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HKVCA Forum: China PE facing tough times

China's deals, exits and fundraising have been disappointing, but panelists at the HKVCA Asia Private Equity Forum agreed that the downs are necessary for the industry to evolve.

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Right now may be "one of the toughest times for private equity in China", CITIC Capital chief executive officer Yichen Zhang told the Hong Kong Venture Capital Association Asia Private Equity Forum today. The country's deals, exits and fundraising totals were all down substantially in 2012.

Zhang said that many GPs promised unrealistic returns in too short a time frame because they relied on the IPO market as the driver of growth. With the IPO window virtually closed, Zhang predicted that investors will begin to be more demanding on how their money will be repaid, and the pressure on GPs will only increase.

"The worst is yet to come," he said.

Over the next two to three years, he believes that 80 percent of the smaller firms in China will not survive.

"The question is, will they come back?" Zhang wondered. "In China, these lessons are never learned the first time."

Part of the problem, he said, is that the industry grew too quickly. Private equity went from next to nothing ten years ago to being a household phrase by 2010, he said in his keynote speech. Indeed, some estimates put the number of GPs in China at 10,000 – more than twice the 4,000 that Cambridge Associates keeps track of in the rest of the world.

Unfortunately, that just meant that too much money was being passed around while the market was still immature – the pool of LPs didn't fully understand the nature of a private equity investment, GPs took a short-term view on investments and returns, and go-betweens like placement agents and funds of funds were few in number.

"The reasons for the downturn were built in from the beginning," Zhang said.

The cause of China's downturn is both structural and cyclical, according to Terry Hu, managing director at FountainVest Partners. Investors "placed too much hope on growth", and in that mindset didn't focus on the companies' needs for operational changes, he said on a Forum panel.

CITIC Private Equity Funds Management president Yibing Wu pointed out that the Chinese private equity industry had similar problems in 2009, with LPs not being faithful to their capital commitments and many existing GPs who actually shouldn't be GPs.

"These times are hard, but in the end they make the industry healthier," Wu said. In fact, he said that his expectation is that the current downward trends will make the private equity industry in China more institutionalised.