Agricultural Bank of China by China's NaSSF, and the \$1.1 billion investment in Taikang Life Insurance by GIC Singapore, Goldman Sachs, and China Guardian Auctions.

Ninety percent of all value raised in exits in China in 2010 came through IPOs; in fact, about 90 percent of all value raised by IPOs (PE-backed and others) in Asia was realized on the Hong Kong and Shanghai bourses. Average trade-sale size increased 75 percent in 2010, to \$158 million.

Local firms are taking a bigger role. In 2007, 32 percent of deals came from local firms, but they were only involved in 11 percent of total investments. In 2010, 34 percent of deals came from local firms, and they were involved in 22 percent of the invested value.

The story in Taiwan, in contrast, is one of navigating a regulatory labyrinth. The crisis resulted in lower deal volumes, of course; but the fall-off was exacerbated by the significant scrutiny that several large deals received in 2010, in particular transactions involving AIG subsidiary Nan Shan Life and cable operator China Network Systems. Moreover, deals in Taiwan have historically taken longer to close than in other Asian markets. For these reasons, foreign GPs will most likely refocus their attention on markets with easier regulatory regimes.

The difficulties are borne out in the numbers. Deal volumes in Taiwan dropped drastically from 27 deals in 2008 to 4 deals in 2009 and just one deal in 2010. Total deal values also dropped precipitously, falling 99 percent from 2008 to 2010 (Exhibit 8).

Exits did not fare much better, falling by 75 percent from 2009 to 2010. Trade sales dominated in 2010, as they have in the last several years. For the period 2005–10, 79 percent of all exit value came from trade sales, even though IPOs were more numerous. The two trade sales in 2010 were MBK's sale of China Network Systems to Want Want Holdings for \$2.3 billion and Carlyle's sale of KBro to Dafu Media for \$2 billion.

Local GPs dominate the PE industry in Taiwan by volume, accounting for 51 percent of all deals since 2005. However, there is no clear trend in the local/foreign GP mix over the years.

Looking at recent history, there seem to be three deal archetypes to avoid in Taiwan, given their low rate of approval by regulators:

- **Taking a leading business private.** The government appears to be sensitive to delisting any business that is traded on both Taiwanese and overseas exchanges (through an American depositary receipt or a global depositary receipt). Most deals fitting this profile have had approval delayed so long that the acquirer pulls out. PIPEs are fine, but going private is not.
- **Funding a deal with suspect capital:** Taiwan's regulators have demonstrated keen interest in examining sources of capital. They have been selectively blocking GPs who are either opaque about their funding or are clearly supported by investors that the regulators view as a threat.
- **Buying a financial company.** Strategic buyers have had little trouble buying Taiwanese banks and financial companies. Private-equity buyers, on the other hand, have run into trouble, especially the perception that their holding period will be short, along with some labor and employment issues.

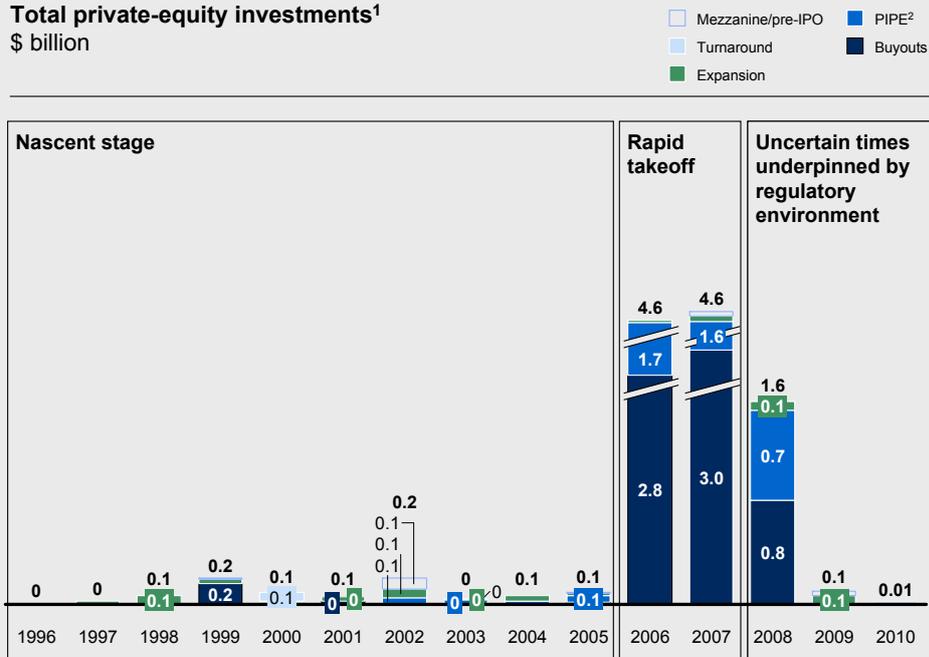
On the other hand, there are a number of reasons to be bullish about potential deal flow in Taiwan:

- **Dynamics within Taiwan's historically family-owned conglomerates.** Recently, several venerable family-owned businesses have faced financial difficulty. They might have benefited from access to private-capital pools to assist in their restructuring. Many family-owned businesses are also facing complicated succession issues, with some family members looking to exit and others looking to turn

### Exhibit 8

Private-equity investments in Taiwan have fallen back to historical levels.

### Total private-equity investments<sup>1</sup> \$ billion



<sup>1</sup> Includes buyouts, expansion, PIPE, pre-IPO, mezzanine, and turnaround.  
<sup>2</sup> Private investment in public equity.

Source: AVCJ; McKinsey analysis

the business over to professional management to spark growth.

- Tech entrepreneurs getting closer to retirement and lacking bench strength.** Here, too, private equity could position itself as a partner to companies looking to professionalize boards and management teams. While many of Taiwan's global companies already have strong management teams and can attract additional talent on their own (and as noted, the government would likely block any PE offers for these "jewels"), there is a "long tail" of midmarket companies that would benefit from such a partnership.
- Improvements in mainland China–Taiwan political and trade relationships.** With the signing of the Economic Cooperation Framework Agreement (ECFA) in 2010, Taiwanese companies can capture market opportunities in mainland China without tariffs or interference. ECFA's scope is limited today but will expand over time to include, for example, additional product categories. This should create a market for growth-capital investments in companies looking to use Taiwan as a gateway to the mainland China market.

