

## Private equity investment

Traditional investment focus on listed securities such as listed equity shares, debt securities and exchange-traded derivatives. In recent years, private equity investments, that is, investments in unlisted equity shares become increasingly popular in the asset management industry. Private equity fund is usually a pool of capital contributed by high net worth individuals and institutional investors for making private equity investments, and is managed by a fund manager with certain industrial experience and expertise. Private equity fund manager may also provide management and operation advice to investing businesses, in addition to equity investment.

Private equity could be classified into a number of categories : *Venture capital* renders working funds for young and growing businesses to commercialise their innovations and products. Overseas experiences demonstrate that venture capital could act as catalyst for the development of innovation and creative activities. *Mezzanine finance*, a subordinate debt with equity warrants for financing leverage buyouts, is usually provided to profitable business pending for Initial Public Offerings (IPOs). *Buyout capital* is made use in gaining a controlling interest of a business and might involve high leverage financial strategy. *Turnaround or restructuring capital* is injected to business encountering performance difficulties.

Private equity investments are manifestation of high risk-high return portfolio. Venture capital is the riskiest form of private equity investments but its potential return is also the highest. Generally speaking, private equity funds can reap their return when the investing business successfully initiates its IPO in stock exchanges. Many companies backed with venture capital were listed on the secondary boards (e.g. Nasdaq in U.S.), which have a lower listing requirement on profitability and financial position. Alternative forms of exit also include selling the unlisted shares to a larger company and seeking repurchase by the investing business.

Private equity funds in the Asia-Pacific region have been flourishing in the past 10 years – the total asset under management has increased to US\$101,100 million in the first-half of 2004, from US\$30,950 million a decade earlier. This represented an average annual growth rate of 13%. Private equity activities are expected to continue to grow rapidly in the Asia-Pacific region, the brightest emerging market. Several large-scale management buyouts in South Korea, Japan and Australia in recent years demonstrated that private equity funds could make decent returns in the region. These provide efficient track records for fund raising activities.

Within the Asia-Pacific region, Hong Kong and Japan, together accounting for over 50% of the private equity funds, are the regional hubs of private equity management activities. Private equity funds managed in the Mainland, South Korea, Taiwan and Australia surged in recent years, mainly due to the completion of a number of leverage buyout transactions.

**Asset under management in Asia-Pacific's private equity funds, 1999-2004 first half  
(US\$ million)**

	<u>1994</u>	<u>1999</u>	<u>2002</u>	<u>2003</u>	<b>2004 <u>first half</u></b>
Japan	17,750	21,729	22,300	25,350	27,320
Hong Kong*	6,037	22,288	26,600	27,050	27,100
The Mainland	N.A.	N.A.	6,380	6,900	7,280
Singapore	1,833	7,791	10,200	10,720	10,880
South Korea	1,902	4,986	6,620	9,120	9,000
Taiwan	562	4,447	6,400	6,500	6,620
Australia	1,655	3,616	4,950	6,000	6,770
Rest of Asia-Pacific region <sup>+</sup>	1,212	4,275	5,746	5,958	6,130
<b>Total</b>	<b>30,951</b>	<b>69,132</b>	<b>89,196</b>	<b>97,598</b>	<b>101,100</b>

Notes : \* Figures in 1994 and 1999 included the Mainland since further breakdown is not available.

+ Including India, Indonesia, Malaysia, Myanmar, New Zealand, Pakistan, the Philippines, Sri Lanka, Thailand and Vietnam.

Source : The Guide to Asia Private Equity, Asian Venture Capital Journal.

Reflecting the prominence of Hong Kong as a regional asset management hub, most private equity funds are sourced outside Hong Kong. A large proportion of these funds are invested in other Asian economies as well as in the rest of the world. Indeed, only about 10% of investments made private equity funds in Hong Kong were invested in local companies in 2001. This was substantially different from the private equity funds in such economies as Japan, South Korea and Taiwan, with a majority of the investments being made to local companies. In Singapore, the proportion of funds invested in local companies was 15%, slightly higher than that in Hong Kong.

**Distribution of private equity investments to companies in selected economies, 2001**

	<u>Hong Kong</u> (%)	<u>Japan</u> (%)	<u>South Korea</u> (%)	<u>Taiwan</u> (%)	<u>Singapore</u> (%)
Local companies	11	87	92	79	15
Other Asian companies	85	5	6	7	64
Non-Asian companies	4	8	2	14	21
<b>Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>

Source : The Guide to Asia Private Equity, Asian Venture Capital Journal