Asian Corporate Governance Association (ACGA)

"How Private Equity can Strengthen Corporate Governance in Asia"

Presentation by

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at

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The structure of Hong Kong's stock market

- Hong Kong main board: 952 companies (July 2006)
  - Top 10 account for 50% of market cap.
  - Top 50 account for 78% of market cap.
- Hong Kong GEM: 198 companies (August 2006)
  - Top 10 account for 51% of market cap.
  - Top 50 account for 88% of market cap.
- 670 of 1,146 listed companies were "penny stocks" (ie, less than HK$1.00) at end-2005.
  - Only 86 were above HK$10.00!
  - 495 were less than HK$0.50

The structure of Singapore's stock market

- Singapore main board: 516 companies (July 2006)
  - Top 10 account for 43% of market cap.
  - Top 15 account for 52% of market cap.

- Singapore SESDAQ: 177 companies (July 2006)

- 403 of 576 listed companies were "penny stocks" (ie, below S$0.50) as at September 2004.

Implications

- A lot of poorly managed companies with no following?
- A lot of companies that came to market badly prepared by their sponsors?
- A lot of companies with weak governance whose directors are simply not trusted by the market?
    - Compare "CG Watch 2005" average scores for Asia large caps (top 100 companies): Average score of only 62.9%; highest = 85.9%; lowest = 33.3%
- Or a lot of companies with upside potential—if they can get the right assistance and advice?

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Advice on what?

- Building boards that can add real value to a business
- Recruiting new directors that will challenge management to think—and hold them accountable
- Developing more effective strategy and new businesses
- Developing more effective internal systems of information and control
- Creating useful board sub-committees (not window-dressing ones)
- Helping to get all directors to understand their role and think like public-company directors
- Building a corporate brand and communicating better with minority shareholders

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Who is best suited to this role?

- Public equity
  - Short term horizon
  - Large number of investee companies
  - High ratio of portfolio companies to staff
  - Size of stake small in relation to controller
  - Too big to invest in small companies
  - Suffers from free-rider malaise
  - Can seek to influence management through dialogue and voting

- Private equity
  - Medium-term horizon
  - Small number of investee companies
  - Low ratio of investee companies to staff
  - Size of stake relatively large in relation to controller
  - Able to invest in smaller companies
  - Potential to realise value from active ownership
  - Able to sit in the boardroom with management, act as a “coach”

Who has put up their hand?

Private-equity investors in Asia that have expressed public support for corporate governance include:

- Asian Development Bank
- CLSA Capital Partners
- GIC Special Investments
- International Finance Corporation
- Lombard Asian Private Investment Company
- Oaktree Capital
- Mekong Capital
- Newbridge
- TVG

- HKVCA: "Corporate governance guideline"

  - *A fairly short list. And a far cry from 6 years ago.*

Has the industry gone quiet?

- I think it has. Why?
- The generous interpretation: Corporate governance is now mainstream. Incorporated in due diligence and portfolio management. No need to talk about it publicly any more.
- The critical interpretation: The flood of money pouring into Asian private equity has led to vastly increased competition. Funds cannot afford to promote governance too vigorously. They fear losing out on deal flow. And getting a "reputation" as activist investors.

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Some statistics

<u>According to Asia Private Equity Review:</u>

- More than US$9.5 billion in fresh capital entered Asia through 51 funds in the first half of 2006. This was a 42% increase on the same period last year.
- Average fund size has only grown by 19.8% (to US$188m), implying a “sharp increase in the number of fund houses engaging in fund raising”.
- Investment transactions totalled US$18.76 billion in first half 2006—a 2.7-fold increase over 1H 2005.
- Number of deals in first half 2006—176—increased by 29.4% over 1H 2005.

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Enter hedge & "CG focus" funds

- The past 18-24 months has witnessed growth in the number of hedge funds interested in corporate governance in Asia—and acting like quasi private-equity funds:
  - Symphony Financial Partners, Tokyo
  - PMA, Hong Kong
- Also the emergence of "CG focus funds", albeit at a slower rate:
  - SPARX and Taiyo in Japan
  - Korea Corporate Governance Fund
- Are they grasping these opportunities because private equity is not? Or is economic change throwing up new investment opportunities?

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