### India: A resurgent industry

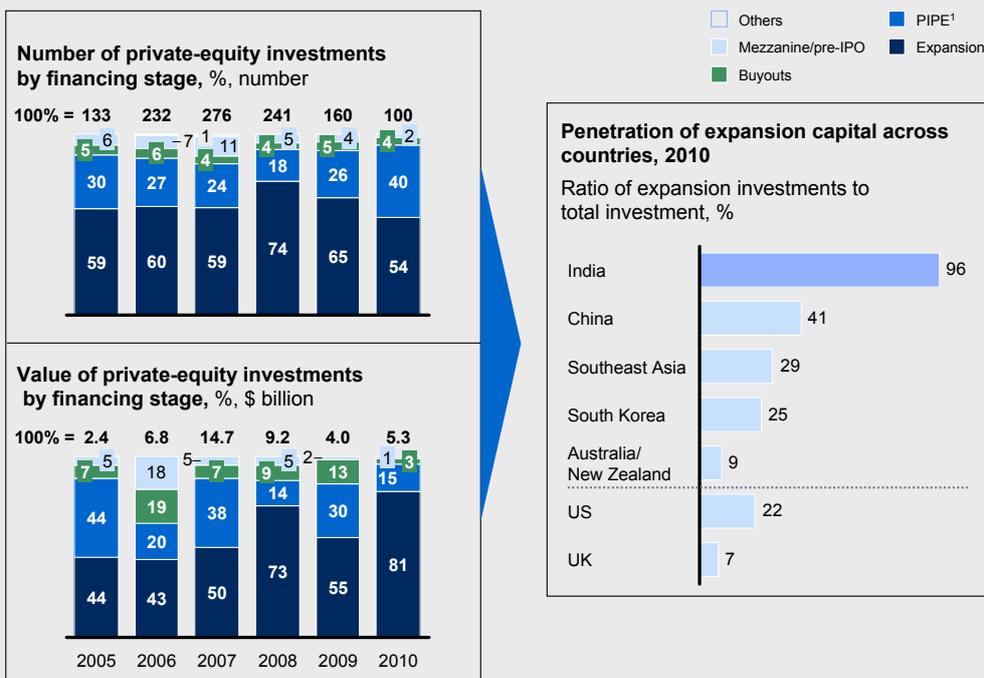
India has also proved resilient. While deal volumes fell 38 percent in 2010, total deal values surged 33 percent and the average deal size increased by 113 percent, from \$24.7 million to \$52.8 million. The penetration rate of Indian PE in the general economy is still low (0.3 percent) compared with the US and UK, and is indicative of room for further growth.

As in mainland China, deals in India in 2010 were almost exclusively focused on growth (Exhibit 9); 96 percent of all deals in the past year were made to help the target company grow. Improving infrastructure was a particular objective, in keeping with the government's stated ambition to invest heavily in new roads, power plants, and so on. Private investment in infrastructure increased by 600 percent in 2010. Nearly 80 percent of investments were in infrastructure, manufacturing, and services including financial services.

Two prominent deals in India stood out in 2010: the \$425 million investment in Asian Genco by a consortium that included Goldman Sachs and General Atlantic, and the \$313 million investment in Viom Networks by Macquarie SBI Infrastructure Management.

**Exhibit 9**

Private-equity investments in India continue to support target companies' growth.



<sup>1</sup> Private investment in public equity.  
 Source: AVCJ; Capital IQ, McKinsey analysis

Thirty-nine percent of exit values in India came via IPO. The average trade sale increased from \$34.5 million to \$58.3 million in 2010, a jump of 69 percent.

As mentioned, local firms became slightly more prominent in 2010, accounting for 9 percent of total deal values, up from 8 percent in 2007, and 28 percent of total deal volumes, up from 25 percent in 2007.

**Southeast Asia: Singapore and Indonesia shine, Vietnam and the Philippines are up and coming**

Deal making was subdued in most of Southeast Asia. Region-wide, the total number of PE investments increased slightly (5 percent) in 2010. However, total deal value decreased by 31 percent. The average deal size decreased by 34 percent, from \$186.7 million to \$123.8 million.

There were some bright spots within the region: Singapore showed promising resilience, Indonesia rebounded, and Vietnam and the Philippines showed signs of growth again (Exhibit 10).

Sixty-seven percent of all deals were done to boost companies' growth. However, measuring by value, we get a different picture: 71 percent of the funds invested went to buyouts. Much of the action shifted from high tech and telecom toward medical industries in 2010.

