ICMR

Institute for Capital Market Research Malaysia

Navigating Malaysia's Private Equity Space: Challenges & Opportunities

Navigating Malaysia's Private Equity Space:

Challenges and Opportunities

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ICMR welcomes and encourages any questions or suggestions. Please address your comments to Cheam Tat Hong at icmrall@icmr.my.

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About this report

Alternative investments have moved from the periphery of the global investment landscape into the mainstream. In just a decade, global alternative investments' assets under management (AUM) grew from US$2.7 trillion in 2010 to over US$8.0 trillion of the global market in 2020.

'Alternative investment', an all-encompassing term that generally refers to investment categories such as hedge funds, private equity, venture capital, private credit, real estate, infrastructure and natural resources funds, have moved from the periphery of the global investment landscape into the mainstream. These diverse categories each have their own unique characteristics and features, as well as risk and return objectives.

The scope of this report focuses specifically on the development of the Malaysian private equity (PE) industry. It refers to a broad spectrum of private investment funds such as hybrid, growth, buyouts, secondaries, turnaround, and private investment in public equity (PIPES) funds specifically. It excludes all general venture capital (VC), seed- and early-stage funds. ICMR in its previous report 'Catalysing the Growth of the Venture Capital Industry' (2019) had already covered the developmental priorities for the Malaysian venture capital industry.

In preparing this report, ICMR conducted secondary market research and applied

mixed methods of analysis on data covering a 10-year period from 2010 – 2020. Data on alternatives was obtained from Preqin, a data provider that has the most comprehensive private capital and hedge fund datasets and tools. Other sources were obtained from various press releases, third-party reports and websites, Malaysia Health Tourism Council (MHTC) and World Bank.

This was complemented by engagements with the regulator, Securities Commission and a broad range of PE practitioners including Khazanah, Bintang Capital, COPE Private Equity as well as previous discussions with Ekuinas, Creador and Navis to develop a better understanding of the changing environment and attain deeper insights. The report has also undergone an external peer-review process.

Executive summary

The global private equity (PE) industry is poised for growth as it continues to play a critical role in economic recovery. Private equity firms are essential for the growth of private businesses and the entrepreneurial ecosystem. The private equity industry has grown to more than US$4.3 trillion propelled by increasing investor appetite for uncorrelated higher yielding assets during this period of low interest rate. By end 2020, the industry has accumulated almost US$1.5 trillion of dry powder — money committed to funds by investors but not yet deployed. The growth in the global PE industry is expected to continue to reach over US$9.0 trillion by 2025, delivering an annual compound growth rate of up to 15.6%.

As more investors increasingly turn their focus to more environmental, social and governance (ESG)-linked considerations, the global PE industry has also seen a fundamental shift in its approach. In 2020, US$1.5 trillion was committed by global investors in ESG-focused PE funds, growing two times more than in 2010. In addition to purpose, greater emphases are also being placed on transparency. This is being driven by a combination of things: demand from limited partners (LPs), the dynamics of origination and regulatory developments.

The Asia private equity market has emerged over the last decade as a market of increasing interest to international investors. Asia has fast become an important destination for international capital as a result of ongoing liberalisation efforts, continuing rapid economic growth and increasing globalisation. Larger funds are now being raised with the emergence of more well-established fund managers with track record. Capital raised in the Asia region grew at a compound annual rate of close to 8% between 2010 and 2020. Aggregate capital raised for Asia-focused funds stood at US$99.1 billion in 2020 compared to US$46.5 billion in 2010. Despite this significant growth, navigating Asia's private capital markets remains a complex endeavour.

Our analysis found that ASEAN is also a major beneficiary of the large pool of global private capitals flowing into Asia in addition to China and India. However, ASEAN markets still lack the depth and liquidity of the more advanced markets. At present, there is still an absence of single-country funds managed by established and emerging fund managers with the exception of Indonesia. This is due to the smaller size of each individual country within ASEAN as well as the differences in levels of economic development.

Similarly for Malaysia, the private equity market has also attracted the interest of international capital with larger deals such as Columbia Asia Hospital and Nirvana Asia being executed over the past five years. However, the PE market size is relatively small compared with some of its regional peers. Assets under management (AUM) has been growing at a sluggish pace of 4.3% annually from US$3.7 billion in 2010 to US$4.9 billion in December 2020 compared to some advance countries that recorded growth of over 10% over the same period. Malaysia, as with other ASEAN countries, presents its own unique set of challenges for the private equity industry. The majority of businesses are state-owned and family-owned and there are a handful of first-timer entrepreneurs with the absence of successful track records. The other key challenge is exiting potential investments via public listing.

On one hand, there is a concentration of the types of private funds in Malaysia. The majority of private capital are growth funds. Buyout funds (which are funds that take up majority shares of an investee company compared to growth funds that take only minimal ownership) are largely absent from the ecosystem. There is ample room for the PE industry to grow as more private companies, or distressed assets, need financing particularly those that have been impacted by the recent pandemic outbreak. On the other hand, there is also a concentration of deals in a particular business vertical, namely the consumer discretionary sector. Compared to the advanced markets, private equity deals are evenly distributed across different business verticals such as healthcare, financial services, agricultural, consumer discretionary etc. Private equity development in Malaysia could encourage investments in areas that will help to address some of the pressing issues brought about by the recent pandemic outbreak such as strengthening the nation's food security and healthcare system as well as areas that we have a competitive advantage in, such as the Halal industry.

Our recommendations focus on strengthening the overall private equity ecosystem from both the demand and supply side, as well as enhancing the relevant supportive frameworks for private funds intermediation:

Increase tailored development efforts for small businesses. In response to the challenges faced by businesses and entrepreneurs, various accelerators and funding programmes were created by agencies like SME Corp, Malaysia Digital Economy Corporation (MDEC), MaGIC and Cradle Fund to help enhance their competitiveness, deepen the pool of skilled labour and professionals, as well as to facilitate the commercialisation process.

Moving forward, policy makers could strengthen the commercialisation process for businesses that need to establish a track record before expanding beyond the domestic market through public procurement. Given the higher risk-profile of some of these businesses, Malaysia could leverage greater symbiotic relationships between entrepreneurial firms and established companies especially given Malaysia's unique GLC and GLIC ecosystem with developmental mandates to pursue catalytic investments.

Policy to catalyse the expansion of PE funds in niche sectors. It is important to expand the existing pool of private equity general practitioners. This could be addressed in two ways. One is by attracting more funds through matching funds like the recent Dana Penjana Kapital. Alternatively, policy makers could introduce private equity tax incentives to supplement existing initiatives. For a start, this could target specific areas such as medical tourism, agricultural tech, and Halal industry.

Broaden investor base through private equity trusts. Globally, there is a broad push towards democratising the PE industry particularly to the general masses. For example, the US has allowed 401K and other individual retirement plans to diversify its exposure to alternative asset classes such as private equity. This coupled with the liberalisation of accredited investors qualification by the US Securities Exchange Commission is intended to allow greater participation into this growing asset class. Similarly, Malaysian PE could be democratised to retail investors with the aim of allowing the general investing public to enjoy the potential outsized and uncorrelated returns that the asset class has to offer. This could be achieved through some form of pool investment vehicle such as private equity investment trusts.

Facilitate PE long-term fundraising through debt capital market. Policymakers have recently considered opening private equity to the broader group of investors through the debt capital market. In Singapore for example, retail investors have had the opportunity to invest in bonds backed by cash flows from private equity vehicles. Unlike corporate bonds, PE bonds are asset backed securities that derive cash flows used to fund their interest and principal repayments from a pool of PE funds or assets. To date, total proceeds raised by private equity GPs in Singapore have reached over US$2.1 billion with 32% (US$583 million) of the proceeds being raised from the general masses. Moving forward, policy makers could consider encouraging the private equity industry to tap its well-developed debt capital market by providing incentives to alleviate some of the costs in bond issuance.

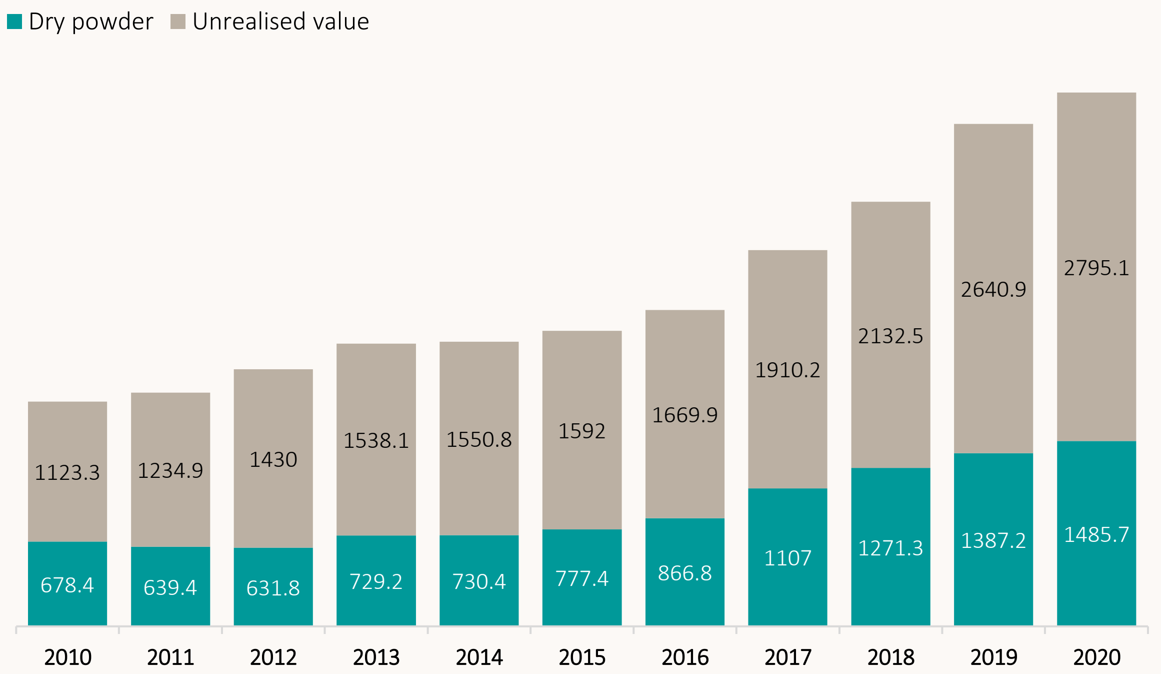
Harmonise regulatory framework across global practices. Fund structure is of utmost importance to both private equity general partners and limited partners. The Limited Partnership structure is preferred for private equity funds globally due to the familiarity of investors with this structure. It is essential for Malaysia to enact an LP structure which is currently largely absent here. As global private equity funds with a focus on Asia will increasingly look towards redomiciling their funds, this could translate into an opportunity for the country to capture a share of this global flow of funds.

Global private equity had a strong finish to the decade

The global private equity market has grown significantly over the last decade. Increasing investor allocations, the outperformance of private firms versus public companies as well as market appreciation have seen global private equity assets reach over US$4.3 trillion in 2020, up from US$1.8 trillion just a decade ago in 2010 **(Exhibit 1)**. Assets under management (AUM) growth is compounding at an annual rate of 9% since end-2010.

According to Preqin's latest report, the industry's AUM is expected to continue its upward trajectory to reach over US$9.0 trillion by 2025, delivering an annual compound growth rate of up to 15.6%. Growth is expected across all regions with Asia envisioned to be a huge driver[1]. The growth is projected to be fuelled by the combination of easily available debt and solid industry returns, as well as the built-in incentives that encourage fund managers to raise ever larger funds. It is fair to say that a significant shift is underway, where the industry is slowly emerging as a mainstream asset class— one that is bound to affect many areas of the economy.

Exhibit 1: Growing global private equity assets under management (ex-VC)
US$ billion



Source: *Preqin*
Note: *Calculations exclude venture capital specific funds*

[1] Preqin, The Future of Alternatives 2025.

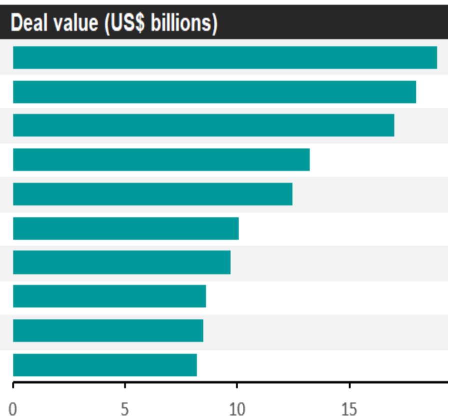
Globally, large institutional investors such as provident funds, university endowments, sovereign wealth funds and insurance companies, have for the most part adopted private equity as a significant component of their portfolio. To date, over 8,400 institutions across the globe, ranging from small private wealth managers to massive sovereign wealth funds, invest in private equity[2]. The asset class provides long-term diversification benefits from the perspective of risks and returns, as well as the ability to offer outsized returns and escape market volatility. And as the challenge to generate alpha in diversified portfolios grows, this asset class will likely become more mainstream for institutional funds globally.

Large sectors of the economy are also directly benefiting from the rise of private equity. The industry, with over 12,000 active private equity firms globally, employs more than 100,000 people around the world, and has even benefited the wider financial services industry through its ancillary services[3].

