

## Q&A: How private equity can plug Asian SMEs' funding gap

By Alison Tudor-Ackroyd | 24 April 2018

### Olympus Capital talks to *FinanceAsia* about investing in under-funded SMEs in Asia and how it plans to grow one such firm, Yuanyu Radio, using audience data.

Private equity firms can help bridge the gaping funding gap for Asia's small and medium-sized enterprises (SMEs) between stock market listings and bank loans, and make handsome returns for investors in the process, [Olympus Capital's](#) managing director David Shen told *FinanceAsia* in an interview.

Since 1997 the firm has been buying and selling SMEs in the region. Currently it is selling its stake in Hong Kong-based Li Tong, which recycles iPhones, according to one person familiar with the process. The firm's portfolio company, CreditAccess Asia, has filed for the IPO of its largest holding, Indian microfinance company Grameen Koota, looking to raise \$200 million.

SMEs account for 98% or more of all enterprises in most countries in the region. They employ about 60% to 90% of the enterprise workforce, generate 30% to 70% of output, and contribute 15% to 40% of exports in the region. However they struggle to source enough capital for growth, according to the Asian Development Bank (ADB), which promotes the use of private capital to back SMEs as a way of boosting economic growth.

ADB invests itself alongside funds. The development bank is also an investor in CreditAccess Asia.

Credit is especially hard to come by, even for fast-growing SMEs in emerging Asian markets, since European banks shrunk their overseas' loan books in the wake of the global financial crisis. Stricter capital adequacy rules, dubbed Basel III, are now reinforcing this trend. While Chinese and Japanese banks have stepped into the breach to a certain extent, there is still a dearth of capital, according to the [Bank of International Settlements](#).

SMEs cannot tap stock exchanges due to listing requirements that often require candidates to be profitable. More importantly, many company managers do not have a basic knowledge of capital market financing.

Olympus Capital is not the only source of private capital to spot the opportunity. Private equity fund-raising for the Asia Pacific region hit \$66 billion in 2017 with regional funds raking in more of the capital at the expense of country-focused funds, jumping to 32% of the total from 21% a year earlier, according to [analysis](#) by consultancy Bain & Co.

Chinese investors have been swiftly expanding across Asia in recent years with prominent backers. Global asset manager [Blackstone said on Monday](#) it had bought a minority stake in private markets investor PAG, which was founded in 2002 in Hong Kong.

However, Olympus Capital, established in 1997, is one of the earlier pan-Asian private investors in the region.

It is also using ontop of current themes, such as ways to use data to unlock the value of its portfolio companies. Olympus Capital talked *FinanceAsia* through the thinking behind its investment in mid-sized [Shanghai-based Yuanyu Radio](#).

*The following transcript has been edited for brevity and clarity*

**Q Why should investors look at Asia's middle market?**

**A** We define the Asian middle market in two ways: by the size of the companies that we look at, which have revenues of roughly between \$100 million and \$1 billion, and by the size of our equity investment, which on average is between \$30 million and \$75 million.

This segment of the market is attractive because there are often significant inefficiencies in terms of both transaction dynamics and how Asian mid-market companies operate. These inefficiencies provide opportunities to negotiate potentially more attractive entry valuations as well as to capture upside from [the] value add that we can bring after the initial investment.

**Q What advantages does a regional fund have in Asia's middle market?**

**A** We have developed different strategies to target the Asian middle market depending on companies' needs.

We have a regional private equity strategy that focuses on control-oriented investments, particularly where we can drive cross-border value creation. At the moment, we are looking at several such opportunities, including one where we are partnering with a Chinese strategic [investor] to jointly acquire a regional business services company, and another where we are acquiring a leading speciality telecom services company in Southeast Asia together with two Japanese strategics.

We also have speciality private equity strategies that focus on both control as well as minority growth opportunities in the environmental and financial services sectors.

Lastly, we have a direct lending/credit strategy that focuses on mid-tier companies in both developed and developing markets within Asia.

Because we are comfortable thinking in multi-jurisdictional terms, our credit team can do deals others may not be able to do. For example, we can reduce overall credit risk by focusing on companies that have assets outside of Asia where it might be easier to foreclose. One company that we've dealt with was able to put up their collateral in Japan where, if necessary, you have the ability to enforce and monetise more easily than, say, certain Southeast Asian geographies.

**Q What are the challenges in the Asian middle market?**

**A** These mid-sized companies are by definition not fully professionalised, so their organisational structures are often immature and dominated by the owner, where the separation of ownership and management of the business is often a key transition issue for us.

Another challenge is dealing with the risks around the investment not closing for non-economic reasons. We often negotiate deals on a proprietary or bilateral basis, and owners can have a strong emotional attachment to the business and can, ultimately, be unwilling to give up the kind of control that we need to institutionalise the business.