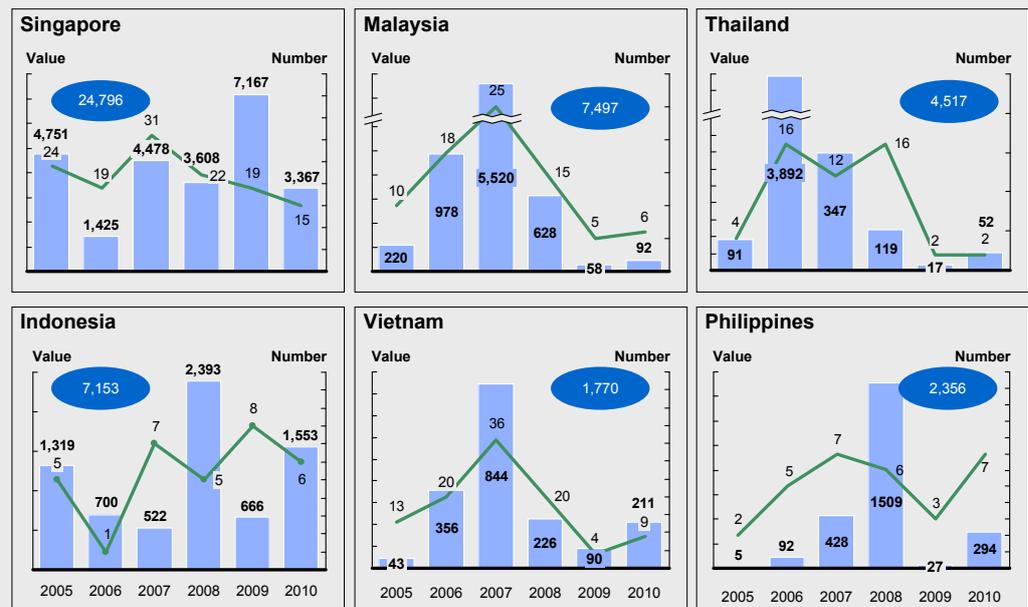
A landmark deal for Indonesia and the region—indeed, for all of Asia, as it marked the return of buyout activity—came in January 2010, with the \$616 million investment in Matahari, a retail group, by CVC. This was not the biggest deal in the region, however; the prize went to Khazanah for its purchase of Parkway Holdings in Singapore for \$2.35 billion, after a bidding war with Fortis Healthcare. Other big deals included the \$300 million investment in Acument Asia Pacific, a maker of industrial fasteners based in Singapore, again by CVC; and a \$275 million investment in Raffles Hotel of Singapore by Qatari Diar and Voyager Partners.

Across the region, 21 percent of exit value was achieved through IPOs in 2010. However, the average trade sale declined significantly (24 percent) in 2010, falling from \$232.2 million in 2009 to \$177.6 million in 2010.

## Exhibit 10

Singapore and Indonesia were resilient through the crisis.

### Private-equity investments in Southeast Asia, 2005–2010 \$ million



Source: AVCJ; McKinsey analysis

Foreign firms dominate Southeast Asian private equity: in 2010, 90 percent of all the value invested came from foreign firms despite these firms' involvement in just 64 percent of the deals.

### Japan: PE is welcome, but divestitures continue to be slow

Many suspect that Japanese investors dislike private equity, which is not the case. As a percentage of all M&A deals in Japan, private equity has a fair share at 11 percent, only slightly less than in the US (14 percent) and the UK (19 percent) (Exhibit 11).

However, the M&A deal value as a proportion of GDP is quite small, and similarly PE penetration of the broader economy is low. With an enormous economy—the world's third largest—yet few PE deals, deal sourcing has been the issue.

The Japanese market has historically been buyout-centric. This is a big distinction from India, China, and Southeast Asia, where expansion and pre-IPO investment are the dominant investment themes. In 2010, the number of buyout deals increased by 29 percent while total buyout values

increased by 128 percent. With the upsurge of buyout deals, the total value of PE investments recovered in 2010; the number of deals increased by 26 percent, after decreasing 39 percent in 2009. Total deal values in 2010 increased by 52 percent, while average ticket size shot up from \$42.9 million in 2009 to \$51.7 million in 2010.

Exits fell in 2010, whether by IPO or trade sales. Average trade-sale size dropped from \$347.5 million in 2008 to \$82.3 million in 2010. Indeed, many PE firms appear to be holding on to portfolio companies, deferring exits until the Japanese public markets recover.

Local firms dominate Japanese private equity: in 2010, 83 percent of all the value invested came from local firms, with these firms involved in 82 percent of the deals. Since 2007, the share of foreign GPs has been steadily declining, from a peak of 41 percent in 2007 to less than one-fifth of the market in 2010 (Exhibit 12).

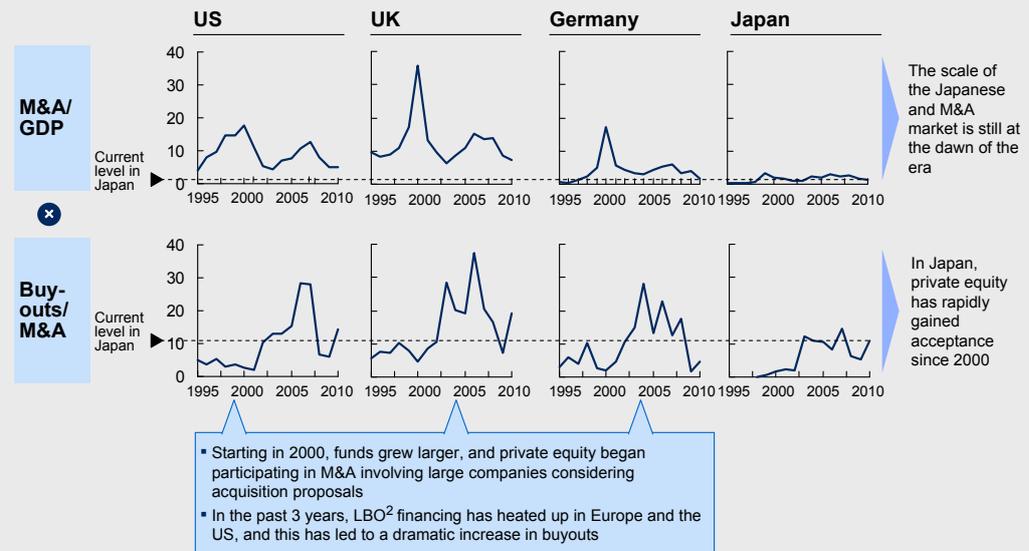
### South Korea: An off year

Deal making in South Korea was dramatically lower in 2010, fulfilling the pattern of a traditionally cyclical industry (Exhibit 13). Private investments decreased by 80 percent; in

**Exhibit 11**

Private-equity penetration in Japan is comparable to US and Germany.