Over the last decade, global private equity benefitted from a liquidity surge of a magnitude never seen before. According to Preqin, the amount raised by private equity firms worldwide increased from US$154.3 billion in 2000 to a peak of $627.9 billion in 2019 before moderating to US$518.2 billion in 2020. This translates to a compound growth rate exceeding 13% per annum. Funds were not the only entities growing in size; so were the deals. Global PE deals totalled over US$450 billion in value across 2020, a 122% percent rise from US$202 billion in 2010. Throughout the decade, buyouts of multiple billion-dollar valuation were engineered. Six of the 10 largest buyouts ever executed took place between 2017 and 2020, as **Exhibit 2** shows.

Exhibit 2: Private equity buyout deals hitting new record (in US$ billions)

Target	Acquirer	Date
TK Elevator GmbH	Abu Dhabi Investment Authority etc.	Feb-20
Kioxia Holdings Corporation	Bain Capital, Toshiba Corp, Apple Inc	Sep-17
Refinitiv Limited	Blackstone Group, GIC..	Jan-18
Johnson Controls' Power Solutions	Brookfield Asset Management	Nov-18
Nouryon Chemicals Holding B.V.	Carlyle Group, GIC	Mar-18
Galderma S.A.	GIC, Abu Dhabi Investment Authority	May-19
Univision Communications Inc.	Searchlight Capital Partners etc.	Feb-20
Supercell Oy	Tencent Holdings, CITIC Capital etc.	Jun-16
BMC Software, Inc.	KKR	May-18
Arm Limited	SB Investment Advisers	Mar-17



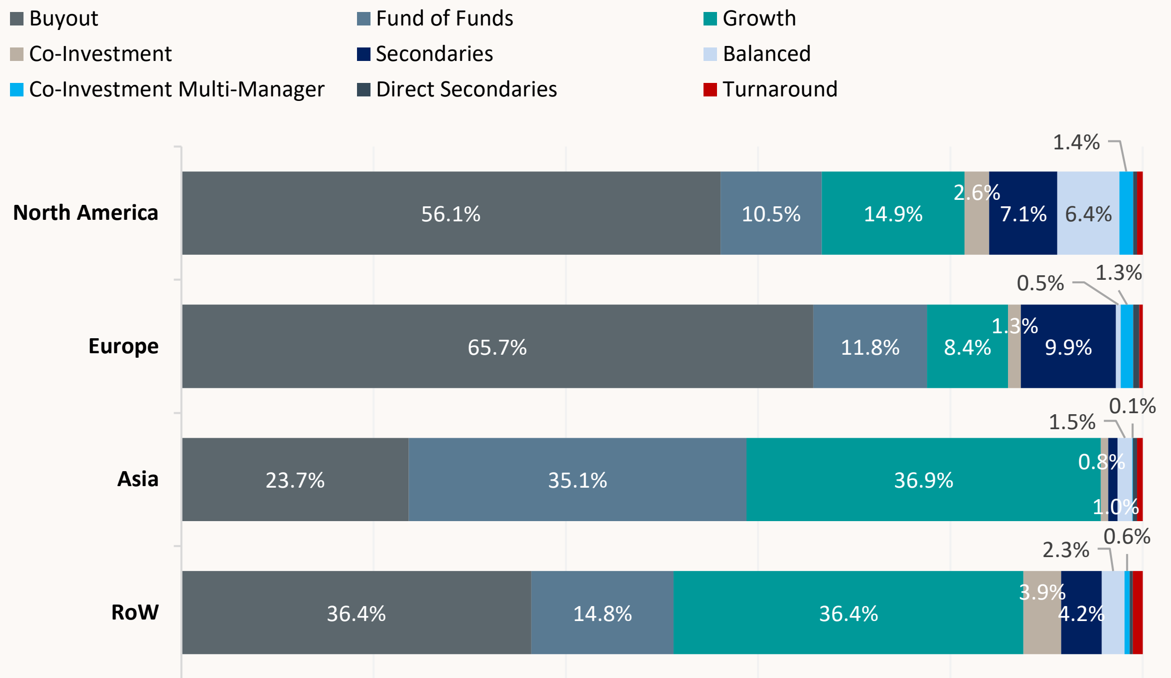
Source: *Preqin*

As the industry rapidly moves into the mainstream market, from being classified as an "alternative" asset class, the marketplace is also maturing with more complex and focused strategies being adopted **(Exhibit 3)**. Historically, capital flowed to primary funds that in turn took equity share in companies. Over time, the industry has witnessed the emergence of funds-of-funds and secondaries structured as primary funds themselves. Co-investments by strategic investors alongside primary funds directly into portfolio companies have also become more widespread. Funds are also becoming more specialised, with an increasingly large range of vehicles focused on specific investment stages such as turnarounds, on strategies such as secondaries, on geographies such as Asia or ASEAN, and on industry verticals such as energy or biotechnology.

[2] Preqin

[3] Data sourced from Preqin and excludes venture capital.

Exhibit 3: Breath of global private equity strategy
Percentage of total Assets Under Management (%), as at March 2021

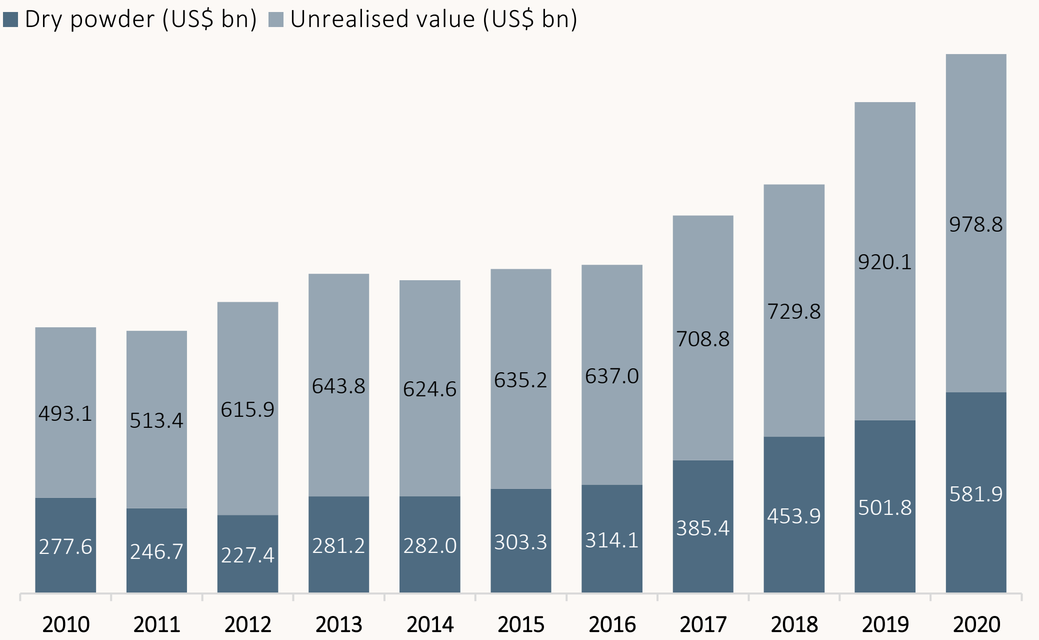


Source: *Preqin, ICMR internal calculations*
Note: *Calculations exclude venture capital and early stage funds, expansion/late-stage included under Growth strategy.*

Private equity weighting in ESG investing

In recent years, there has been a trend in the asset management industry moving towards sustainable and environmentally friendly investments, and private equity is no exception. Limited partners in PE funds have become increasingly prominent in bringing forward the desire to invest in funds with social and environmental objectives. For instance, in 2020, US$1.5 trillion was committed by global investors in ESG-focused PE funds, growing two times more than in 2010 **(Exhibit 4)**. A survey conducted by PWC in 2021 finds that 65% of the 209 respondents, including 198 private equity practitioners, have developed a responsible investing or ESG policy and the tools to implement it[4]. In addition to corporate governance, other issues such as net zero, climate risk, biodiversity and emerging technologies are fast becoming business-defining.

Exhibit 4: Private equity increases its commitment to ESG



Source: Preqin

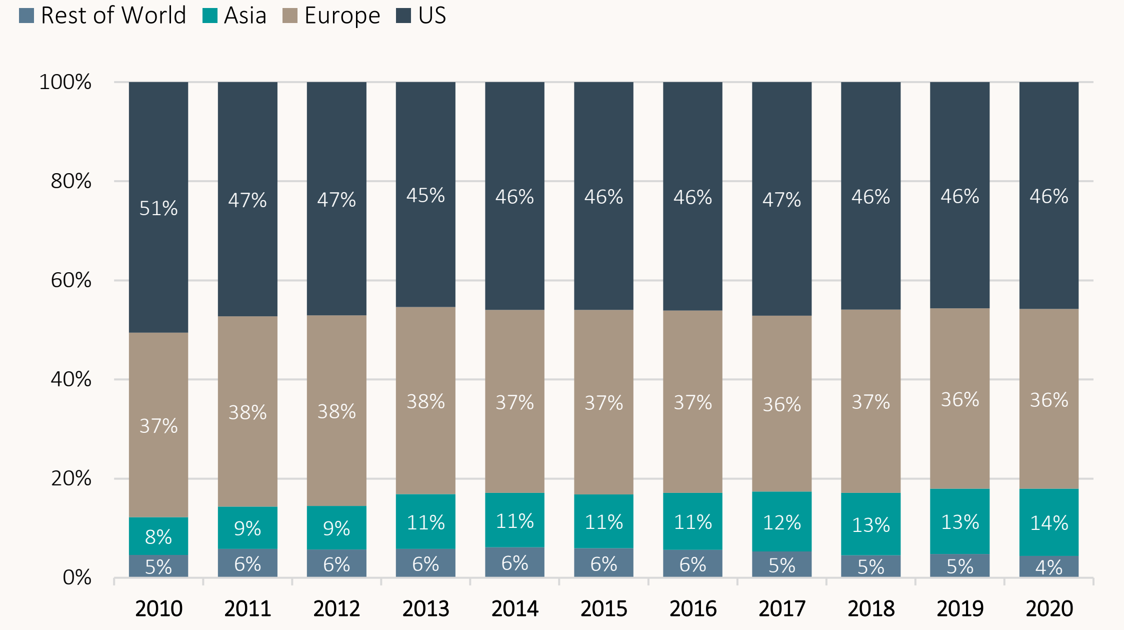
And even in these unprecedented times, Asia's commitments toward sustainable investing continued to grow in 2020 with total AUM hitting a record high of US$211.3 billion compared to US$58.5 billion a decade before. To date, Asia comprises 14% of the global ESG committed PE funds **(Exhibit 5)**.

While the technology sector has been a consistent sweet spot for growth in private equity in Asia, the recent pandemic outbreak has hastened healthcare deals with digital health services predicted to see continued growth both in the short and long term[5].

[4] https://www.pwc.com/gx/en/private-equity/private-equity-survey/pwc-pe-survey-2021.pdf

[5] https://www.bain.com/insights/asia-pacific-global-healthcare-private-equity-and-ma-report-2021/

Exhibit 5: Interest in ESG investing grows in Asia



Source: *Preqin*

The social impact of the Covid-19 pandemic has intensified the industry's awareness of ESG principles. Many investors and policymakers are drawing parallels between the unforeseen risks of the pandemic and issues such as food security, healthcare, climate change, and further calls for attention to align ESG related issues with traditional financial metrics when evaluating investment risks. Temasek and German pharmaceutical major Bayer, for example, in 2020 had committed a 50-50 joint venture to develop and market seeds for vertical farming both in Singapore and California[6]. The partnership is envisioned to increase the volume of food production in Singapore and explore potential development of new varieties of crops through plant-based genetic modifications.

In addition, this trend is now evident in many limited partnership agreements through various provisions that either require or encourage the fund to consider ESG objectives when sourcing investments. The Institutional Limited Partners Association has further recognised the importance of focusing on sustainable investments by releasing a guiding principle in 2019 that aims to foster transparency and alignment of interests between general and limited partners on ESG related matters[7].

ESG investing is no longer a bespoke niche in the private equity market. With more and more institutional investors such as pension and sovereign wealth funds taking the ESG policies of the funds they invest in into consideration, it seems likely that more private equity funds will emphasise ESG investment policies moving forward. We expect that this area will be one of further interest to PE funds in the Asia market, such that we will see more financing facilities tailored to meet certain ESG criteria with respect to how proceeds are used.

