OPINION

Asia's private equity needs to adapt to a new slower growth reality

Firms must transform by focusing on value creation and operational expertise

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A view of the city skyline in Singapore, home to many firms in the private equity industry. © Reuters

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Asia's private equity industry is facing unprecedented challenges. The recently released Asia-Pacific Private Equity Report 2024 by Bain & Company paints a grim picture: Deal value plummeted to $147 billion in 2023, marking a 35% decline from the previous five-year average and a staggering 59% drop from the 2021 peak.

Exits have plunged and fund-raising hit its lowest point in a decade. Asia-Pacific-focused funds raised only $100 billion in new capital, a 60% decrease from the prior five-year average. The number of active investors in the region fell by 25% compared to 2022.

This stark reality contrasts sharply with the industry's prosperous past. Previously, Asia's private equity sector thrived in a uniquely favorable economic climate characterized by rapid growth, massive investments in infrastructure and manufacturing, and a dramatically expanding middle class. The attractiveness of Asia's investment landscape drew both global and local capital pools, cementing the region's position at the global private equity table. Low interest rates provided ample funding for cheap leverage, further fuelling the private equity boom.

In this high-growth environment, success in Asian private equity hinged primarily on deal-making and financial engineering rather than fundamental business skills and operational improvements. Asia's robust economic growth took care of revenue expansion, making deep business acumen less critical. What mattered most was an investor's ability to source and close deals, with relationships and networks becoming paramount. This dynamic created a situation, particularly pronounced in markets like China, where the speed of executing deals often trumped due diligence and adherence to fundamental business principles.

Fast forward to 2024, and these once-favorable conditions have given way to a challenging environment marked by high interest rates and diminishing market growth. Many private equity firms now find themselves saddled with unattractive assets, lacking the growth story that once seemed assured. The old playbook of securing deals and hoping for the best has become a liability.

In response to these challenges, the industry is undergoing a profound transformation. Some of the region's largest multi-asset investors, such as GIC and Actis, have pivoted away from private equity, focusing more on other asset classes like infrastructure investment or private debt. Others, like KKR, remain committed to private equity but have diversified their portfolios.

Trading information for KKR & Co is displayed on a screen on the floor of the New York Stock Exchange.

Meanwhile, a new breed of players has emerged, placing value creation at the heart of their investment thesis from the outset. Firms like Growtheum, which spun out of GIC, pride themselves on their meticulous pre-investment due diligence process, targeting only proprietary deals and insisting on operational control with a clear value creation plan in place before committing any capital.

Other players are attempting to bolster their portfolio management teams, recognizing the critical importance of operational expertise and strategic acumen. Temasek, for instance, has recently announced the hiring of new leaders with backgrounds in industry and strategy consulting for its portfolio management team.

However, for many firms, the gap between rhetoric and actual execution in driving operational enhancements has been exposed. As an advisor to PE firms and their portfolio companies, I have witnessed the consequences of PE teams' limited time and attention span, which often prevents them from diving deep into the core issues facing a portfolio company. It's common for portfolio companies to be pulled in multiple directions, with PE representatives struggling to align with management teams around a clear, unified vision and set of priorities.

The divided attention of PE representatives, stretched thin across numerous board positions, fundraising and investor relations duties, and new deal sourcing and closing, often means they lack the bandwidth to truly understand and address the root causes of underperformance in their portfolio companies. Moreover, Asia's top-down management culture, coupled with the big-ego deal-makers that typically run the show at Asia's PE firms, means that diverging viewpoints from more junior colleagues or portfolio staff are often not heard. This results in a failure to benefit from the nuanced, on-the-ground insights critical for navigating each business's unique challenges.

Instead of carefully diagnosing problems and collaboratively developing tailored solutions, there's a tendency to reach for quick fixes or rely on generic playbooks. This approach often falls short, as each business has its own unique challenges that require a nuanced, hands-on approach to transformation. These challenges often touch upon the full gamut of business strategy, operations, organization, leadership and technology -- a level of complexity that requires more than a 30-minute zoom call to address effectively.

The reliance on financial engineering and multiple expansion in the past has allowed private equity to mask their shortcomings in operational expertise. But now, with growth slowing and interest rates rising, firms are being forced to confront the reality that their value creation claims are often more aspirational than practical. The lack of deep operational expertise and a true understanding of the levers that drive sustainable business transformation has become a glaring weakness in the face of today's challenges.

This disconnect between perception and reality is a critical hurdle that private equity firms must overcome. Investors and acquisition targets are now scrutinizing value creation promises with a sharper eye, demanding tangible proof of firms' abilities to transform businesses and create lasting value. As a result, the largest and most established players are capturing an increasing share of available funds at the expense of smaller players which have not been able to build a convincing track record fit for the new era.

Private equity firms will have to confront the limitations of their past strategies and capabilities. No longer can they rely solely on the tide of Asia's economic growth and cheap funding sources. Instead, they must cultivate a new set of skills and capabilities, placing a premium on operational expertise, strategic foresight and the ability to drive tangible value creation within their portfolio companies. The firms that can adapt and embrace this transformation will emerge as the leaders of Asia's private equity landscape in the years to come.

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