**Penetration in Japan and Western markets, 1995–2010**  
 %<sup>1</sup>



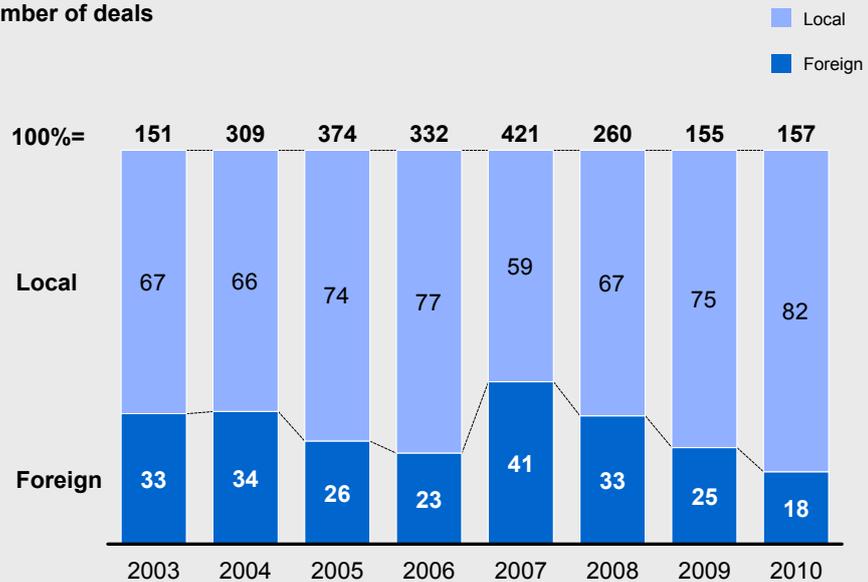
<sup>1</sup> Dealogic only contains M&A data from 1995 onward; private-equity data from Japan only available from 1998 onward.  
<sup>2</sup> Leveraged buyout.

Source: Dealogic; Global Insight Co. Ltd.; Recof M&A database; Capital IQ; McKinsey analysis

**Exhibit 12**

Local private-equity players are still a strong presence in Japan.

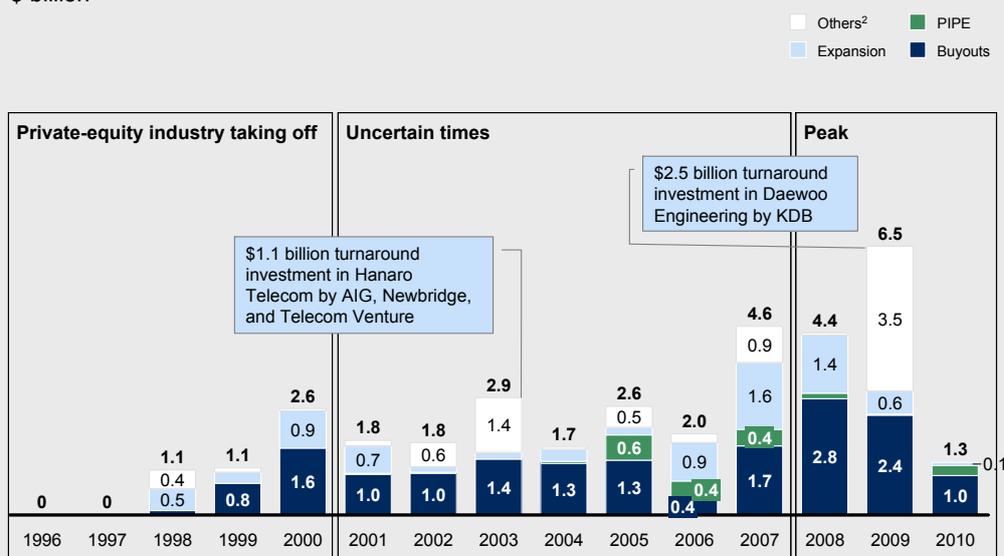
**Private-equity deals in Japan**  
 %, number of deals



Source: Recof M&A database; McKinsey analysis

**Exhibit 13**

South Korea's private-equity industry is highly cyclical, with three distinct phases.

**Total private-equity investments<sup>1</sup>**  
 \$ billion


<sup>1</sup> Includes buyouts, expansion, PIPE (private investment in public equity), pre-IPO, mezzanine, turnaround.  
<sup>2</sup> Others include mezzanine/pre-IPO, turnaround, and other investment.

Source: AVCJ; McKinsey analysis

fact, only 12 deals were recorded for the whole of 2010. Some of the more noteworthy deals included:

- Local PE firm Vogo Investment bought out Tong Yang Life Insurance for \$798 million.
- Temasek Holdings of Singapore invested \$188 million in Celltrion Inc. in a PIPE deal.
- Woongjin Capital, a Korean PE firm, invested \$91 million in Seoul Mutual Bank.
- Macquarie Bank bought out North East Chemicals for \$88 million.
- IMM Private Equity, a Korean PE firm, bought out CAP Co. Ltd for \$50 million.
- Steward Partners, a Korean PE firm, bought out SK Incheon Oil, a refiner, for \$35 million.
- Skylake Incuvest, a Korean PE firm, invested \$23 million in SCD Co. Ltd in a PIPE deal. The firm also invested in Posco Power, providing capital for expansion. Deal value was not disclosed.
- Shinhan Private Equity led a consortium to invest \$18 million in Everdigm Corp in a PIPE deal.

Korea's National Pension Service (NPS) has been quite active in private equity in the past year, and it intends to increase its allocation to private equity in 2011. Its target allocation to private equity is between 1.5 percent and 2 percent of total assets. As of the first quarter of 2011, just 1 percent of assets were allocated to private equity. NPS is also seeking to invest in direct private equity by establishing joint venture funds with Korean conglomerates.<sup>13</sup>

IPO exits continue to be scarce in Korea, with only nine PE-backed IPO listings in 2010.

Local firms dominated what little activity there was. Local PE firms were involved in 8 out of the 12 deals—a slight decrease from 2009, when local firms were responsible for 74 percent of the deals.

### Australia/New Zealand: Steady

In Australia and New Zealand, deal making dropped in 2010; volumes fell by 32 percent. However, total deal value increased by 15 percent in 2010, to \$8.5 billion. Average deal

<sup>13</sup> Based on NPS's profile in Preqin.

size increased by 68 percent, from \$101.8 million to \$170.9 million in 2010. The industry was cheered in May by the bid for Healthscope, a hospital operator. At A\$2.7 billion (\$2.3 billion), this is the largest buyout deal in Australia since 2006. TPG and Carlyle were the successful bidders.