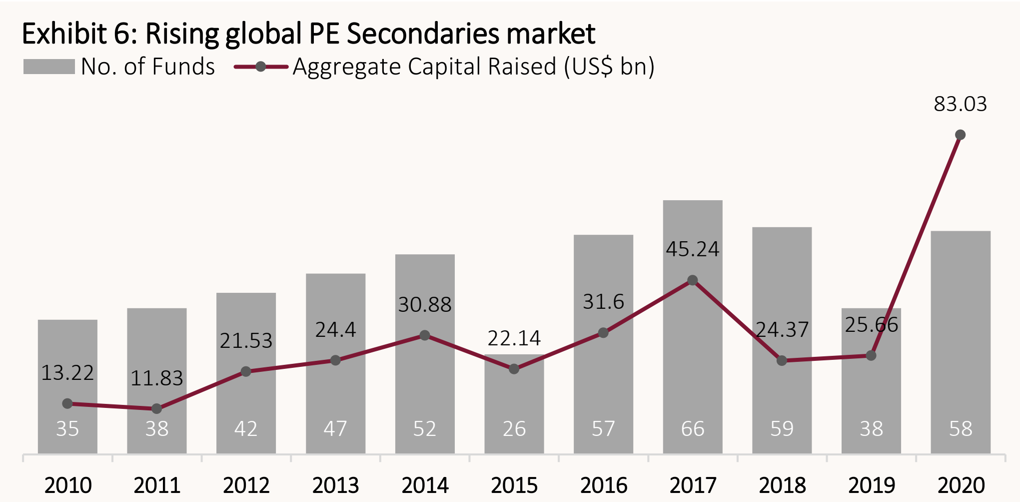
[6] https://media.bayer.com/baynews/baynews.nsf/ID/Bayer-Temasek-unveil-innovative-company-focused-developing-breakthroughs-vertical-farming

[7] https://ilpa.org/wp-content/uploads/2019/06/ILPA-Principles-3.0_2019.pdf

Secondaries options in times of illiquidity

The private equity secondaries market has grown in line with the global PE industry. 'Secondaries market' refers to the acquisition and sale of existing stakes in PE investments, either limited partners' single interest or portfolio of interests. Secondaries offer owners of PE a way out of an otherwise illiquid investment, as well as flexibility in managing a portfolio.

Fundraising in global private equity secondaries market continues its growth from US$13.2 billion in 2010 to US$83.0 billion in 2020[8] **(Exhibit 6).** The market has received increasing attention by a wide range of institutional investors and traditional asset managers such as BlackRock[9], JP Morgan[10] and Citi Group etc. While activity in Asia pales in comparison to the more advanced markets in the US and Europe, private equity participants in the region are increasingly exploiting the secondaries market for new opportunities and liquidity solutions. In 2020, Asia-Pacific-focused secondaries funds raised a total of US$1.8 billion, up from US$40 million raised in 2010[11].



Source: Preqin

Secondaries investments too are making inroads to becoming mainstream. Global transaction volumes have continued to grow from US$25 billion in 2012 to US$88 billion in 2019 before declining to US$60 billion in 2020. Despite a slight setback from the record volume in 2019, the market overall presents an upward trajectory as it continues to expand year after year[12]. One of the most significant recent developments is the increase in transactions led by the general partners (GPs) of private equity funds. Traditionally, secondaries were very much focused on LP interests. To date, the secondaries market is being used by general partners to rebalance their portfolios and provide liquidity to their limited partners. The advent of this market has enabled investee companies to benefit from a PE fund's continued ownership of it, while providing an exit to any of its investors and allowing any LPs who still wish to remain exposed the ability to do so.

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8 Preqin & ICMR internal calculations. Data represents funds raised for secondaries and direct secondaries.

9 https://www.wsj.com/articles/blackrock-raises-3-billion-for-first-dedicated-secondary-strategy-11617184800

10 https://www.pehub.com/jp-morgan-enters-us-secondaries-market-fund-with-1-billion-fund/

11 Preqin & ICMR internal calculations. Data represents funds raised for secondaries and direct secondaries.

12 https://www.greenhill.com/en/content/greenhill%E2%80%99s-secondary-market-analysis-shows-strong-rebound-transaction-volume-and-pricing#:~:text=%E2%80%9CWhile%20transaction%20volume%20dropped%20to,period%20in%202019%2C%E2%80%9D%20commented%20Bernhard

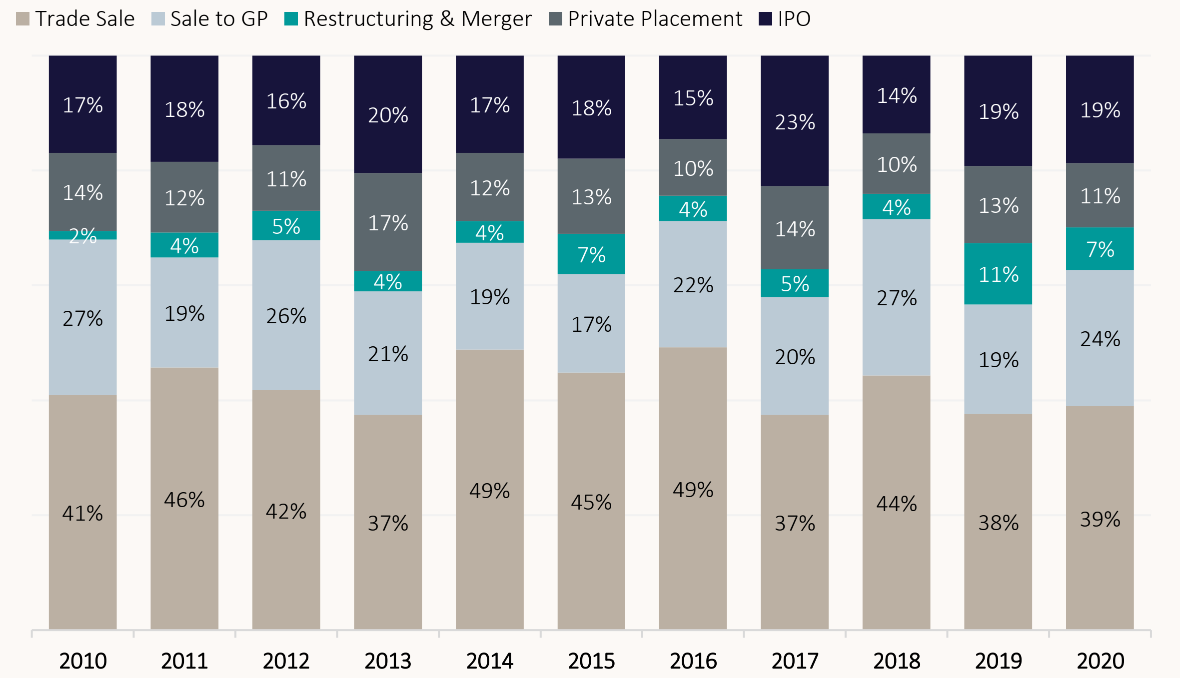
Private equity reassessing their exit strategies

Exiting illiquid investments could prove challenging. On a global basis, trade sales represent the most common exit strategy, followed by sales to other general partners (e.g. secondary buyouts), and to a lesser extent by IPOs and restructurings, as shown in **Exhibit 7**. Private equity exits have been adversely affected by the global pandemic outbreak. Recent research suggests that in May 2020, with the world economy in lockdown, exits declined almost 70% year-on-year[13]. Meanwhile, more than 80% of private equity managers responding to a survey organised by Investec in 2020 said that they would retain their investment holdings for another year[14].

The result of the survey illustrates that the pandemic has driven considerable value in some areas of the economy such as healthcare, e-commerce and technology enablement for instance, that warrants re-investments and delayed exit plans. While the survey represents cross-sector figures in general, the hiatus in private equity exit activity is even more pronounced for harder-hit areas, such as hospitality, bricks-and-mortar retail and commercial real estate.

Exhibit 7: Private equity refining exit strategies during Covid-19

% of total deals



Source: *Preqin and ICMR internal calculations*

In reality, IPOs exits are relatively rare events, and account for only 19% of global private equity exits in 2020. Despite the growing popularity of Special Purpose Acquisition Companies (SPACs) in the last few years as an alternative tool for Unicorns to list on the public stock exchange, trade sales still represent the preferred exit mechanism for

[13] https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/preparing-for-private-equity-exits-in-the-covid-19-era

[14] 10th Annual GP rends 2020, Investecc.

private equity managers, accounting for 39% of global PE exits in 2020. The growth of private capital in advanced markets have significant ramifications for the capital markets, particularly in relation to the attractiveness of traditional public listing as a tool for fund raising.

Contrastingly, the numbers in Asia are slightly different when it comes to exit mechanisms for private equity. In 2020, IPOs account for 47% of private equity exits, followed by trade sale (24%), private placement (15%) and sale to GPs (13%)[15]. The high number of IPOs are driven mainly by emerging markets' attempts to improve exit environment through a series of market-wide reforms. In China and Hong Kong, for example, alternative listing avenues have been established and listing regimes have been modernised to facilitate greater risk capital intermediation.

[15] Preqin and ICMR internal calculations.

Private Equity in Asia

Private equity in Asia bears little resemblance to its counterparts in the more developed countries especially in the way that Asia's PE industry benefits from a highly supportive government-led ecosystem. This includes, but is not limited to, enabling government developmental policies, confidence-inducing legal frameworks that govern the conduct of general partners and protect investors, as well as allocation of incentives that offer PE affordable access to diverse sources of capital.

As the global private equity industry evolves and matures, the sources of funds and their destinations have become more diverse. Despite the Covid-19 lockdowns and ongoing economic uncertainty, the number of active investors in the industry continued to climb, rising from 2,915 investors in 2015 to over 4,100 investors in 2020[16]. As of December 2020, North American investors account for 68.2% of the total investor pool, while the rest came from Europe (19.4%), Asia (7.4%) and to a lesser extent from investors elsewhere (5.0%) as shown in **Exhibit 8**. While the pool of Asia's private equity investors had only witnessed marginal increment over the last five years, the average allocation to PE investments by Asia investors however has increased significantly to exceed 15% in 2020 compared to 8.7% in 2015 **(Exhibit 9)**.

Exhibit 8: Demographics of private equity LPs

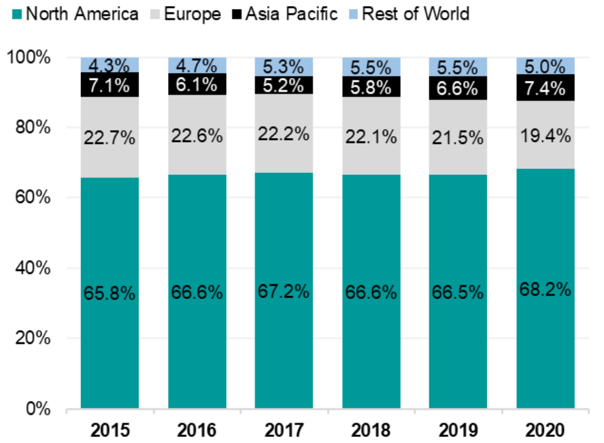
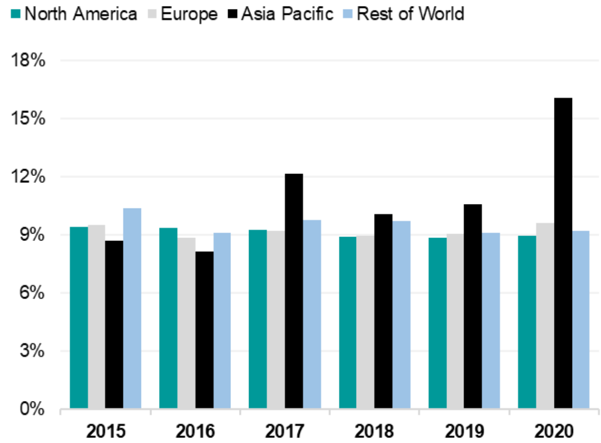


Exhibit 9: Average current allocation to PE

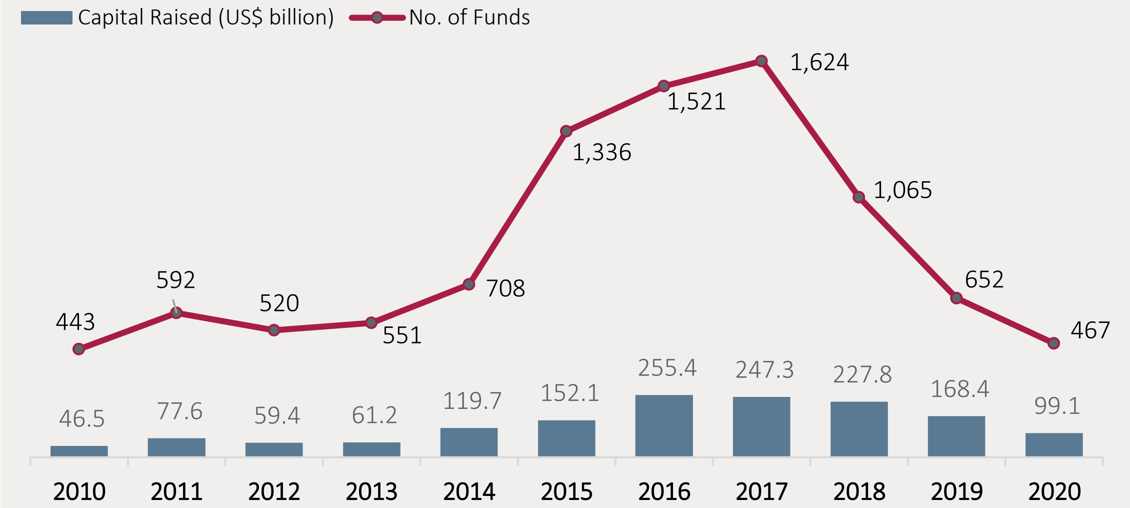


Source: *Preqin*
Note: *ICMR internal calculations and exclude venture capital asset class.*

In terms of fundraising, the capital raised in the Asia region grew at a compound annual rate of close to 8% between 2010 and 2020. Aggregate capital raised for Asia-focused funds stood at US$99.1 billion in 2020 compared to US$46.5 billion in 2010 **(Exhibit 10)**. While the number of new funds has decreased substantially over the past three years, the average funds raised has increased to US$212 million in 2020, representing upticks of around 100% compared to US$105 million in 2010. Private equity, however, is still seen as a relatively nascent industry in developing Asia compared to the US and Europe. It is still generally perceived as lacking depth, offering fewer buyout opportunities and limited exit options. However, the rapid economic growth offered by the region had made it a tantalising prospect for global private equity investors.

