



Venture capital and private equity in Asia-Pacific in 2018

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Hogan
Lovells

*"A living drollery. Now I will believe
That there are unicorns"*
(Sebastian, Act 3, Scene 3, *The Tempest*)

While Prospero's enchanted isle may not fall within our definition of "Asia-Pacific"; it would appear that today's explorers of the region share Sebastian's belief in unicorns...

As one of the world's leading international law firms, with market-leading practices throughout Asia-Pacific, advising on headline deals such as Walmart's recent acquisition of a 77 per cent. stake in Flipkart, Hogan Lovells is well placed to comment on the changing face of venture capital (VC) and private equity (PE) in the Asia-Pacific region in 2018.

This article explores

- the evolution of the venture capital market in Asia-Pacific since the turn of the millennium;
- the distinctions that are still to be found between venture capital and private equity, despite outliers such as Masayoshi Son's SoftBank, a Japanese multinational conglomerate disrupting traditional definitions of how venture capital funds should behave; and
- the trends we are observing in the Association of Southeast Asian Nations (ASEAN), including whether venture capital can unleash the potential of ASEAN's 'sleeping giant', Indonesia.

1. The evolution of venture capital in Asia-Pacific

In 2000, venture capital outside of the U.S. was in a nascent form: such investment was in a proto-embryonic stage in the major cities of Western Europe and virtually non-existent in Asia-Pacific. According to Venture Economics, in 1999 Asia represented just five per cent. (or US\$7 billion) of the global private equity and venture capital market (then valued at US\$131 billion). Since the Asian financial crisis twenty years ago, the move towards economic liberalization and the trend towards the removal of barriers to foreign investment by Asian governments has made Asia-Pacific an increasingly fertile environment for venture capital. Today the Asia-Pacific region challenges North America as one of two key global venues for venture capital investment, mirroring the geo-political shift from the Atlantic to the Pacific witnessed in the first two decades of the 21st century.

According to data prepared by EY, in Southeast Asia alone, PE and VC investment activity across 101 completed deals was valued at US\$5.9 billion in 2017; the largest such deal being Macquarie Infrastructure and GIC's (advised by Hogan Lovells) US\$1.3 billion acquisition of a significant minority stake in Energy Development Corporation. A recent Preqin press release confirmed Asia as the leading arena for venture capital deals in Q1 2018: 1,359 Asian deals were reported throughout the quarter (including nine out of the 10 largest global deals), with a combined value of US\$22 billion (representing 43 per cent. of the global venture capital market in Q1 2018 by deal value), surpassing the North American market in both number of deals and aggregate value.

Walmart announced on 9 May 2018 that it had acquired a majority stake in Flipkart. The deal is perhaps the prime example to-date of international venture capital facilitating the growth of start-ups – from Series A funding to acquisition by a strategic buyer – in the Asia-Pacific region outside of the PRC and will be seen by many as the ultimate endorsement of venture capital as an established feature of business in this part of the world. The terms of Walmart's investment give Flipkart a valuation of US\$20 billion, a figure made all the more extraordinary given that Flipkart's Series I investment round in 2017 was executed based on a valuation of the company of just under US\$12 billion. SoftBank's Vision Fund's investment of US\$2.5 billion will shortly result in a realization of approximately US\$4 billion, once the transaction completes. The Vision Fund's return on investment epitomizes the rude health of venture capital in Asia-Pacific as we move towards the end of the second decade of the 21st Century.

2. Venture capital vs. private equity in 2018

A 2002 article, *Venture Capital and Economic Growth: an Industry Overview and Singapore's Experience*, written by a pair of professors at the Singapore Management University defines the twin disciplines of private equity and venture capital with a certainty rarely seen today: "venture capital refers to investment in young unproven start-ups while private equity generally refers to investments in mature companies, which may include the provision of financing for expansion, buyout of private and public companies and which involve significant corporate restructuring".

The traditional definitions of venture capital and private equity are no doubt under pressure in 2018. The idea of venture capital has diversified, with the emergence of "angels" and "micro-VCs" at one end of the spectrum, compared to sizeable "corporate VCs", such as Tencent and Alibaba from the PRC or Google Ventures and M12 (formerly Microsoft Ventures) from the U.S., alongside the gargantuan Vision Fund at the other end of that same spectrum. As well as the diversification of venture capital, the proliferation of "unicorns" (start-up companies that grow to have a billion-dollar plus valuation) has ballooned in recent years, with 53 start-ups earning "unicorn" valuations in 2017, and 22 having done so as of 26 April 2018. The potential for such companies to grow into the next Facebook or Apple has seen an explosion in private equity investment in "unicorn" companies with deal count quadrupling over the past five years according to data from PitchBook. According to the same data set, Warburg Pincus has made 12 investments in unicorns since the start of 2007, more than any other buyout investor; KKR has backed 10 companies with billion-dollar valuations in the past dozen years; while Silver Lake has completed nine such deals. The growing trend of PE firms investing in unicorns, as well as the ever more diverse nature of "venture capital" in 2018, reflects the continued blurring of the lines between traditional buyout shops and venture capital funds.