Even without the Healthscope deal, buyouts dominated the mix of deal types in 2010. Ninety percent of the private capital invested went to buyouts, though growth/expansion was the rationale behind over half of the deals in the two countries.

Eighty-eight percent of the private capital invested went to services, transport, and medical industries. Two of the bigger deals (besides Healthscope) in 2010 were the \$2.1 billion investment in Port of Brisbane by a consortium led by Abu

Dhabi Investment Authority and the \$1.5 billion buyout of DP World Australia, one of the largest marine-terminal operators in the world, by Citi Infrastructure Investors.

As should be clear from the three deals cited above, trade sales dominated exits in Australia and New Zealand in 2010, accounting for 99 percent of all value raised. IPOs accounted for the rest. The size of the average trade sale increased substantially, from \$75.8 million to \$179.4 million, a jump of 137 percent.

Local players were involved in about 55 percent of all deals in 2009 and 50 percent in 2010. Overall, however, the share of deals involving local players has been decreasing since a high of 78 percent in 2005.

# Cross-cutting themes

As noted, Asia must be approached not as a whole but as a series of different markets. Our research has found, however, several cross-cutting themes that recur from country to country. As LPs and GPs consider their Asia strategy, these themes, which we discuss here under the headings of competitive strategy, fund-raising, and deals and exits, present a useful backdrop and should underpin a more specific approach to each market.

## Competitive strategy

### Eastward ho

The numbers paint a rosy picture for Asian PE, and the activities of both GPs and LPs are a further testimony to the region's attractiveness. Both Blackstone and Fortress have made significant executive changes. Blackstone has announced it will send a senior executive from New York to Hong Kong to head its Asian private-equity operations, underscoring the increasing importance of the region to the world's largest buyout firm by assets under management. A new head of global macro funds at Fortress has been hired in Singapore to oversee its expansion in Asia. A big global investor stated, "We are hiring and relocating more professionals to Asia." These titans are at the vanguard of a larger wave. As one interviewee said, "Global GPs are shifting focus to Asia for growth." Another predicted that "in the next 10 years, most of the returns in the global PE industry will come from Asia." And still another confirmed the trend: "Expected returns in Asia are higher (than in Western markets). The only exception might be Japan, where we expect returns similar to those in the US and UK."

For their part, global LPs are also pursuing the trend, by increasing their allocation to Asia. Historically, California Public Employee Retirement System (CalPERS) focused its Alternative Investment Management (AIM) program in the US, with almost 20 percent in California alone. AIM is seeking to diversify its private-equity investments across Asia following a decision made in December 2007 to increase the proportion of its portfolio, at that time one-third, allocated to international private equity; this will primarily be achieved by making additional investments in Asia. It expects to increase its investment pace in 2011 and is particularly keen to gain increased exposure to the Indian private-equity market.<sup>14</sup>

Similarly, in the second quarter of 2008, Canada Pension Plan Investment Board (CPPIB) announced that it was looking to increase its exposure to Asia and planned to begin

making private-equity investments in India. These are but two of the bigger names. In the meantime, LPs and sovereign wealth funds, such as Government of Singapore Investment Corporation (GIC) and Temasek Holdings, which have both been investing in Asia for long time, continue to be very active across the region.

More broadly, many PE investors we spoke with, both GPs and LPs alike, plan to increase their exposure to Asia.

### Land grab requires new strategies

More global GPs are coming to Asia, and the number of local GPs is mushrooming. They are joined by a number of new players, including sovereign-wealth funds, and of course strategic investors such as diversified conglomerates, all looking at direct investments but with very different expectations and economic structures. One LP laments that "there are now over one thousand GPs in India, and the number of firms that have written checks for more than \$50 million is close to 70, including PE firms, sovereign-wealth funds, and family offices." A global adviser to a big GP agrees, saying "competition has broadened beyond PE firms ... a number of other types of investors have capital and are going after the same assets as PE firms."

With competition intensifying, GPs—especially top-tier global GPs used to Western markets—need to reexamine their business model, their economic structure, and especially their strategy. A leader of one such firm acknowledges this, wondering, "What is the strategic direction that we should take and how can we differentiate ourselves in this market?" A second asks, "Is there anything that we are not doing well that we can do better? What can we learn from other firms that are doing better than us?"

The pressure to rethink strategy is also being felt from investors. LPs are increasingly questioning GP strategy, with some complaining that some global GPs have strayed from their strategy and should stick to their knitting. "LPs do not want GPs to deviate from their core strategy ... we want assurance that GPs have sufficient focus." Another LP echoes the complaint: "How can you leverage or adapt your existing franchise to compete in local markets without diluting your core value proposition and eroding investors' confidence in what you stand for?"

Another LP defines the problem this way: "What is challenging for top-tier global GPs is when they try to go from top-tier to midmarket. If you want to move down-market, you

<sup>14</sup> Preqin.

should think about how you can use your assets to bring value to the midmarket. A danger arises when you move away from your core; you might be moving the problem along and you risk stumbling.”

### Looking for hot spots

China and India are primary goals for PE investors in Asia, as the moves by CalPERS and CPPIB<sup>15</sup> attest. One global GP told us: “We can still find good value in China. There is a fair bit of intermediation. Auctions are small, with few participants. Advisers are paid to bring in capital, not to create competitive tension. Term sheets are simple—a couple of pages will do it.” This investor’s outlook on India is more cautious: “You can still find great companies in India, but value is more difficult—prices are being bid up. Everything is priced for perfection. There are too many advisers. Term sheets are overly sophisticated.”

Others may dispute this characterization. In October 2010, Blackstone’s chief executive publicly confirmed that it expected to invest more in India; the firm has already invested over \$1 billion. There is little doubt that both China and India are important destinations for PE investment. Indeed, a big global GP, speaking of its expansion plans beyond China and India, told us recently: “We are shifting investment professionals from the US and Europe to Asia. We started in Asia in 2006 with a presence only in China and Japan; now we also have offices in Korea (Seoul), India (Mumbai), Australia (Sydney), and Southeast Asia, and we are still growing. We have expanded from 0 staff to 70 in Asia.”