[16] Preqin

Exhibit 10: Rising PE fundrasing in Asia over the last decade



Source: *Preqin*

Note: *Calculations exclude venture capital specific funds*

In 2007, KKR raised a US$3.9 billion fund for investment in Asia, trumping the US$3.8 billion fund raised by TPG for the region. The fund was marked as the largest fund ever raised for Asia investments at that point in time. As of mid-2014, the industry witnessed the emergence of new players with a particular country-specific focus on China, South Korea, and Japan. Over the last decade, many funds have become prominent players in Asia's private equity space with increasingly larger amounts of capital continue to be raised. Today, a group of fast-growing private investment funds such as Baring Private Equity Asia, Boyu Capital and Primavera Capital have launched what are expected to be the largest-ever US dollar funds—amounting to over US$6 billion respectively—that focuses more widely on Asia[17,18]. Taken together, Asia accounted for about 15% of global funds raised and 17% of funds invested in 2020.

Private equity funds are being deployed on a more global basis, with more and more funds focusing outside of North America. While North America still accounts as the major region of focus (54%) for private equity investments, Asia's private equity activities have also continued to advance over the last decade; rising from 9% in 2010 to 17% in 2020 **(Exhibit 11)**. Investment activities in Asia rose three-fold to reach US$76.5 billion in 2020 compared to US$23.2 billion at the start of the decade. China led dealmaking activity in the region, contributing more than 2.5 times the deal value of India, which ranked second in deal value. Government-guidance or -affiliated funds, which are government-backed, continued to play a significant role facilitating domestic deals. There is also evidence that the industry is becoming not only more global but also more globalized over the last two decades. In a study published in 2008, Aizenman and Kendall found that the proportion of deals which are funded with some cross-border participation has dramatically increased over time[19].

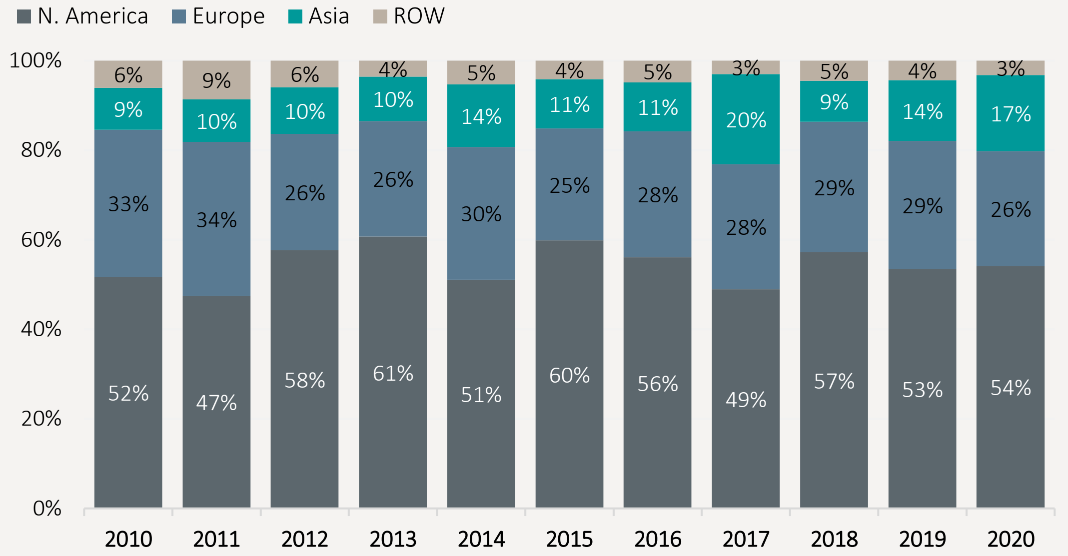
[17] https://www.bpeasia.com/news/baring-private-equity-asia-fund-vii-raises-us6-5-billion-at-hard-cap/

[18] https://www.reuters.com/article/us-boyu-capital-fundraising-exclusive-idUSKBN2AO0KK

[19] https://www.nber.org/system/files/working_papers/w14344/w14344.pdf

Exhibit 11: Investors doubling down on Asia PE investments

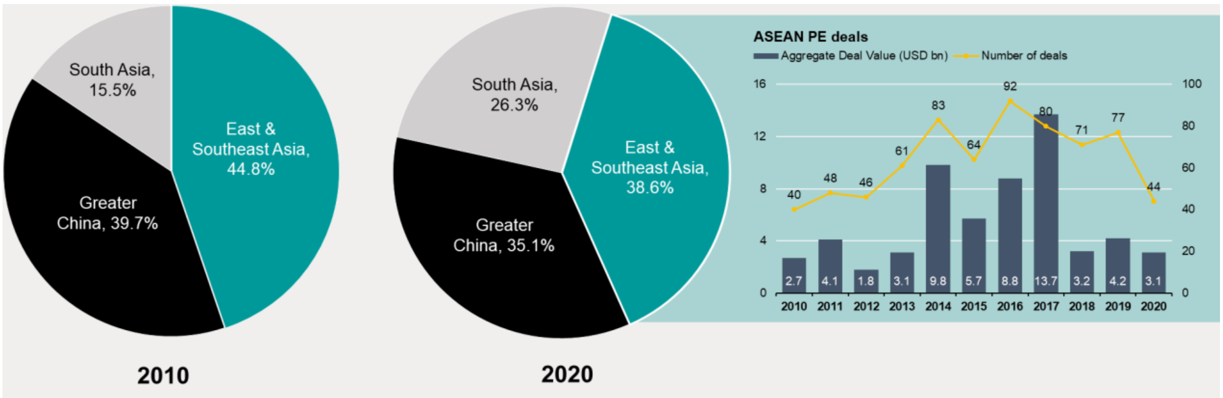
Percentage (%) of total deals



Source: Preqin, ICMR internal calculations

Asia's dynamic private equity industry has continued to grow, in spite of challenging macroeconomic conditions. Within Asia, private equity investments were concentrated among East & Southeast Asia and Greater China, accounting for 38.6% and 35.1% of the region's total deals in 2020. **(Exhibit 12)**.

Exhibit 12: Distribution of PE deals within Asia Region



Source: Preqin, ICMR internal calculations

Capital was concentrated among established GPs, underscoring an overall ongoing flight to quality. Six out of the ten largest ASEAN-focused private equity funds closed in the last decade had successfully raised over US$29 billion[20]. Growth and buyout are the main strategies for this region. Despite the improvements in deals for ASEAN, both in terms of value and number of deals, the market is relatively nascent compared to the developed markets and are generally not sizeable to support any country-focused funds thus far. Most general partners are regional players, though there are a few exceptions for Indonesia.

[20] Examples of global PE funds with ASEAN focused includes Baring Asia Private Equity Fund; Affinity Asia Pacific Fund; Warburg Pincus China-Southeast Asia II; RRJ Capital Master Fund III etc.

Over the last decade, policy makers in Asia (including parts of ASEAN) have made substantial efforts to enhance its private equity regimes in order to ensure that the region becomes more attractive as a centre for private funds and their managers. From the launch and subsequent expansion of China's Qualified Domestic Limited Partnership (QDLP) in 2012, through enactment of the Hong Kong Limited Partnership Fund Ordinance, to the establishment of Singapore's Variable Capital Companies (VCC) in 2020, these regimes were pushed ahead to create a local user friendly and attractive regime for private funds. Various incentives were also followed through to ensure that the programme launched would meet its intended objectives.

Take Singapore for example. VCC was established to provide alternative fund structure, with greater flexibility in the areas of capital contributions and distribution profits, to general partners. This is similar to the open-ended investment company structure in the UK and protected cell company structures in jurisdictions like Guernsey or the Cayman Islands. To date, the framework has attracted over 200 participants ranging from traditional asset managers to single family offices shortly within the initial eight months of its launch[21]. To further encourage industry adoption of the VCC framework, the Monetary Authority of Singapore launched a Variable Capital Companies Grant Scheme[22] that is envisioned to help defray the costs involved in incorporating or registering a VCC. The scheme will subsidise 70% of eligible expenses paid to Singapore-based service providers for a period of up to three years. The grant is capped at S$150,000 for each application, with a maximum of three VCCs per fund manager.

Some of these new regimes provide a widely drawn list of safe harbour activities for limited partners which will not cause it to be regarded as taking part in the management of the funds that would otherwise incur joint or several liability with the general partner. This, coupled with the establishment of OECD's Base Erosion and Profit Shifting (BEPS) framework[23] and codification of economic substance doctrine[24] coming into play, could level the playing field for Asia's private fund industry against the advance markets. These economic substance regulations were largely aimed at counteracting the effects of zero tax and preferential tax regimes around the world, particularly in key offshore jurisdictions.

Additionally, capital markets in some parts of Asia and ASEAN were also deepened to usher in greater investments and innovation. Domestic public listing activity in some Asia bourses has gained some traction over the past few years; owing to the adoption of new listing regimes that aim to increase the appeal of local listings. As at March 2021, 146 new economy companies had listed in Hong Kong, raising a total of US$88 billion and has accounted for 61% of the total IPO fund-raising[25]. This has set some emerging markets on an equal footing with global exchanges in terms of IPO fundraising and number of listings over the last three years[26].

[21] https://www.mas.gov.sg/-/media/MAS/News-and-Publications/Surveys/Asset-Management/Singapore-Asset-Management-Survey-2019.pdf
[22] https://www.mas.gov.sg/schemes-and-initiatives/variable-capital-companies-grant-scheme
[23] https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-progress-report-july-2019-july-2020.pdf
[24] https://www.law.cornell.edu/uscode/text/26/7701
[25] http://www.xinhuanet.com/english/2021-04/29/c_139915114.htm
[26] Potential Policy & Regulatory Responses to Changes in Primary Market arising from Trends in Innovation Landscape, ICMR.

The Future of Private Equity: Opportunities for Malaysia

Overview

Private equity has broadly stood out as an asset class in the ASEAN region over the last decade. Investors are betting on higher economic growth, rising investment in technology and a growing middle class across the trade bloc. The International Monetary Fund (IMF) forecasts stable growth for the ASEAN-5 nations of Indonesia, Malaysia, the Philippines, Thailand and Vietnam, with growth of 4.9% in 2020 and 6.1% in 2022[27]. With 674 million people, diverse population demographics and a growing middle class, ASEAN presents an attractive component of a well-diversified portfolio, as well as a great alternative to China moving forward.

However, there is more that needs to be done to level the playing field against the private equity industries in more advanced markets. Despite the presence of a string of global investors such as Singapore's GIC and Temasek, Abu Dhabi Investment Authority, family-owned Verlinvest and corporates like Alibaba and Tencent for example throughout the last decade, the region's private equity scene is still at a nascent stage. To date, ASEAN accounts for less than 1% of the world's US$4.0 trillion private equity assets under management and there is huge potential for the industry to grow.

Private equity was a relatively obscure slice of the Malaysian financial landscape until the late 2010s, when the securities regulator issued a framework for Private Equity. However, the industry existed long before the legal framework; its origins trace back to 1998, when the first private equity firm, Navis Capital Partners, was licensed as a private asset manager. Assets under management for the Malaysia private equity industry has been growing at a sluggish pace of 6.7% annually from US$3.7 billion in 2010 to US$6.8 billion in December 2020[28] compared to Singapore (18.6%), Japan (14.9%), South Korea (29.6%), and even ASEAN region as a whole that have recorded growth of over 14.8% over the same period.

While the total number of deals has decreased marginally from 69 in 2015 to 53 in 2020, the average deal size has increased substantially over the same period. Based on Preqin's data, average deal size for venture capital grew from US$1.7 million to US$4.1 million between 2015 to 2020. Similarly for buyout deals, average investment size has increased significantly from US$22.6 million (2015) to US$238.2 million in 2019 before scaling back to US$99 million in 2020. The hike in funding rounds for 2019 was driven by several notable buyouts deals such as US$40 million acquisition of Real Education Group by Paramount Corporation, and US$1.2 billion acquisition of Columbia Asia Hospitals by Hong Leong Group etc.