**Q How are limited partners (LPs) looking at Asian private equity in 2018 based on your conversations?**

**A** Some international LPs are starting to think about rotating into Europe and emerging markets, and out of the US where they have done very well in recent years.

For those international LPs that have an exposure to Asia, most followed their global managers to Asia and have over time invested in some of the larger country funds. However, they typically do not have much exposure to Asia's middle market segment.

We have noticed that more [chief investment officers] are now interested in looking at the middle-market segment because of [the] growing market size, entry valuations and [potential] upside from operational improvements.

**Q How fierce is competition from other private equity firms in Asia's middle market?**

**A** The regional middle market space has emptied out in recent years as some of the traditional regional PE managers have either moved up to larger caps or exited the business.

**Q Where do you think the best opportunities are in credit?**

**A** We focus on high quality credit opportunities with collateral that generate mid-teen returns in net [of fees] terms. Our target companies generally have strong operating cash flow to service a current yield, but may not be able to achieve their objectives via bank financing.

Typically we would extend a three-year loan, but on average a loan could be repaid earlier so we have make-whole protection. We ask for collateral, usually two times loan-to-value.

**Q You recently acquired a controlling stake in Yuanyu Radio, a broadcasting radio advertising services company in China. Why did you invest in a company with exposure to traditional broadcast radio?**

**A** Broadcast radio is about as traditional media as you can get but it is actually the only traditional advertisement channel that has experienced stable growth in recent years, while the others like TV and print have all declined.

We like Yuanyu Radio's scale – it is the largest radio advertisement services company in China, with clear scale advantages in terms of customer relationships - 19 of [the] top 20 auto brands and 12 of 20 financial services brands in China - and channel coverage, across a base of 120 national and regional radio stations that collectively cover over 1.2 billion people or 85% of China's total population.

What we are trying to do is move Yuanyu from a one-way broadcast business model to more of an interactive proposition, where you get to know more about what your listeners are doing, where they are, what interests them and what they respond to. As you know, these insights about consumers have become very critical and valuable to many media, e-commerce, and internet companies.

**Q What kind of data are we talking about?**

**A** Historically, Yuanyu helped ad clients develop audio programmes to be distributed through traditional broadcast channels. At the moment Yuanyu's radio channels reach up to 1.2 billion people in aggregate, but at any given time it is difficult to know where the listeners are and what they are responding to.

In 2016 Yuanyu started an internet platform that allows DJs and listeners to interact with one another, which allows the company to glean important insights about its listeners, including location, demographic profile, interests, and hobbies. In this way, Yuanyu is able to further leverage its traditional media resources to realise additional value [for] its advertising clients and maybe even other e-commerce players

**Q How do you encourage listeners to interact with the station?**

**A** We work with advertising clients and radio stations to develop specific marketing campaigns, and train DJs on how to elicit responses from their listeners. Listeners can respond by clicking our app on their phone (or simply shouting out if they are driving) or sending a short response to a WeChat group – we have found that Chinese listeners respond very well to couponing and polling.

All of these interactive features are designed to be easy to use, and can be completed while driving – say, shouting out “Hongbao!” [a red envelope containing a monetary gift]. The survey programmes can be completed with a couple [of] simple key strokes when drivers are waiting for a red light.

**Q What do the radio station's advertisers get out of it?**

**A** Advertisers always want to be much more efficient with their marketing dollars. Via analytics of data they can get much more specific feedback for their marketing campaigns. This is a very strong trend as models like these can eventually help advertisers (and large-scale e-commerce players) to develop a better understanding of consumers' behaviour pattern and anticipate their future purchase decisions.

**Q How does Yuanyu Radio compete against the internet radio players?**

**A** Many research analysts have raised the development of internet radio as a threat to the long-term viability of traditional broadcast radio as a medium. But based on extensive industry expert interviews and consumer surveys during our due diligence, we believe Yuanyu is unlikely to be affected by internet radio over the medium term due to its business model and competitive position.

For instance, the peak listening hours of Yuanyu are the rush hours, 0700 to 0900 and 1700 to 1900, while those for internet radio stations are after dinner and after rush hours.

Consistent with that, Yuanyu's listeners also prefer live programming such as news and traffic rather than pre-recorded programmes on internet radio.

**Q Are on-line or off-line businesses more valuable going forward?**

**A** We believe Yuanyu Radio is a good example of how the traditional offline models can actually offer significant value if we can develop a new online model by leveraging the business' conventional strengths. We like these resulting hybrid online-to-offline models because they are often more resistant than pure online models to disruption, and it's usually cheaper to acquire the traditional business to begin with.

To mitigate the execution risk associated with developing the new media strategy, we usually only value the original investment based on the company's traditional business and treat the new media strategy as upside.



*Tune in to David Shen's thoughts*

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