Southeast Asia also presents an exceptionally attractive opportunity. Consider:

- In January 2010, the global investment firm CVC concluded its purchase of Matahari, a big Indonesian retailer. At \$616 million, the deal is the largest in the country’s history.
- In November 2010, the government of Vietnam announced an auction to sell a 15 to 20 percent stake in Petro Vietnam Gas Corp., worth a reported \$600 million. Two prominent global firms are believed to be among the suitors. In the same month, the government also floated part of the company in a small IPO.
- In December 2010, TPG joined with the Government of Singapore Investment Corporation, the city/state’s sovereign-wealth fund, to buy a stake in Delta Dunia,

Indonesia’s second-largest coal mining contractor. At \$400 million, the deal is one of the largest private-equity transactions ever in Indonesia.

Despite the rush of activity, one investor raves that there is still “plenty of plenty in Southeast Asia.”

### The rise of the locals

A crucial consideration for strategy is the competitive environment between local and global GPs. Foreign firms saw some victories in 2010. For example, in May the Chinese government allowed foreigners to raise RMB funds, a move global GPs hope will help them land some of the deals they previously missed or could not get approved, and allow them to expand their fund-raising sources.

Others are more cautious and think the new rules might not open many doors. Some of the same restrictions that have dogged foreign firms in the past will continue, such as the rules against investing in certain sectors. Indeed, with respect to its divergent treatment of local and foreign investors, China is a special case. One LP goes so far as to say that “there is an unwritten rule that you must invest in domestic GPs.” While this may be an exaggeration, it is nonetheless true that firms must understand both the official regulations and the unofficial ways of working in order to be successful.

Other factors also weigh against overseas firms. One global GP we spoke to lamented that “the competitive environment is getting tougher in China. The locals have become more of a threat to us, particularly the ‘princelings’”—the Chinese term for the well-connected offspring of senior Communist Party officials. The same GP told us that “in order for us to compete, we are going deeper in industry expertise. We now have hired a partner with 30 years of manufacturing experience. We are about to hire someone else in clean energy. We will likely bring in industry experts to be CEO at some of our portfolio companies.”

Elsewhere, local firms do not enjoy the same advantages as in China but are nonetheless gaining the upper hand. In Korea, local GPs continue to dominate; these firms have been involved in more than 70 percent of all PE deals since 2008. In India, a plethora of local firms is making the market deeply competitive. And in Japan, one GP told us, “We strongly believe that the business is locally driven—that is, you need local people and expertise.... For that reason, we want to focus on our local market, because as a local GP we believe we have

<sup>15</sup> Prequin.

competitive advantage. We see our mandate as helping our portfolio companies grow in Asia.”

Many large LPs have noted the rise of the locals. One said that “global LPs that traditionally have only looked at bigger funds such as KKR and TPG are increasingly looking at local GPs.” Another said that “we now have a greater level of comfort with local funds rather than mega funds.”

Not everyone is convinced. Many see significant risks in investing with first-time funds — a widespread problem in Asia, as most local funds are just starting out. One big LP has analyzed the problem: “There is a large risk from investing with new local GPs; we believe that between 70 and 80 percent of first-time funds fail.” Another LP told us that “local GPs are several steps back. In the long term, there will be a few successes, as mediocre local GPs raise their game, but many more are likely to fail, and overall the number of real players will dwindle.”

### ‘Go glocal’: Foreign GPs’ new mantra<sup>16</sup>

In response to increased localization, global GPs are trying to develop a hybrid model that comprises the best of their global capabilities and investing experience with the entrepreneurship and cultural savvy of local firms.

The overarching theme for the winning model is solving practical problems in target companies. A few characteristics are starting to emerge:

**1. A flexible investment scope and deal size.** Firms must be able to invest along a range of investment themes: traditional domestic growth, helping Asian companies expand or acquire outside of Asia, and helping foreign or Asian firms do domestic acquisitions. Looking for a single type of deal, as many do, is unlikely to keep a firm in enough conversations. Deal size also matters. There are many Asian companies that are too small for large global investors to take seriously but still represent good investment opportunities. In countries like China, small companies can become large ones very quickly.

### **2. The ability to source deals effectively at the regional level.**

In China, for instance, most Western firms concentrate on Beijing and Shanghai. However, many investable deals do not originate in the ministries of Beijing or the office towers of Pudong but rather at the local level.

**3. Leadership by senior local deal makers.** Figurehead leadership is not enough. That would make sense only if deal-making skills are not central to success. No Western firm grew to success with a figurehead leader; why would it be different in Asia?

**4. Extensive political and deal-making experience inside—and outside—Asia.** Asian companies need this experience to get deals done outside Asia.

**5. High-quality investing and operations teams.** The winning model will not cut corners on staff. Winning firms will provide investors with true partners, people with experience in making things happen in Asian companies. The success of Western PE firms was built in part on the excellence of their people. In Asia, if firms scrimp on staff, potential target companies quickly notice.

**6. An Asia-savvy investment committee.** Global investment committees bring useful experience to potential deals but often turn into “Asia 101” classes. Moreover, global committees can get skittish because of unrelated and poorly understood developments in China, and even in other emerging markets. As such, localization of investment decision making is something we expect to see more of in the coming years.

**7. Substantial capital from local LPs.** If you can’t convince local investors that you can invest their money, what does that say about your firm?

### Active ownership: Back in vogue

The benefits of active ownership—the set of practices and management techniques that top-quartile PE firms use—have been amply demonstrated in the more mature markets of North America and Europe.<sup>17</sup> One prominent global GP told us, “Active ownership is very important. One thing we do really well is to add value by improving operations—incentive systems, operations processes, and so on. We believe that this kind of operational value-add is the main way to distinguish between a good investor and a bad investor.”