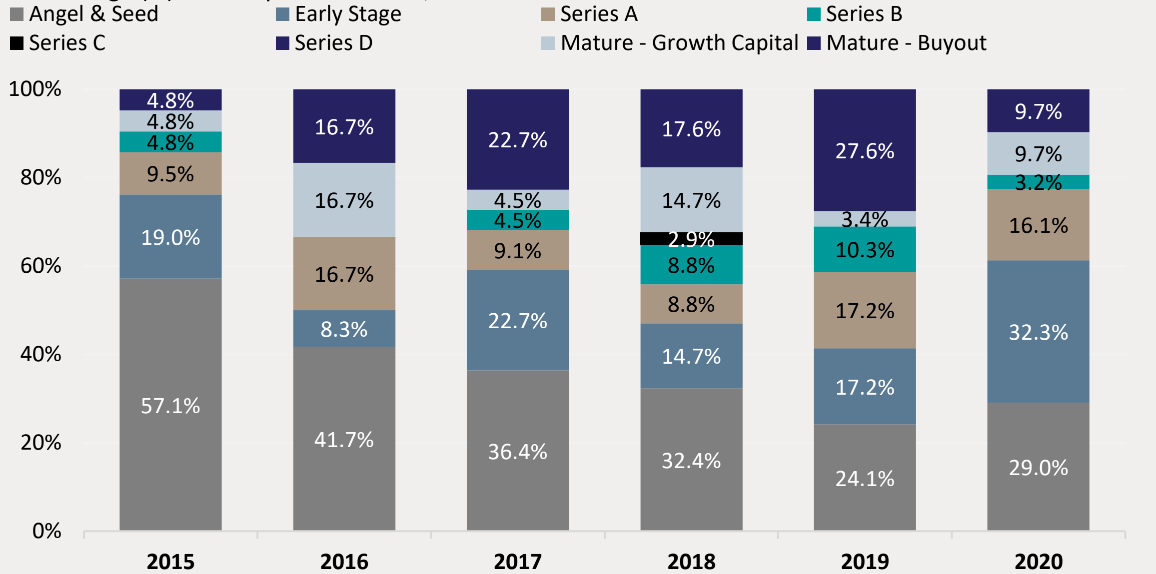
While seed and early-stage deals have captured more than 76% of private capitals invested in 2015, the Malaysia private fund industry is nevertheless undergoing its transformation process **(Exhibit 13)**. Over the past five years, the industry has witnessed a gradual diversification from Angel & Seed-stage financing to larger deals resulting from market volatility, together with readily available finance.

[27] World Economic Outlook: Managing Divergent Recoveries, International Monetary Fund, April 2021.

[28] Source from Preqin & calculations are based on 10-year CAGR from 2010-2020.

Exhibit 13: Investors pivot to Series-A & Growth stage

Percentage (%) of Malaysia total deals, 2015-2020



Note: *Matured growth & buyout deals calculated as private equity deals.*
Source: *Preqin, ICMR internal calculations.*

To date, there are over 70 active general partners operating in Malaysia. Approximately 63% of these GPs' main strategy comprised of venture capital, followed by growth (20%), buyout (7%) and others (10%). Only the best performing funds have raised subsequent and larger funds in Malaysia.

Over the past two decades, various initiatives were undertaken by policy makers to deepen the industry. This includes setting up a dedicated Government-linked private equity investment firm EKUINAS, provision of matching funds, as well as establishing a VCPE association to help improve and internationalise the local industry.

Yet despite these efforts, the Malaysian PE market is relatively nascent compared to the more advanced markets such as the US and the UK. Private equity investors who traditionally buy large majority stakes or conduct leveraged buyouts are largely absent from the market.

Industry insiders say that Malaysia, as with other ASEAN countries, presents its own unique set of challenges for the private equity industry. Majority of the businesses are state-owned and family-owned, and currently there are a large number of first-timer entrepreneurs with the absence of successful track records. While the country has witnessed some seasonal local private equity firm (e.g., Creador, Navis, COPE private equity etc.) launching consecutive funds, nevertheless, the volatility in exchange rates and absence of a limited partnership structure has undermined the attractiveness of the country as a fund-raising destination for private equity.

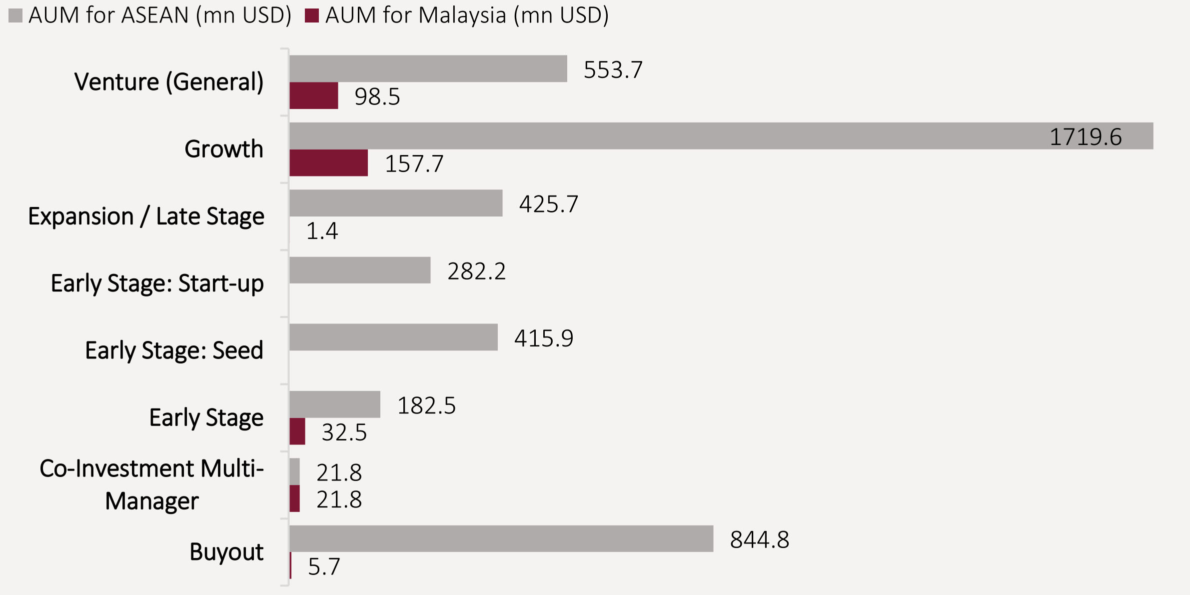
The other key challenge is exiting potential investments. The capital market has witnessed relatively low public listing deals sponsored by private equity GPs over the last decade. Trade sale and sale to GPs are still the preferred exit routes. While there is increasing interest and depth in the country's initial public offering market over the past 12 months, it is relatively insignificant compared to the volumes and diversity of listings seen in other parts of Asia such as China and Hong Kong for instance. Intrinsically, to continuously grow the Malaysia PE industry, it must be supported by a healthy and diverse ecosystem of fund managers, investors and exit opportunities.

1 Need for diversity in private equity strategy

Private capital investments tend to take a different form in ASEAN. One third of the ASEAN-focused private funds are comprised of smaller venture capital funds that focuses on early-stage of the business cycle. Approximately 38% of the funds raised across ASEAN to date have been concentrated primarily on growth equity - a term often used to denote minority investment in which committed capital is used primarily to fund growth rather than buy out existing shareholders.

Similarly in Malaysia, the private equity industry tends to be less diversified. The majority of private funds in the market targets early-stage venture investments. As of September 2020, growth funds made up over 49% of the total ASEAN-based Malaysia focused private funds, aggregating US$157.7 million AUM. Unlike the more established markets of Japan, South Korea, US and Europe, buyouts and late-stage strategies in Malaysia comprised only 1.8% and 0.4% respectively of the country's total private funds **(Exhibit 14).**

Exhibit 14: Majority of Malaysia-focused private funds focuses on early-stage investment



Source: *Preqin, ICMR internal calculations.*
Note: *Calculations are based only on AUM of ASEAN-based funds focused on Malaysia and ASEAN by strategy as of 30 September 2020.*

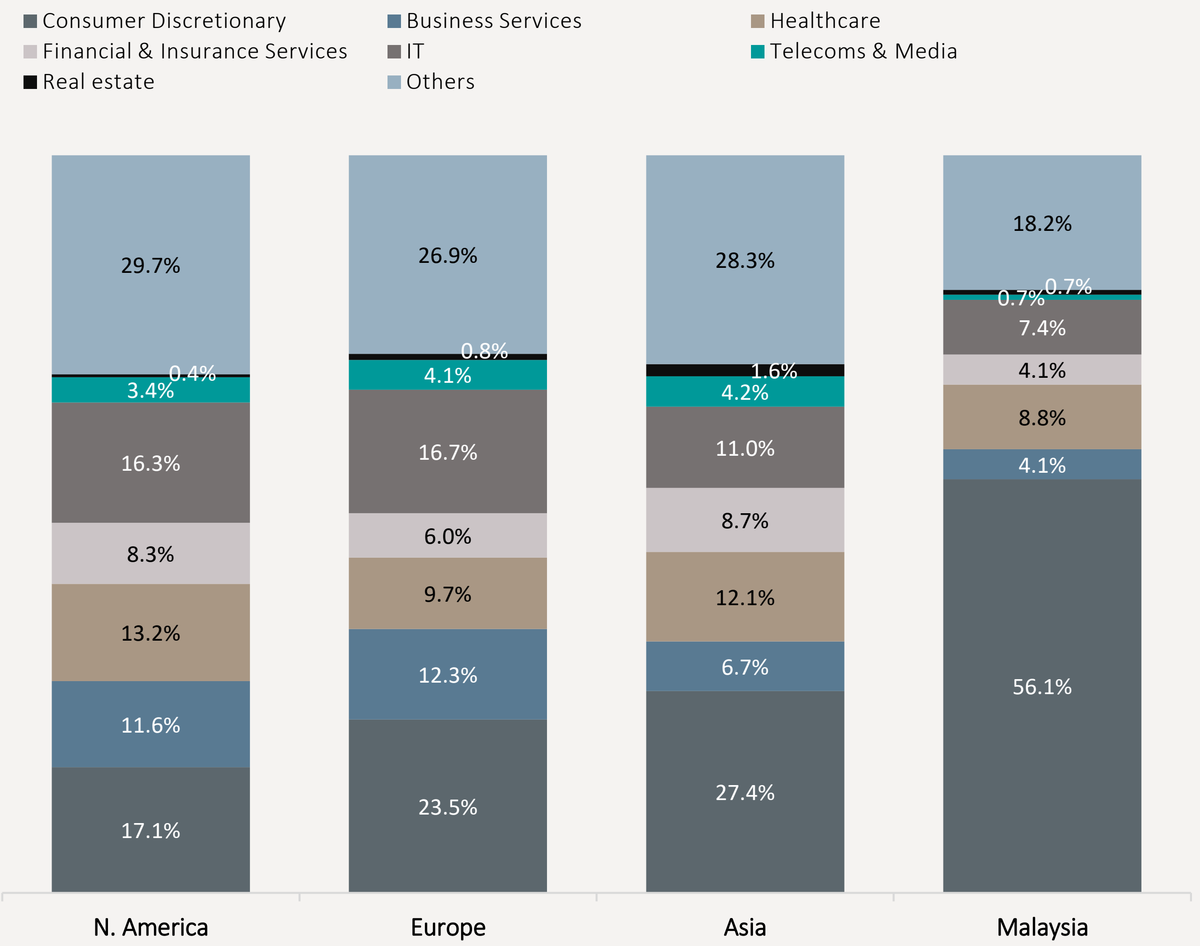
The global Covid-19 pandemic shows few signs of letting up. Deceleration in growth prospects and global trade momentum driven by the recent pandemic outbreak has undermined business confidence in Malaysia. However, private equity can approach the coming economic slowdown far differently. Instead of treating a contraction as a time to pull back, well-positioned turnaround and buyout funds could utilise this time to advance their market position, embrace new investments, and fast-track business improvements. Divestitures of non-core or troubled assets from larger companies could present a buying opportunity for many private equity funds, and hence it is vital to widen the pool of private equity strategies such as turnaround and buyout funds in Malaysia to address the increasing liquidity needs going forward.

2 Need to overcome concentration of deals

With many regional economies set to recover at a fair clip from the Covid-19 pandemic outbreak, Malaysia's appeal will only grow. While the recent slowdown had affected deal making in the private equity industry, dry powder for Malaysia-focused private equity funds has witnessed a declining trend over the last decade. At US$0.7 billion, the amount of dry powder as of December 2020 made up 10% of the total US$6.8 billion in AUM, which is slightly below the 10-year average of 27%. Capitals are being deployed actively over the last decade in search for attractive investment opportunities.

However, majority of the private equity deals in the country are concentrated in limited sectors such as consumer discretionary (56.1%) and others, of which majority are comprised of raw materials/energy utilities (12.0%), unlike in other regions **(Exhibit 15)**.

Exhibit 15: Majority of buyout deals concentrated in consumer discretionary
(% of total deals), 2010-2020



Note: *Others include Energy & Utilities, Raw Materials & Natural Resources, Industrials*
Source: *Preqin & ICMR internal calculations*

While there has been a surge of interest in other areas such as technology and healthcare over the past 3 years, the country needs broader private investment opportunities particularly in agriculture, financial and insurance services and healthcare, for example, to address the growing challenges brought on by urbanisation, food security, and infectious disease outbreaks.