An important distinction between Tencent and Alibaba and equivalent "corporate VCs" in the U.S. is that Alibaba and Tencent account for 40-50 per cent. of venture capital flows in mainland China, compared with corporate VCs who account for less than five per cent, according to data compiled by McKinsey. A further difference – and a complicating factor for any observer of venture capital trends in the Asia-Pacific region – is that Tencent and Alibaba invest through multiple units, including the family/personal funds of each entity's founder, Pony Ma and Jack Ma, respectively, in addition to making acquisitions on Alibaba's and Tencent's own balance sheets.

According to further data from McKinsey, Tencent has US\$60 billion in funds under management, separate from its own balance sheet. This makes Tencent a monster in the traditional world of venture capital funds, but even Tencent is dwarfed by the US\$217 billion

(according to McKinsey) under the management of SoftBank, including the US\$100 billion Vision Fund. Almost half of the Vision Fund's capital comes from Muhammad bin Salman, the dynamic new Crown Prince of Saudi Arabia who has overseen the investment by Saudi Arabia's Public Investment Fund of US\$45 billion into the Vision Fund. The Crown Prince's huge investment blurs the line between SoftBank and sovereign-wealth funds, a blurring only further compounded by Mubadala's (the sovereign-wealth fund of Abu Dhabi) investment of US\$15 billion alongside the Saudi Arabian Public Investment Fund into the Vision Fund.

In the view of the authors of this article, the outliers of Tencent, Alibaba and SoftBank should not distract market participants or analysts from the fundamental differences that still exist between venture capital investors and private equity investors. To give an idea of the gulf that exists between such outliers and the majority of venture capital funds, consider that the three next biggest traditional growth funds of venture-capital firms (i.e. excluding sovereign-wealth funds and corporate VCs) behind the SoftBank Vision Fund have an aggregate of US\$12 billion under management, and all but the biggest are now often priced out of later-stage funding rounds. Rather than attempting to characterize such disparate types of funds within one broad-church, a third class of quasi-venture capitalism fund should be envisaged: a class including the likes of Tencent, Alibaba and SoftBank, where the investors have huge reserves of capital at their disposal and can make investments for reasons other than the pure-play financial return model that has been a common feature of both traditional private equity and venture capital investors over the last two decades.

Given the depth of capital in reserve for funds such as SoftBank, Tencent and Alibaba, certain voices argue that this third class of quasi-VC funds represents a threat to the unfettered operation of free-market capitalism. A recent example cited by such concerned market analysts was the shock to regulators in Singapore, Vietnam and the Philippines when, after Grab merged with Uber (both SoftBank portfolio companies and both reported to be due to be moved under the ownership of the Vision Fund within a matter of months), the latter prepared to wind down, leaving Grab as the monopoly operator in those markets. Competition reviews have begun in all three jurisdictions. Across the Pacific, a U.S. investigation is pending into SoftBank's acquisition of its stake in Uber, an investigation that as-of-yet has prevented Rajeev Misra, a senior Softbank executive, from taking his seat on Uber's board.

It remains to be seen whether the investment style of these quasi-VC funds represents a brave new world or harks back to the excesses of the Dot-Com boom. What is clear is that while the old distinctions of PE and VC may still exist for now, when unicorns are in sight, those managing money have increasingly less regard for the "rules" that others have written for their funds and their investment decisions.

3. The ASEAN market and venture capital: Can venture capital unleash the potential of ASEAN's 'Sleeping Giant'?

Singapore has a long history with international private equity and venture capital funds, playing host to the headquarters of many in the Asia-Pacific region and boasting a synergistic hub of leading global financial institutions and international law firms that makes the island the world's gateway into South-East Asia. In contrast, Indonesia – despite having an economy well over double the size of Singapore's (based on the IMF's April 2018 estimates of nominal GDP) – has remained largely unknown to the international private equity and venture capital community until the last few years. With a population of around 260 million, Indonesia is the world's 4th most populous country. Over the last 10 years, Indonesia's GDP has grown at an

average annual rate of 5.5 per cent., largely driven by its rising middle class. Based on current trends, Indonesia is predicted to become a G6 or G7 country by 2030.

In spite of the lofty economic predictions and rapid growth, the baseline in Indonesia is still relatively low: with an average per capita GDP of US\$3,570, Indonesia ranks in the 3rd quartile worldwide of the IMF's latest purchasing power parity per capita global rankings. Indonesia's rapid rise from such a low base is reflected in the industries and investments that are thriving in the country today. Indonesia, along with much of Sub-Saharan Africa and other developing Asian nations, is a "mobile first country", meaning that many Indonesian citizens' first exposure to banking is through their smartphone. At present only 36 per cent. of Indonesians have a bank account, making Indonesia a prime target for e-commerce and e-banking entrepreneurs.