But in Asia, the lack of operational expertise is especially acute. In India, for example, “valuations are high everywhere. It is impossible to buy cheap. Therefore firms need to work harder to get returns,” says one global GP. Another says that “this is a transparent market so there is no opportunity to

<sup>16</sup> Special thanks to David Cogman, a principal in McKinsey’s Shanghai office, for his contributions to this section.

<sup>17</sup> For more, see “Why some private-equity firms do better than others,” by Joachim Heel and Conor Kehoe, *The McKinsey Quarterly*, February 2005, [www.mckinseyquarterly.com](http://www.mckinseyquarterly.com).

extract value in conventional ways ... creating value through active ownership is the only way, at present.”

LPs tend to agree. One notes that “we prefer GPs with active-ownership skills—that is, those that can add value post-investment.” Another is slightly more broad-minded, though still focused on active ownership: “Deal sourcing, post-value creation, and execution skills are the key criteria that we look for in GPs. We spend a lot of time doing due diligence on these factors when investing.” A third reports that “GPs’ operational capabilities are becoming more important—how much they can increase EBITDA and what kind of resources they can leverage to lift performance, instead of their financial-engineering skills.”

The penalty for lack of operating expertise is significant; more than a few big investments have gone sour in recent years. In response, savvy firms are getting much more involved in portfolio-company operations. A prominent global GP acknowledges the shift: “We think this is a significant change in the way PE firms operate. We are increasing the number of operations professionals. We used to have no operations professionals in Asia; now Asia makes up 30 percent of our global team of professionals with operations expertise. We see other global GPs headed the same way.”

Not everyone is convinced, however. One GP says that “hiring operational partners is mainly great marketing. For instance, hiring a famous ex-CEO will give a firm more credibility with its LPs. However, having them on the ground for just a few days doesn’t really help in the end.”

## Fund-raising

### Still tough

As the figures in the previous chapter showed, fund-raising remains “very tough,” as one GP told us. Another detailed its problems this way: “I have made presentations where the executives are not enthusiastically listening.”

The problem, GPs told us, is that investors who have seen their returns plunge in recent years are still licking their wounds. Returns have been hurt, and investors are reassessing their allocations for private equity. Some GPs detect a flight to quality, believing that as investors become more selective, they will support those that came through the crisis well, while those that were worst affected will find it difficult, or

perhaps even impossible, to raise funds. A global LP puts it bluntly: “The mediocre guys have had no traction for two to three years and will continue to struggle.” Others are even less charitable about these marginal players; one skeptical LP told us: “Dumb money entering the industry is not good for the business.”

Others see trouble for fund-raising given the region’s substantial capital overhang—the considerable amount of “dry powder” that firms have yet to spend. Worse, the capital overhang is not likely to dissipate quickly. Some think that because of the difficulties in deploying capital in China and India, the overhang is likely to persist for a while.

Not all LPs are troubled by the capital overhang. One we spoke to said, “GPs that perform well—something of a rarity, as not many Asian GPs have a good track record—will have no problem raising funds. It is the poor-to-mediocre performers that will struggle.”

### The year of the RMB fund

One bright spot in 2010 was in China, where, as mentioned, the government unveiled a new policy allowing foreign funds to raise RMB-denominated funds. These were an immediate sensation and accounted for about 70 percent of total funds raised in China in 2010. However, troubles persist. As discussed earlier, uncertainty about the new rules remains. Some foreign LPs also suspect that the new funds are succeeding at the expense of older, dollar-denominated funds. In their view, firms that manage both kinds of funds tend to reserve the best deals for the local funds. So long as this sentiment continues, RMB funds will be a double-edged sword for GPs in China.

LPs are concerned about both the deal allocation and the time allocation among these funds. The issue threatens to break the alignment of interest between a GP and the LPs of its different funds. As a result, “many LPs have adopted a wait-and-see attitude,” says one. Others are less concerned: “There is a big issue with GPs that manage both US dollar and renminbi funds, but we think this is only a short-term issue.”

### GPs and LPs: The balance is shifting

We found abundant evidence that limited partners are gaining in their delicate relationship with general partners. One LP reports that “2010 turned out to be a very positive environment for LPs.” Another says it got “more favorable

terms, better negotiation power, more control.” A large institutional investor disclosed just how good 2010 was: “Management fees for a few larger funds were reduced from between 2 and 2.5 percent to between 1 and 1.5 percent. Fees at smaller funds are essentially unchanged. Carry is still 20 percent, but some catch-up items and terms are changing. We were able to negotiate carry better, getting better rights, including ‘drag-along’ and ‘tag-along’ rights; a say in the setup of the advisory board; and some involvement in the GP’s operation, such as the right to visit any time, and even veto power over some decisions.” Indeed, the shift in power is already reflected in the formal codes that govern behavior. In September 2009, the Institutional Limited Partners Association (ILPA) published its *Private Equity Principles*, a 15-page best-practices road map.

LPs naturally believe that even better days are ahead. One says, “LPs have stronger buying power now, and they will push for more.” Another says that “terms will not be as favorable to GPs as in the past. LPs are asking for lower fees, more management control, and they are demanding that GPs not deviate from strategy.” One big LP said: “We expect more LP-friendly terms in Asia. We have even decided to walk away from a fund because of unfavorable terms and conditions.”

As a corollary to LPs’ growing power, recent years have seen a marked rise in the number of co-investments and direct investments. By jointly investing in the portfolio companies with PE firms, LPs stand to make higher returns: they avoid paying the fees and commissions on the additional capital they invest. Some caution that the trend is short-lived: “There is a growing number of partnerships, but there is also a limit to the number of partnerships that can be formed.” Some indication of the interest in collaboration can be seen in one Asian GP’s comment: “The biggest single issue we face is how to maintain support from LPs.”

## Deals and exits

### Control deals, few and far between

Deals for control remain few and far between; minority stakes are still the dominant deal type. Without control, PE firms must develop other means to achieve their ends. One global LP says that “what you need in minority deals is the power to influence. This boils down to personalities and how the target views its prior partnerships. Big egos don’t work well in the minority context.”