The recent pandemic outbreak has, in fact, highlighted the importance of developing a sustainable healthcare and food security system particularly at times when global borders are closed. Despite having the full support of the government and communities, the public and private healthcare systems, as well as the agricultural sector in its broadest sense, have been fighting an uphill battle since the onset of Covid-19 lockdown.

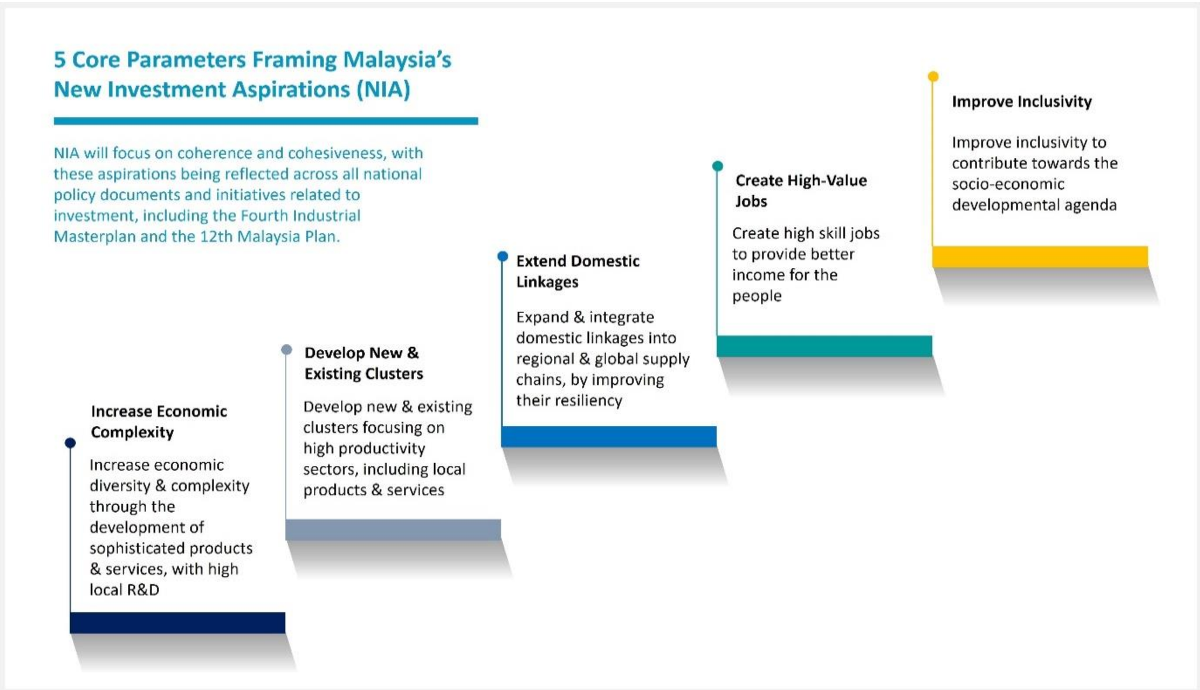
Private equity can play an important role in paving the way for a more sustainable and resilient recovery for the country. With the enormous amount of dry powder available both globally and within the ASEAN region, the industry could be set to hold a strategic role in rebuilding Malaysia’s economy, through rapid and targeted capital deployment in the several areas described in the following sections:

i. Delivering on sustainability goals

As climate change, urbanisation and outbreaks of infectious diseases continue to intensify, the outperformance of environmentally and socially responsible companies will only increase. We are already seeing this manifest. The recent pandemic outbreak has resulted in tremendous uncertainty across a number of fronts, especially with regards to food security and sustainable healthcare systems. Supply chain disruptions have left agriculture output sitting idle at the ports of most countries. Recent curfews or movement control orders in some of the world's biggest rice exporters have driven consumers to hoard rice, a staple for many countries in Asia, for fear of a prolonged stay-at-home order[29,30].

This, coupled with climate change and rapid population growth for the decades to come will likely result in a complex set of challenge in attaining food security. According to the 2020 Living Planet Report, agricultural expansion and global food demand at large are responsible for the alarming loss of biodiversity[31]. As global temperatures rise, weather patterns shift, and precipitation becomes more unpredictable, and farmers are struggling to keep up with this climate crisis.

Additionally, as the urbanisation process and economic modernisation activities take place relentlessly and in parallel, healthcare systems are struggling to respond to the challenges brought on by this transition. Disparities in healthcare capabilities, population demographics, state of public's health, and economic capabilities have resulted in various challenges for different countries in combating current epidemic. Between 2008 to 2018, high-income countries on average spend around 12% of GDP on healthcare expenditure, while middle-income and lower-income groups spend around 3-6% of GDP respectively on healthcare[32]. Evidently, there is a huge range of differences in healthcare capacities across the world.



Source: Mida

[29] https://www.tridge.com/stories/vietnams-export-ban-on-rice-causing-a-ripple-effect
[30] https://www.nst.com.my/world/region/2020/05/592981/cambodia-lifts-ban-rice-exports

[31] WWF Living Planet Report 2020
[32] World Bank database

Developing Asia, or ASEAN precisely, has been going through rapid urbanisation over the last decades, resulting in increasing frequency of infectious disease outbreaks that is correlated directly with socio-economic, environmental, and ecological factors. These outbreaks have had a huge impact in terms of health security and the economy as a whole. The Severe Acute Respiratory Syndrome (SARS) for example, claimed over 800 lives, and has devastated ASEAN's tourism and aviation sectors[33]. During this outbreak, tourist arrivals in Malaysia from China fell by 37% while total tourist arrivals fell by 21%; inevitably tourist spending during this period fell by 39% and 17%[34]. Fast forward to the present day, the implementation of Movement Control Order (MCO) to contain the Covid-19 epidemic has similar detrimental impact on the Malaysian economy. Malaysia lost RM2.4 billion a day during the MCO period, with an accumulated loss of RM63 billion up to the end of April 2021[35].

ASEAN's contribution to food and health insecurity, growing unemployment and climate-related challenges over the next decade cannot be understated. Private equity development in Malaysia could strive to focus on helping to improve healthcare provisions in the country such as providing better access to affordable healthcare facilities or provision of more quality primary healthcare services to the general public.

In addition, these private capitals can help strengthen domestic linkages into regional and global supply chains, as well as improve inclusivity to contribute towards the socio-economic developmental agenda. This bodes well with the government's new investment aspirations[36] (NIA) that focuses on increasing economic diversity and complexity through the development of more sophisticated products and services, with high local research and development (R&D) as well as innovation.

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[33] J.W. Lee and W. J. McKibbin. 2004. Estimating the Global Economic Costs of SARS. In S. Knobler, A. Mahmoud, S. Lemon, et al., eds. Institute of Medicine (US) Forum on Microbial Threats. Learning from SARS: Preparing for the Next Disease Outbreak: Workshop Summary. Washington, DC: National Academies Press (US). https://www.ncbi.nlm.nih.gov/books/NBK92473/.

[34] https://www.marc.com.my/index.php/marc-news/1177-the-malaysian-economy-impact-of-the-coronavirus-outbreak-20200207

[35] https://www.readcube.com/articles/10.1371%2Fjournal.pone.0091630

[36] https://www.mida.gov.my/malaysia-is-shifting-gears-national-investment-aspirations-nia/

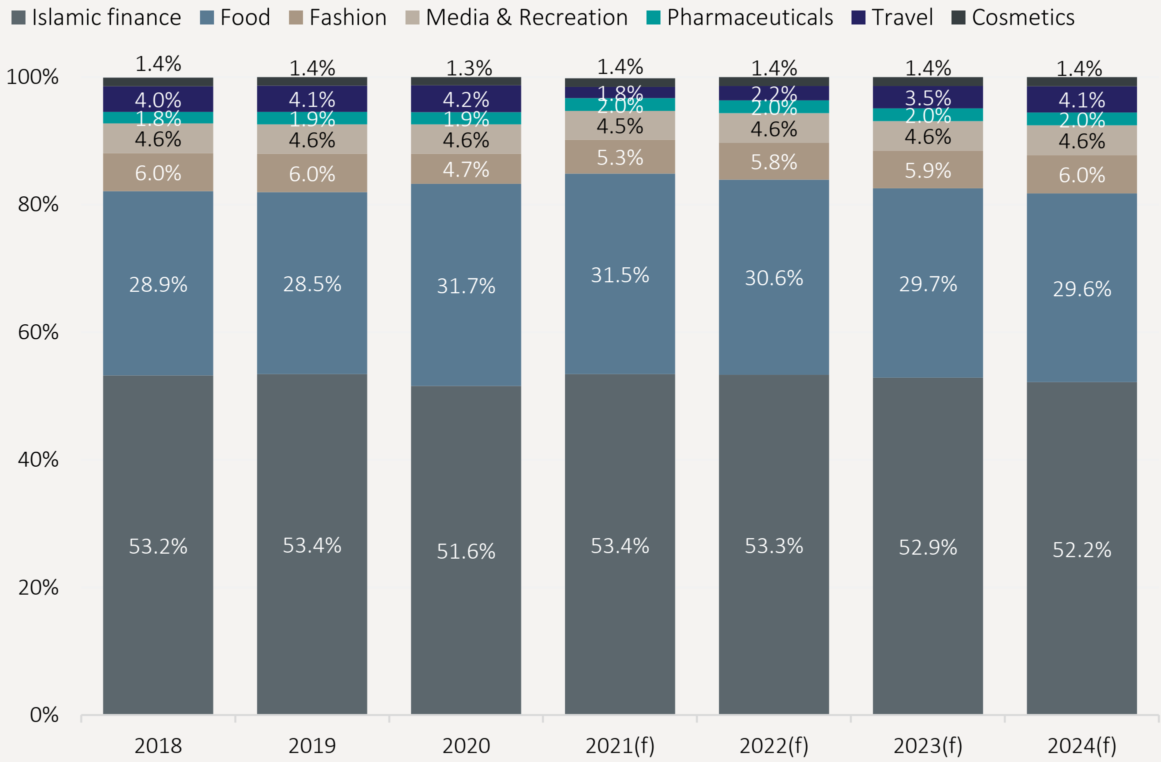
ii. Expanding Malaysia's Halal industry

The Halal industry is fast becoming one of Malaysia's main engines of economic growth. The industry currently makes up 15% of Malaysia's GDP with the food and beverage sector dominating over 85% of the country's total halal exports. Despite the many ongoing challenges brought on by the recent pandemic outbreak, the industry continues to attract investors' interests both globally and domestically. To date, Malaysian Halal parks[37] have attracted a cumulative total of RM16.1 billion in investments since 2011. Of this, RM9.5 billion (or 59%) is foreign direct investment (FDI) while RM6.6 billion (or 41%) is domestic direct investment (DDI). A growing Muslim population, rapid digitalisation, high demand of Halal products and an integrated global economy, propels this trend.

Both Muslims and non-Muslim producers are tapping the substantial potential in the global Halal industry. Asia alone is home to about two-thirds of the world's Muslim population. Non-Muslims have also taken to purchasing Halal products as the certification is seen as a hallmark of reliability, food/product safety, and hygiene. As worldwide demand for Halal products continues to increase, greater efforts are needed for Malaysia to stay ahead in the Halal industry. Global Halal market size is estimated to be worth US$3 trillion over the next five years and is expected to grow rapidly to US$11.2 trillion by 2030[38].

Exhibit 16: Greater diversification opportunities in other Halal sectors

Global Halal industry market share by sector, 2018-2024



[37] Halal Park is a specialized economic zone for the production of halal products for both local and international markets.

[38] https://www.adroitmarketresearch.com/industry-reports/halal-market

Source: *Statista*

As such, the Halal industry has huge potential for growth. In 2019, a total of 1,876 exporting companies of Malaysian Halal products was recorded, and over 76.2% of these companies comprised small and medium enterprises. In addition to changing consumer preferences and supply chain disruptions brought about by the recent Covid-19 outbreak, huge challenges persist for these companies to extend their reach in the global Halal supply chain due to firm size constraints.

Intrinsically, there is a need to address challenges in the Halal sector that have led to subsequent transformations within the industry following the outbreak, while also exploring changes and opportunities. This could be addressed by attracting more private investments for the local Halal market. Together with global private equity dry powder amounting to US$4 trillion, this capital can play a strategic role in strengthening the competitiveness of Malaysia's Halal industry. Incentives can be explored to attract regional private equity investments to help broaden existing Halal industry verticals to areas such as pharmaceuticals, tourism, and healthcare, as well as to deepen local Halal industry connection with regional or global supply chain.

Moving Forward: Achieving diversity in private equity to drive recovery

1 Increase tailored development effort for emerging businesses

In the search for improved funding for small business and new customer opportunities, there is a source of new revenue opportunities that far too few small business owners are recognising — the government. Many governments are increasingly utilising new public-procurement mechanisms to drive innovation, promote economic development, and access new technologies from new types of partners, like entrepreneurs or members of the creative economy.

Governments around the world have been working with small businesses and are increasingly offering programs to create better ways to on-board them to the global value chain. Programmes such as Government e-Market in India and the Office of Government Contracting in the US, for example, has promoted participation of smaller, disadvantaged and woman-owned businesses through procurement of federal government contracts. One of the challenges of introducing new products is that such products have not been tested or widely accepted. Naturally, the market may be slow in embracing such products. New innovative businesses seldom have the resources or network to expand into new or even existing markets to bring their products out. As such, governments and corporations, with their strong networks and deep pockets, could lend a hand to these new innovative businesses by providing the kind of market access and reach to potential customers.

