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KKR IN ASIA: A STRATEGIC VIEW
FEATURING SIR DERYCK MAUGHAN, CHAIRMAN OF KKR ASIA

Program on Alternative Investments,
Center on Japanese Economy and Business
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The private equity boom has exploded across the United States and Europe in recent years, but the private equity market in Asia, the fastest-growing part of the global economy, remains in its infancy. Much of this is due to historical and cultural differences in Japan, where stakeholders have more sway than shareholders and where private equity investors, particularly those from the West, are often viewed with suspicion. And as for China, the growth engine of Asia, private equity buyouts have been few because most of the publicly traded companies are controlled by the state.

Despite these factors, Kohlberg Kravis & Roberts (KKR), one of the oldest private equity firms in the world, sees attractive opportunities in Asia as the center of gravity of the global economy shifts to that region. That was the main theme when Sir Deryck Maughan, chairman of KKR Asia, visited Columbia Business School in February of 2007 to discuss the buyout firm's strategy in Asia. Maughan, whose visit was part of the Program on Alternative Investments of the Center on Japanese Economy and Business, gave a broad overview of the private equity industry before discussing KKR's strategy in Asia and responding to questions from a full audience at Columbia's Casa Italiana.

To put the market in perspective, Maughan noted that private equity is booming amid the growing sense that public ownership has limitations. It is now generally accepted that the intense pressure to beat earnings estimates and regulatory hurdles distracts managers from focusing on long-term value creation. Private ownership allows managers to focus on creating value away from the glare of the public-market spotlight. In 2006, private equity firms put $700 billion to work globally, up from $70 billion in 1996. It is no wonder, then, that 110 percent of Columbia Business School's graduating class aspires to work in private equity, joked Alicia Ogawa, director of the Program on Alternative Investments.

Maughan stressed that, as one of the oldest private equity firms, KKR takes a long-term view and its strategy is to unlock value "through operations, not leverage. Anyone can buy a business. It's what you do with it once you own it." The firm, which has engaged in 145 transactions for a total of $274 billion since 1976, has an average holding period of seven years and is organized into industry teams. It currently has 17 investment professionals in the region, based in Tokyo and Hong Kong.

Despite the attractiveness of China's booming economy, Maughan said investors should be under no illusions about the political environment. "China is an autocratic state firmly under the grip of the Communist authorities," he said. That being said, he believes it is in the mutual interests of the United States and China to engage with each other and that in the long run, while not the classic buyout market, China may present some interesting private equity opportunities. And although a recent McKinsey & Company study highlighted the Chinese manufacturing sector as being most attractive to private equity, Maughan said KKR is not pursuing a sector theme in China. Rather, it is looking for first-class managers who want to improve their firms and compete on a global level.

Japan, meanwhile, continues to exhibit a collectivist stakeholder mindset that subordinates shareholder interests and makes it difficult for private equity to gain a foothold. "Management is still in the driving seat, and insider boards are still the norm," Maughan noted. He cited global merger and acquisition activity figures from 2006 to indicate just how reluctant Japanese companies are to change. Of the $3.75 trillion in global M&A, Japanese M&A accounted for a paltry $149 billion. Meanwhile, the United States and Europe accounted for $1.9 trillion and $1.8 trillion, respectively. "Japan had less M&A than Australia, with an economy six times as large," Maughan said. This is so, in part, because private equity was first introduced to Japan in the late 1990s as an acquirer of distressed banks, coloring local perceptions about buyout firms.

But given's Japan's economic prowess, Maughan said private equity will undoubtedly grow as a force for change in the country, which represents "the single-largest restructuring opportunity ever. It may not happen, but it is a bet worth taking," he said. Maughan insisted KKR wants to distinguish itself in Japan as a long-term investor, welcomes coinvestment with respected Japanese investors and will be flexible on structures. He again noted that the firm differentiates itself by focusing on operational expertise by industry. And, in acknowledgment of the white-hot private equity market that has benefited from an abundance of global liquidity and has allowed firms to regularly buy and sell companies, he described KKR's long-term global strategy as "the antithesis of much of the activity that has happened to date."

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