Deal making continues to be difficult in other ways. For foreign investors, the regulatory environment continues to

hinder deal making. In India, some sectors, such as retail, are off limits to foreign owners. The “license Raj” persists with respect to foreign investment; two regulators must vet foreign purchases. In China, the story is similar. One way around the problem is through partnership with local firms. But this is not a panacea; domestic firms do not always collaborate in the ways that foreign firms expect.

One big foreign GP sums up the problems in deal making this way: “You can get deals done in Southeast Asia and in offshore China. Only distressed deals can get done on the mainland. Entrepreneurs won’t sell out, and neither will state-owned entities.” On the other hand, the outlook for financing, according to this investor, is improving: “Leveraged deals in the mainland still take a while. But restrictions on the high-yield market are slowly falling away. Five years ago, you needed to be a triple-A company to get a corporate loan, or be guaranteed by a triple-A bank. Today, banks are becoming more sophisticated. Another says that “the debt market—both corporate bonds and bank lending—is increasingly favorable.”

### Get creative

Creativity in sourcing and deal making is prized in Asia. “You need the ability to understand local regulation to structure creative deals,” says one big global GP. It wanted to invest in a large media company in India. However, by law foreigners can only own 26 percent of the outstanding shares. The firm realized that recent regulation provided a way around this, through the creation of a holding-company structure. It took advantage of this and made a successful investment.

Other creative structures are also possible. One Indian GP told us that “structured deals always work best when there is a mismatch in valuation. A lot of funds are now looking at principal protection as the basic guarantee, with some upside. People are becoming more risk-averse and most large deals are being structured this way.” Another big local PE firm relies on an old-fashioned form of creativity; it says that “sourcing proprietary deals is a key capability, and this is only possible by leveraging local networks.” With the proliferation of deals for minority stakes, firms need to think of new ways of exercising influence. One big GP alludes to this by saying, “Even though most of our investments in China and India are minorities, in most cases we are the largest minority shareholder, and so we have no problems effecting changes.” Still other possibilities arise from mixing asset classes. “We invested in a deal that is a cross between real estate and private equity, but from the LP’s point of view, they are actually investing in real estate,” reports one GP.

The imperative for creativity may be helping to force a change in traditional approaches. The “spray-and-pray” method of investing, in which firms invest in dozens of companies in the hope of a few hits, is “on the wane,” according to one investor. A Japanese GP told us, “You just need to be patient; deals in Japan take longer to conclude than in other markets.... Firm leaders cannot set a three-year horizon and then fire people if there is no deal ... but that does not stop us from using our creativity to shorten the time horizon of deal sourcing.”

### Exits are coming back

Exits were one of the hot topics of 2010. A global GP says that “2010 was focused on exits, especially IPOs and secondaries.

A lot of firms in India used their recent opportunity to exit.” Another saw the source of the opportunity as “increasing valuations and higher multiples.” April saw exits for CVC Asia Pacific, which sold Malaysian company Paperbox Holdings to Japan’s Oji Paper, and TPG, which divested its 24 percent stake in Singapore-listed health care service provider Parkway Health for \$685 million.

No one knows with any certainty where things are headed. But our discussions with Asian private-equity leaders suggest that several stories are likely to make the headlines in the coming year.

# Eleven headlines for 2011

**1. Plenty of opportunities—for sellers.** Despite recent sell-offs, valuations in China and India remain high, with promoters still asking for the sun and the moon. Unless broader macroeconomic conditions change, finding good value will be hard work.

**2. Europe discovers Asia.** European firms belatedly turn their attention to Asian markets, years after their US counterparts. Many will come not for direct investment but rather to help their portfolio companies become more active here.

**3. New study confirms: Only one fund in four is top-quartile.** Asian performance data become more transparent; as it becomes easier to tell winners from underperformers, LPs smarten up accordingly.

**4. Chinese insurers dip their toes.** Chinese insurers now can invest up to 5 percent of their assets under management in private equity. While regulators polish the rules of engagement, Chinese insurance companies start to experiment with the asset class.

**5. ILPA terms take root in Asia.** LPs are getting their act together globally and are pushing for stronger terms in Asia as well.

**6. Agriculture becomes sexy. Yes, agriculture.** The macroeconomic fundamentals have long been in place for food companies. Deals are now starting to flow. LPs are scratching their heads, though: is this a sector ... or a brand new sub-asset class?

**7. Asian corporates travel abroad with PEs.** With strengthening currencies and ambitions, expansion-minded Asian companies look for acquisitions abroad. Many will co-invest with PE firms to get management expertise, not to mention political air cover.

**8. LPs strike out on their own.** As LPs get more sophisticated, more of them will have the capability to make direct investments or start their own PE funds. Leading the way, South Korea's National Pension Service is looking to set up its own PE fund while China Life Insurance teams up with the China Development Bank and NaSSF.

**9. Japanese PE returns amidst muted M&A activity.** Private equity in Japan is gaining public acceptance after years of being perceived as not welcome (despite figures showing otherwise). However, M&A activities will continue to be limited as global firms focus on deals in faster-growing Asian countries.

**10. South Korea recovers.** The February 2010 decision by the Financial Services Commission, South Korea's top financial regulator, to ease rules on private-equity funds opens the floodgates of PE investments into South Korea.

**11. Search for frontier markets continues.** As more capital flows into Asia, investors are starting to look for nontraditional markets with compelling potential. Two landmark deals in 2010—in Indonesia (Matahari) and Vietnam (Petro Vietnam's sale of an approximately 20 percent stake in November)—set the stage for more deals to come.

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**James Ahn** is a principal in McKinsey's Seoul office. **Chinta Bhagat** is a principal in the Singapore office, where **Fredrik Lind** and **Jean-Marc Pouillet** are directors and **Ivy Kwan** and **Timothy Ye** are consultants. **Keiko Honda** is a director in the Tokyo office. **Vivek Pandit** is a principal in the Mumbai office. **Bruno Roy** is a principal in the Beijing office.

Contact for distribution: Ivy Kwan  
Phone: +65 6586 4881  
E-mail: [Ivy\\_Kwan@mckinsey.com](mailto:Ivy_Kwan@mckinsey.com)