In most emerging countries, the public sector could possibly be the biggest procurer of goods and services, which makes them an attractive client for innovative and emerging firms seeking to get a leg up in their business. Recognising the importance of this relationship, some public authorities have initiated various forms of public procurement policies to incentivise, support and otherwise sustain domestic firms. It would be beneficial to link public procurement and new innovative and emerging businesses considering that some emerging countries have yet to provide preferential access to government contracts for these group of companies. The challenge rests with how best to design transparent and market-friendly facilitation mechanisms which are targeted more at innovative and emerging businesses in public sector procurement.

The Malaysian government too is increasingly recognising that providing emerging businesses with access to wider markets or stakeholders could go a long way in overcoming many of the business challenges. Evidently, various alternative platforms that assist new businesses to expand customer-base and launch significant product breakthrough have been established. In 2015, MDEC's Global Acceleration and Innovation Network (GAIN) was launched to assist Malaysian start-ups to tap into the existing networks and scale up quickly. Likewise, Endeavour, MaGIC's Global Accelerator Programme (GAP) and Alliance Bank's SME Innovation Challenge

2014 programme, to name a few, have also provided participating new innovative businesses with an opportunity to be coached by corporate titans, a platform to network through, and access to markets.

With the growing presence of government-linked companies (GLCs) within the country, it will be beneficial for these organisations to contribute collectively to the public interest by providing diversity in products and services, as well as stimulating jobs or economic activity. Increasing outsourcing trends amongst GLCs may provide an excellent avenue to future-proof a business while ensuring SMEs maintain a competitive edge in the global market. The government could intensify and strengthen inter-firm linkages with GLCs by applying greater flexibility in identifying a procurement strategy. The implementation of Green Procurement and Eco-labelling Programme (GGP) in 2017 by the Malaysia government for example, demonstrates that the government, by being the biggest purchaser of a country, could use their purchasing power to influence environmentally friendly goods, services and works, and make an important contribution to sustainable consumption and production. However, a 'one size fits all' approach may not be appropriate for all projects. There is a need for new and innovative ideas regarding the ways in which social objectives can be embedded into procurement specifications while ensuring value for money in their delivery.

Government contracts can serve as a strong motivator to scale up any businesses and raise transactions levels for the Malaysian commercial landscape. Policy makers can capitalise on digital solutions to provide a more streamline and transparent public-procurement platform that is accessible to smaller business. Existing public contracts can be reassessed to eliminate discriminatory practices, and ensure all potential suppliers are treated equitably based on their commercial, legal, technical and financial abilities, as opposed to going by their size. Such a platform could provide an avenue for businesses of all sizes to build global brands, as well as accelerate the flow of funds from the private equity sector into the domestic "new economy[39]" industries.

[39] "New Economy" as defined under OECD Glossary of Statistical terms, describes aspects or sectors of an economy that are producing or intensely using innovative or new technologies. This relatively new concept applies particularly to industries where people depend more and more on computers, telecommunications, and the Internet to produce, sell and distribute goods and services.

2 Policy to catalyse the expansion of PE funds in niche sectors

Malaysia has remained committed to developing the private funds industry over the past decade. Various initiatives, ranging from setting up a dedicated investment arm through implementation of matching funds facility, to enactment of private funds regulation, have been introduced to broaden and deepen the local private funds industry over the years. Take the recent US$145 million (RM600 million) Dana Penjana Kapital matching fund programme as an example. The programme was initiated to attract both local and foreign players to invest in the local private funds industry and has successfully generated over US$290 million (RM1.2 billion) in assets under management (AUM) to date. This AUM is envisioned to be invested primarily in Malaysian or ASEAN investee companies that could yield tangible economic benefits to the country's economy.

The programme has made great strides in liberalising the local private funds industry. However, the initiative still lacks focus in terms of strategy and scalability to attract greater participation from regional GPs. The programme has placed higher weighting on venture capital as compared to private equity as only one out of the eight recipients under the Dana Penjana Capital programme falls under the private equity strategy[40]. As private equity fund's size continues to grow, it would be challenging for the government to continuously allocate funding to attract foreign GPs through matching programmes.

With limited resources coming into play, this report calls for a more focused approach to broaden the pool of private equity funds in Malaysia to help solidify economic growth on a larger scale. For a start, policy could focus on attracting specific GPs in the areas of healthcare and agri-tech to help strengthen the country's existing healthcare and agriculture sector. To promote the establishment or re-domiciliation of private equity funds in these areas to Malaysia, policy makers could consider subsidising expenses involved in setting up such PE funds in the country.

Instead of expanding the broader healthcare sector, policies could emphasise on growing the country's medical tourism sector. Medical tourism is fast becoming a contributing factor to the national economy with revenue generated surging from US$127 million in 2011 to over US$400 million in 2019. Although this added only 0.11% to Malaysia's US$364.7 billion GDP in 2019, this sector was recognised as a key driver of economic growth and may potentially generate US$1.04 billion in gross national income and produce over 5,300 medical professionals by 2020[41]. These revenues could not only help to sustain but also upgrade medical facilities for local healthcare users' benefits thus providing Malaysians with alternatives to the current crowded public health care situation. In addition, investment in medical tourism infrastructure could further generate demand for goods and services in ancillary sectors such as clinical research and development, pharmaceuticals, logistics and hospitality. This could assist in generating both medical and non-medical jobs and spur the growth of small and medium enterprises.

Food production and distribution are also undergoing significant shifts due to technology advancement. The growing importance of food security has attracted the private sectors' attention over the years with many corporations gradually stepping in to help nurture and develop the agriculture sector. Capital flows going into agriculture are growing more and more institutionalised, and more and

[40] http://www.penjanakapital.com.my/index.php/newsroom-2/mediarelease/media-release-14-december-2020

[41] https://www.npra.gov.my/images/Announcement/2015/NRC-2015-day3/P10.3-P-NKEA-Healthcare2015-FABIAN-DELL.pdf

more private. Assets under management of agriculture-related private equity funds grew from US$9.8 billion in 2010 to over US$13 billion as at December 2020[42]. With the advent of a new wave of funds such as Agriculture Technology (AgTech), and as more specialised funds take place, the agriculture private equity market sector is poised to grow even further over the coming years and could be positioned to raise the domestic food production level in a more sustainable manner. Public policy should target to attract more private equity funds to invest and develop the country's agriculture sector with a focus on either sustainable development and management of natural resources, productivity improvements through technological innovation, or expansion of business enablers such as local storage and transportation.

Other targeted incentives such as tax exemption could be utilised to complement the above-mentioned efforts in attracting private equity investments. To date, profit tax incentive is only available to the venture capital industry. Legislative amendments could be introduced to create a unified tax exemption on profits and carried interest payable by private equity funds. As a start, the tax incentives could be targeted at private equity funds that invest in small businesses that hold the promise of rapid growth and a "double bottom line" of not only financial returns but also community and economic development benefits.

This, together with the other tax exemptions already granted under the country's 76 Double Tax Treaty Agreement[43] will certainly shape how fund sponsors choose to domicile their private equity funds. Such initiatives could help the country to seize the opportunities presented by OECD's current on-shoring drive, as well as enhance the comprehensiveness and competitiveness of Malaysia's fund regime against the backdrop of the growing number of foreign funds and family offices within this region.

[42] Preqin.

[43] 73 Double Tax Treaty plus 3 Limited Agreement with Argentina, Saudi Arabia & US.

3 Broaden investor base through private equity trusts

Private equity is typically considered a risky investment asset class. Lack of liquidity and transparency has been a prime concern as it can take a long time to realise an investment, and the likelihood for fledgling businesses to succeed remains fuzzy. Previously, the asset class was only accessible to institutional and professional investors who are qualified under the capital market laws as sophisticated or accredited investors.

But this is all changing.

In an effort to attract large amounts of investment capital, there has been a broad push in some developed markets to allow retail investors to access the private equity asset class and reap the same benefits experienced by professional investors. In June 2020, the US Department of Labour announced that the provisions on fiduciary responsibility in the Employee Retirement Income Security Act of 1974, would allow fiduciaries of 401(k) and individual retirement plans to include diversified investment options with private equity exposure, if certain requirements are met[44]. Securities laws were amended to open access to private markets and expand investment opportunities for some investors. In August 2020, the SEC broadened the definition of accredited investor and qualified institutional buyer in the Securities Act of 1933 to permit participation of wider investor groups in the private capital markets[45].

Today, there is a larger trend that affects all investors, be it in the private or public market. With the decline in public offerings over time, extended period of low interest rates, rise in unicorn firms that stay private longer, and other geo-political considerations, it is important to broaden the pool of investment opportunities available to both professional and retail investors. Globally, the private equity industry has evolved beyond its leveraged buyout roots and is seeking to expand its capital base that traditionally has been tied to institutional investors. In line with this, more emphasis needs to be placed on exploring how pooled investment vehicles, including private and regulated funds, can provide a more level playing field for retail investors to access potential outsized and uncorrelated returns offered by alternative investments such as private equity.

Similarly in Malaysia, it is necessary to broaden the types and number of participants for the domestic private equity industry. In July 2021, the securities regulator in Malaysia has also broaden the scope for more people to qualify as sophisticated investors[46]. This will assist in maintaining a vibrant and compelling investor base. It is also important to create a more transparent funding vehicle to provide non-sophisticated investors with the opportunity to realise any financial benefits that private equity has to offer.

Private equity investment trusts are a seemingly straightforward route into this market. Contrary to most unit trust funds, which are open-ended funds, private equity trusts are structured as closed-end vehicles, usually listed on a stock exchange, in which investors buy and sell shares in the trust rather than the underlying assets. One of the biggest benefits of a private equity investment trust fund is that it is more affordable. While some funds may raise money from its investors and invest directly in unlisted companies, others will instead invest in other private equity funds (**Exhibit 17**).

[44] https://webstorage.paulhastings.com/Documents/Default%20Library/stay-current-department-of-labor-allows-private-equity-investment-exposure-in-401(k)-plans-(4)-(003).pdf

[45] https://www.sec.gov/rules/final/2020/33-10824.pdf

[46] https://www.sc.com.my/api/documentms/download.ashx?id=72b64b5c-313b-44dc-9841-36e0d50906ac

Exhibit 17: Examples of UK Listed Private Equity Trusts

Fund name	Share class	Strategy	Launch date	NAV	Share price
HarbourVest Global PE	Ordinary Share	Fund-of-funds	May-10	2,921.0	2,225.0
HgCapital Trust PLC	Ordinary Share	Direct	Dec-89	334.9	338.0
NB Private Equity Partners	Class A Ordinary	Direct	Jun-09	1,936.0	1,527.5
ICG Enterprise Trust PLC	Ordinary Share	Direct	Jul-81	1,398.5	1,066.0
Pantheon International PLC	Ordinary Share	Direct	Sep-87	3,521.9	2,670.0
3i Group PLC	Ordinary Share	Direct	Jul-94	1,042.0	1,295.5
Standard Life PE Trust	Ordinary Share	Direct	May-01	570.9	437.5
BMO PE Trust	Ordinary Share	Direct	Mar-99	477.2	409.00

Note: *Share price and NAV denominated in GBP; data obtained as of 26 July 2021.*
Source: *Citywire.co.uk*

Just like any other investment product, there are risks and challenges involved. As a listed close-end fund, the investment vehicle brings administrative and operational requirements that can present challenges, even for the most experienced fund manager. Hence, the proposed vehicle should consider providing fund managers with a certain degree of flexibility in asset allocation (e.g. in terms of combination of listed and unlisted securities allocations). This could create the scale for investment managers to charge vastly lower fees than in private equity-only portfolio. Additionally, this move could provide sufficient liquidity to overcome challenges such as 'out of market' timing. It would also provide the ability to quickly reinvest the proceeds from sales of private investments or to hold onto private investments once listed if they remain strong investment opportunities.

Another advantage is the flexibility to raise or deploy additional cash without having to change the overall profile of the portfolio.

The added transparency of being publicly listed coupled with allowing a combined public-private portfolio approach may be a plausible route for non-sophisticated investors to gain exposure to private equity. The Public Offering of Closed-end Fund Framework in Malaysia could serve as a foundation for establishing a private equity investment trust in Malaysia. However, the existing framework limits investment of no more than 10% of its net asset value in unlisted securities. This could be enhanced to allow private equity closed-end funds to hold a greater amount and wider range of unlisted securities and non-equity-based investments such as debt and derivatives.

4 Facilitate PE long-term fundraising through debt capital market

Globally, policy makers and professional investors believe that private equity is required for diversified participation in global growth. However, given the risks and obscure nature of private equity, these funds are not open to all individuals for subscription. Capital was usually raised from institutional investors who have substantial reserves of liquidity as well as the ability to hold long-term investments.

Nevertheless, policy makers have recently considered democratising this asset class to the broader group of investors. In an effort to expand the opportunity of private equity to include retail investors, policy makers in Singapore have allowed private equity funds to issue a fraction of PE bonds (Bonds) to the mom-and-pop investors. The Bonds are typically structured as a structured product backed by a diversified portfolio of hedge funds, private equity funds or any type of cash flow stream for that matter.

