KEYNOTE INTERVIEW

Breaking new ground

Japanese private equity hit new highs in 2023 as succession deals, corporate carve-outs and take-privates all continued to gain momentum, says Deloitte Asia Pacific's Satoshi Sekine

Q How would you describe the dealflow that you are seeing in Japan, and how does it compare to other regions?
Japan was the most active private equity market in the Asia-Pacific region by volume and value in 2023. Our latest research shows that deal count increased by nearly 5 percent to 252 deals and deal value increased by 49 percent to $38.8 billion, equating to a record high. Japanese investment value represented around 33 percent of the Asia-Pacific total.

South Asia, and India in particular, also experienced growth last year. Deal volume grew 15 percent to hit 180 deals, and deal value grew 66 percent to total $18.5 billion. Australia and New Zealand, however, experienced a significant drop in deal value, to around half that seen a year earlier – though this can be partly explained by Blackstone's acquisition of Crown Resorts in 2022 for a reported value of $6.3 billion, which skewed the numbers.

Meanwhile, China – historically the largest buyout market in the region – fell into second place amid ongoing macroeconomic and geopolitical challenges and despite several large transactions taking place throughout the year, including the Wanda, Chindata and Tricor-Vistra deals. Excluding the roughly $14.9 billion represented by these three transactions, Chinese deal value would be less than that of India, and close to South Korea in fourth place.

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Q What are the key drivers of Japanese dealflow?
We believe there are three primary drivers, the first of which is business succession. The owners of family businesses are ageing, and many have struggled to find a successor. According to Teikoku Databank, the average age of CEOs in 2022 was 60.4, and as of 2022 the nationwide absence rate of successors stood at 57.2 percent.

Business succession deals continue to gain momentum as business owners become increasingly familiar with private equity and as they recognise the value that private equity firms can bring in terms of operational improvement and value creation. Based on our analysis, business succession deals represent more than 60 percent of private equity deals in Japan and this trend will continue given Japan's ageing and shrinking population. According to World Bank data, 30 percent of Japan's population is aged 65 or above compared to 14 percent in China.

The second driver of dealflow involves carve-outs. Continuous corporate governance reforms have urged Japanese companies to pursue business portfolio rationalisation and improve capital efficiency. More sophisticated shareholder activist campaigns have also created opportunities for private equity firms, and there has been an increase in selling profitable but under-managed non-core businesses.

The third dealflow driver involves public-to-private management buyouts. A wave of de-listings has been triggered by a number of factors, including a revised corporate governance code and takeover guidelines; an increase in activist funds operating in Japan (with the current figure sitting at around 70 compared to just eight in 2014, according to data from IR Japan Holdings); the Tokyo Stock Exchange's request to companies with a price-to-book ratio below one to improve corporate values; and low-cost financing still being available.

Q What are the key value creation levers at play in the market?

Private equity firms can help provide resources for international expansion and bolt-on acquisitions. Meanwhile, the growth of small and medium-sized businesses in Japan is often limited by a lack of managerial resources and funding. Private equity firms may appoint C-suite executives to gain new perspectives on strategies, improve governance and transparency, and to help align the interests of investors and portfolio companies.

Private equity firms also prioritise the improvement of financial and non-financial reporting systems, and review operations including supply chains, marketing, research and development, and sales to streamline and improve management practices. Improvement of reporting systems reinforces governance, transparency and accountability, and enables firms to have visibility over the portfolio company's performance and make better investment decisions.

Japanese companies lag behind in digital transformation, in particular, so extensive use of digital technologies and data analytics to strengthen business will be a key differentiator. Furthermore, as cyber attacks soar, implementation of cybersecurity measures will be of critical importance.

Q How would you describe LP appetite for Japanese private equity?

LP appetite for Japanese private equity has been growing, not least because the region has generated strong returns. According to a survey by the Japan Private Equity Association, private equity funds in Japan outperformed the TOPIX Total Return Index by 9.2 percent between 2012 and 2021.

In addition, the growing acceptance of private equity as a solution for divestitures of non-core businesses, business succession and management buyouts has contributed to a rise in private equity investments in Japan. The country has a diverse industry base with advanced technology and expertise, and solid infrastructure. Japan has been a particularly key global player in manufacturing sectors such as automotive, machinery, electronics, aerospace and biochemistry. We've also seen a rise in ESG awareness among GPs in Japan.

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Private equity professionals' experience levels have increased now that many global and domestic PE firms have been active in the market for 20 years. Their hands-on approach to institutionalising companies, especially family-owned businesses, has created strong exits in trade sales, secondary buyouts and IPOs.

Q How will the Japanese market evolve?

Unlike other regions, Japan's PE market remains strong because debt capital continues to be readily available at a low cost, and the economy continues to be resilient. In particular, we expect public-to-private management buyouts to significantly increase given growing cases of activism and pressure from the Tokyo Stock Exchange to improve capital efficiency and stock prices.

Competition among PE firms will also intensify as new entrants – particularly global players – continue to move into Japan. This means that valuations will remain robust, especially for the largest transactions, and enhancing deal sourcing and operational capabilities will be critical for future success.

We believe Japan will remain an attractive market for PE firms because of its many undermanaged and undervalued companies, and the potential for value creation. Indeed, as private equity becomes more accepted in the Japanese market as its track record grows, the asset class will play an increasingly significant role in consolidating fragmented industries. This will only become more important for the Japanese economy as excessive competition makes Japanese companies less profitable than their counterparts in the US and Europe, in turn making it more difficult for them to compete on a global scale. ■

Satoshi Sekine is co-leader of Deloitte Asia Pacific's private equity practice