Indonesia's demographics and prevailing economic forces mean that the nation is fast emerging as a key market for international private equity and venture capital funds and will doubtless emerge as the pre-eminent target market for investment flowing into the ASEAN region over the coming years. In the last two years alone, Go-Jek, Travoloka, Tokopedia and Bukalapak have all emerged as Indonesian "unicorns".

Go-Jek – the Indonesian ride hailing, logistics and payments start-up – is the pre-eminent example of venture capital investments into Indonesia. In its latest Series E funding round in February 2018, Go-Jek raised US\$1.5 billion from the likes of Tencent, the Chinese e-commerce giant JD.com, Singapore's Temasek Holdings and Google Ventures, giving the company a reported post-money valuation of US\$5 billion. In its Series D funding round in May to August 2017 Go-Jek raised US\$1.2 billion from investors including Tencent and JD.com, having received at least US\$550 million in August 2016 from prominent international investors including KKR, Warburg Pincus, Farallon Capital, Capital Group Private Markets, Sequoia and Northstar. Go-Jek is now even looking beyond Indonesia, announcing on 24 May 2018 that they will invest US\$500 million expanding into Singapore, Vietnam, Thailand and the Philippines, setting the scene for a battle of the ASEAN ride-hailing giants between the incumbent, Grab, and the usurper Go-Jek. It will be interesting to see if Go-Jek's investment into these other ASEAN states marks the start of a trend of Indonesian companies expanding beyond the nation's borders, a novel trend for a nation traditionally associated with inbound investment.

Not to be outdone by its compatriots, JD.com and Tencent, Alibaba has added to the sense that PRC-based investors may lead the charge of international capital into Indonesia; in August 2017, Alibaba announced a US\$1.1 billion investment in the online marketplace Tokopedia, joining existing investors such as Softbank, Sequoia and East Ventures. Even more recently, in April 2018, Alibaba doubled its investment in the Indonesian e-commerce company Lazada to US\$4 billion. It remains to be seen how – and if – these PRC-based companies will leverage these investments to strengthen their own product offering in the Indonesian market.

While personal transportation and e-commerce are key focus-areas for venture capital across the globe, the authors of this article see healthcare as the key sector to watch in Indonesia. Indonesia scores comparatively poorly in terms of the percentage of its GDP being spent on healthcare, the number of doctors and available hospital beds, meaning there is plenty of spare capacity for growth in Indonesia's burgeoning healthcare sector. The potential in healthcare can be seen in recent transactions, such as CVC's August 2016 investment of US\$165 million for a 15 per cent. shareholding in Siloam International Hospitals, an Indonesian healthcare

provider. In addition to healthcare, we see one of the key battlegrounds ahead – in Indonesia and the wider ASEAN region – as the race to become the pre-eminent payment platform. Both Grab and Go-Jek have made acquisitions in this space (which is remarkable in itself when one remembers that they themselves are recent "start-ups") and it is to be expected that Alibaba/Alipay will join the fray in the not-too-distant future.

Venture capital and private equity interest has shifted away from Indonesia's historically important resources and commodities sector due to depressed prices in recent years. Infrastructure (including power) has been and will remain an important growth sector. At the same time, high capital intensity and the presence of large state-owned entities raises a barrier for private equity investments; however, the sector may nevertheless provide investment opportunities for more mature assets with stable cash flows, such as toll roads and communication towers going forward.

Indonesia undoubtedly has the population and the growth trajectory to support its position as the next great land of potential for venture capitalists and private equity investors willing to take an educated risk. Goldman Sachs recently identified Indonesia as the site of the next key battle for technology companies due to: its large population, high rate of economic growth and untapped market potential. With investment in Indonesian tech start-up firms up to US\$3 billion in 2017, double the 2016 figure, the early signs would appear to indicate that Goldman have correctly identified the prizes on offer for those investors able to stir ASEAN's sleeping giant.

Final thoughts

Speaking at an *Atlantic* event in Washington D.C. in March 2014, the Microsoft founder Bill Gates rebuked economists and analysts for suggesting that the pace of technological innovation was slowing. "Innovation", Gates explained to the audience, "is moving at a scarily fast pace". To an observer of the ASEAN investment scene in 2018, there is little to disprove Gates' view. Everything, it seems, from the technologies and markets that promise the most attractive rewards to investors of capital, to the very models by which we utilize investment capital, is changing at an unprecedented speed. While this article has endeavored to plot the changing course of the market in which we operate, whether the pace of such innovation scares us – à la Gates – or excites us is another matter. What is for certain, however, is that, like it or not, such change is coming.

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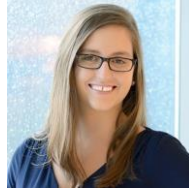
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