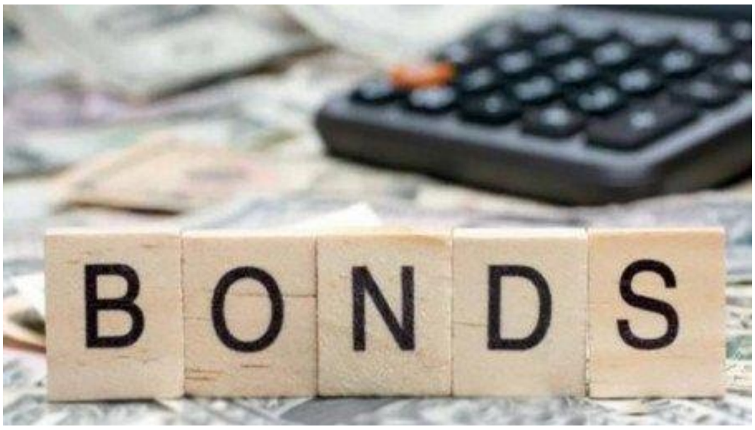
Azalea Group, a subsidiary of Singapore's Temasek Holdings specialising in private equity investments, has launched a number of private equity bonds with the first bond being issued in 2016. Its fourth offering (Astrea IV) offers a series of fixed rate notes, including a retail tranche, whose assets are composed of 34 private equity funds, with a current net asset value of over US$1 billion. Retails investors are not investing in private equity directly. Instead, they will be investing in bonds that are backed by the cash flows from a diversified portfolio of all the 34 private equity funds managed by reputable PE general partners such as Bain Capital, Warburg Pincus, and TPG for example. Retail segment, and other senior tranches, will have the highest priority for interest payment and redemption. Other structural safeguards such as a reserve account that builds up cash to redeem the bonds in tranches are kept in place to ensure that retail investors are protected. To date, over US$2.1 billion has been raised from Astrea and Vertex' PE bonds, with 32% of the proceeds (US$583 million) raised from the public **(Exhibit 18)**.

Exhibit 18: Summary of Azalea's IV, V & VI PE bonds

Bonds	Exposure	Underlying Funds	Total Issuance	Details
Astrea IV (2018)	U.S (63%), Europe (19%), Asia (18%)	US$1.1 billion in 36 PE funds 596 investee companies	US$560 million (include US$121 million retail tranche) Coupon 4.63% (retail)	• Retail tenure 10 years • Scheduled call date in 2023 • Step-up i/r 100bps if not called • Bonus 0.5% of principal on redemption contingent on performance conditions
Astrea V (2019)	U.S (56%), Europe (22%), Asia (22%)	US$1.3 billion in 38 PE funds 862 investee companies	US$600 million (include US$180 million retail tranche) Coupon 3.85% (retail)	• Retail tenure 10 years • Scheduled call date in 2024 • Step-up i/r 100bps if not called • Bonus 0.5% of principal on redemption contingent on performance conditions
Astrea VI (2021)	U.S. (61%), Europe (23%), Asia (16%)	US$1.5 billion in 35 PE funds 802 investee companies	US$643 million (include US$282 million retail tranche) Coupon 3.00% (retail)	• Retail tenure 10 years • Scheduled call date in 2026 • Step-up i/r 100bps if not called • Bonus 0.5% of principal on redemption contingent on performance conditions
Vertex Venture (2021)	U.S. (13%), China (27%), S.E.A (21%), Israel (14%), RoW (25%)	US$4.5 billion in AUM	US$330 million (not available for retail) Coupon 3.3%	• Senior unsecured bonds • Tenure 7 years • Issued under Temasek's US$2 billion Multicurrency Debt Issuance Programme

Source: *MAS, Bondevalue.com, ifast Global Markets, Bondsupermart*

Private equity funds are open and accessible to many people but not necessarily to the broad masses. By creating a product which is diversified and provides a better risk adjusted return for the individual, policy makers could democratise this asset class by introducing a new category of product to the market for the retail investor. Moving forward, policy makers could consider encouraging issuance of private equity bonds that allow retail investors to diversify their investment portfolios into private equity. The Malaysian bond market has always been touted as a success story that offers relatively attractive seasoned bonds compared to many bank savings products. With its current depth of over US$380 billion in debt securities outstanding, the Malaysian debt capital market can be further leveraged to facilitate the raising of long-term funding for the private equity industry. Essentially, policy makers could explore incentives that alleviate the costs of bond issuance for private equity managers to spur greater interest in the local bond market.



5 Harmonise regulatory framework across global practices

While Hong Kong and Singapore may seem to be a centre for finance and a location of choice for global investors, many private fund managers still prefer to domicile their funds in offshore jurisdictions such as Cayman Islands, Mauritius, Delaware and Jersey, due to the familiarity of the regulatory framework and tax regimes in these locations. Despite the availability of various fund structures globally, Limited Partnership (LP) remains the prevalent legal structure used by Asia-based private equity general partners **(Exhibit 19)**.

Exhibit 19: Importance of Limited Partnerships for private equity

PE Funds Legal Structure for Asia-based GPs, 2010-2020

	Company Structure				Fund Structure			
	Cayman LLC	Limited Liability Company	Limited Life Company	SAS	Limited Partnership	Limited Liability Partnership	Limited Partnership Fund	Trust
2010	-	6	1	-	62	-	-	-
2011	-	5	-	-	114	-	-	-
2012	-	4	-	-	102	-	-	-
2013	-	2	-	1	120	-	-	-
2014	-	5	-	-	183	-	-	-
2015	1	4	-	-	457	-	-	-
2016		11	1	-	494	1	-	2
2017	1	6	-	-	452	1	-	2
2018	-	2	-	-	213	1	-	-
2019	-	3	-	-	163	-	-	4
2020	-	6			136	-	1	2

Note: *Data and calculations include closed-end and comingled private equity funds only. It is based on available data and exclude VCC.*

Source: *Preqin*

A limited partnership differs from a traditional partnership structure or corporate structure by limiting the liability of certain partners up to the amounts they have contributed. It is not a separate legal entity and within the structure, sponsors are liable for all debts and obligations of the firm. Another key characteristic of Limited Partnership is that they are treated as tax transparent vehicles. Tax is not levied at the limited partnership level but at the share of income accruing to each partner which will be taxed at the rates applicable to each of them respectively.

Limited Partnership has been the default structure until today as there had not been an alternative structure that can be used by the private equity industry in Asia before the enactment of QDLP (China), Limited Partnership Fund (Hong Kong) and Variable Capital Company (Singapore). Many of these new regimes were created to encourage the relocation of private funds as the growing scrutiny on offshore jurisdictions and the race for economic substance regulations rages on. Also, by providing contractual flexibility and simplified procedures, these new partnership agreements offer limited liability for LPs, unlimited liability for GPs, as well as safe harbours for LPs to undertake certain activities without losing their limited liability status **(Appendix)**.

To capture investments in areas mentioned earlier in the previous chapters, and to further bridge capital markets with the real economy, it is important for policy makers to recognise the importance of providing the right fund structure for private funds' providers to operate in a flexible and responsive manner. A wider set of alternative fund structures will plug a gap in the Malaysian fund ecosystem and provides private capital fund managers with additional options to structure and domicile their funds in Malaysia.

At present, the Malaysian fund ecosystem are constrained by five main types of business vehicles namely sole proprietorship, partnership, limited liability partnership (LLP), private and public company. While there is no one-size-fits-all approach to determining the optimal structure to adopt for a private fund, none of the country's existing fund structure matches the practice and flexibility accorded by the widely used LP structure. In line with this, policy makers will have to work closer together in harmonising the industry regulations and funds vehicle with global standards to address the rising challenges posed by cross-border competition.

Conclusion

Despite a decade of spectacular growth for the global private equity industry, many investors and practitioners had braced for a tough 2020. Recession and market turbulence as a consequence of the recent pandemic outbreak have taken a toll on the industry, curtailing return expectations, exits and fund-raising. Holding periods will likely get longer in anticipation of a slow post-Covid-19 recovery. Trade exits became more difficult to accomplish, leaving some to rethink their exit strategy. On a positive note, the revival of public equity markets for some countries in Asia has enabled the initial public offering exit channel to thrive. Without it, exit value would have been even more depressed.

Successful general partners navigate through the murky waters in part by focusing on digital business sectors. E-commerce and e-learning, for example, are some of the important digital sectors that accelerated in 2020 and are likely to enjoy long-term momentum as consumers get accustomed to the economic realities. Anticipating tougher international trade environments and greater supply chain disruptions moving forward, many private equity firms are stepping up efforts to develop domestic markets and domestic demand. While the impact of the recent pandemic has started to ease for some, many challenges will remain as we move forward through this new decade. This includes the need to address food security, sustainability of the public healthcare system, climate crisis, and other uncertainties relating to social inequality.

In line with this, global private equity practitioners are taking steps to bolster the resilience of their portfolios by placing greater emphasis on environmental, social and governance (ESG) investing. Mounting pressures were exerted on private equity funds to re-evaluate their portfolios and incorporate ESG principles into their GP-LP agreements.

While the global private equity industry grappled with unprecedented uncertainty and disruption in 2020, the industry nevertheless ended the year on a high note with some Asia markets such as China and India witnessing a strong bounce-back. Private equity remained a popular source of alternative capital in the Asia region. The industry is projected to continue its upward trajectory and could play a critical role in driving economic recovery. With over US$1 trillion in dry powder, private equity is well capitalised to take advantage of new investment and realisation opportunities.

Job creation. Improving economic opportunity. Encouraging sustainable growth. These priorities are at the forefront as Malaysia grapples with both recovering from the pandemic outbreak and addressing the needs of underprivileged communities. As a decade of relative global prosperity gives way to a new and more turbulent era, policymaking should review approaches to increase the resilience of the country by encouraging greater private investments in areas that could, (1) improve resiliency and long-term sustainability of the Malaysian economy, (2) emphasise on community and economic development activities and, (3) bridge the gap between domestic and international private capital fundraising. With a modern and robust regulatory regime for the private equity industry, a pro-business environment coupled with continued government support through tailored tax incentives, Malaysia would be well-poised to capitalise on the growth in private capital AUM in Asia.

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Appendix

Examples and key features of various fund structures employed by private equity industry globally.

	Luxembourg			Cayman	Hong Kong	Singapore
Legal form	Special Investment Funds (SIF)	Reserved Alternative Investment Funds (RAIF)	Special Limited Partnership (SCS)	Exempted Limited Partnership (ELP)	Limited Partnership Fund (LPF)	Variable Capital Company (VCC)
Key features	No separate legal personality At least 1 general partner & 1 limited partner Net assets must reach EUR 1.25 million within 12 months following launch date. Variable or fixed capital structure	No separate legal personality At least 1 general partner & 1 limited partner Net assets must reach EUR 1.25 million within 12 months following launch date. Variable or fixed capital structure	No separate legal personality At least 1 general partner & 1 limited partner Unregulated & no minimum capital requirement	No separate legal personality At least 1 general partner & 1 limited partner No share capital requirement	No separate legal personality At least 1 general partner & 1 limited partner Variable or fixed capital structure	No separate legal personality At least 3 directors (e.g., Singaporean residents) & 1 shareholder Single membership can be used in fund structures with the VCC having 1 shareholder, but multiple underlying investors
Investment parameters	No restriction in the type of asset classes *(Investment restrictions depending on the investment strategy and type of investors the AIF is addressed to)*	No restriction in the type of asset classes *(Investment restrictions depending on the investment strategy and type of investors the RAIF is addressed to)*	No restrictions in the type of asset classes and strategies *(unless if the CSC qualifies as an AIF)*	No restrictions in the type of asset classes and strategies	No restrictions in the type of asset classes and strategies	No restrictions in the type of asset classes and strategies Able to segregate investments under umbrella structure/ sub-funds

	Luxembourg			Cayman	Hong Kong	Singapore
Eligible investors	Professional and/or well-informed	Professional and/or well-informed	Unrestricted & Non-AIF qualified	Professional, high-net worth	Professional, high-net worth	Professional, high-net worth, retail *(through retail or restricted funds only with custodian arrangements)*
Marketing	Marketed to EU professional investors only *(unless SIF AIF with a full-fledged AIFM)*	Marketed to EU professional investors only	Non-AIF *(unless activities fall within the scope of article 1(39) of the AIFM law.)*	May be marketed to any third country jurisdictions by seeking permission from each respective jurisdiction.	May be marketed to any third country jurisdictions by seeking permission from each respective jurisdiction.	May be marketed to any third country jurisdictions by seeking permission from each respective jurisdiction.
Regulation	Authorisation & supervision by CSSF RAIF must be managed by an authorised external AIFM		Unregulated No authorisation & supervision by CSSF	Registered office in Cayman Islands & provided by a service provider licensed by Cayman Islands Monetary Authority	Fund registered with Hong Kong Registrar of Companies Required HK SFC licensed fund manager unless not carrying on any regulated activities in Hong Kong	Registered with ACRA. Required MAS licensed fund manager

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