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You reap what you sow

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Asian family offices making more direct investments

With the glut of new self-made billionaires in Asia demonstrating a sharper focus on diversifying wealth from their core businesses, the demand for family offices to manage their fortunes has been growing apace region-wide.

In China, where the government has eagerly incubated private companies as a way to shift the country's economic growth engine away from bureaucratic state-owned enterprises, luminaries like Alibaba Co-Founder Jack Ma, Hanergy Chairman Li Hejun and Dalian Wanda Group Chairman Wang Jianlin, have risen to prominence and in the process become some of China's richest men. Notably, these men are first-generation wealth creators still in their prime who have enjoyed rapid capital accumulation in tandem with the growth of the companies they founded.

For this reason, it is still too early for them to think of transferring their wealth to their offspring. Still, China's newly-minted elite are increasingly keen to set up family offices with a view to growing – and diversifying – their wealth. Additionally, outsourcing their wealth management to a family office allows them to concentrate on running their core businesses.

The broader implication, however, is that the still fast-growing base of emerging billionaires in China looks set to fuel the growth of the family office industry in Asia for years to come. According to the *The Institutionalisation of Asian Family Offices* report by INSEAD and Pictet, the number of family offices in Asia grew from between 19 and 53 in 2008 to between 100 and

200 in 2013. Unsurprisingly, the biggest hubs for these outfits are Hong Kong and Singapore. In fact, collectively they are home to more than 75% of Asian family offices established in the region over the past decade, the main reason being their tax-efficient environments. This has also helped attract a number of non-Asian families to relocate or set up family offices in the two Asian finance centres, the report claims.

Major hubs

Claudia Zeisberger

Comparing the development of Hong Kong and Singapore in the family office space, Claudia Zeisberger, the report's author, professor of entrepreneurship and family enterprise at INSEAD, tells *Asia Asset Management* that the competitiveness of both cities is built on their well-established legal frameworks and financial market strength. Despite their long-running rivalry, she argues they play different roles in addressing burgeoning family office demand.

"The choice between Singapore and Hong Kong is often driven by the desired investment emphasis of the portfolio. Family offices with a focus on North Asia will tend to set up in Hong Kong; those with a desire to explore opportunities in Southeast Asia will prefer Singapore," Ms. Zeisberger explains.

In terms of the growing demand from Chinese high-net-worth-individuals (HNWIs), Ms. Zeisberger adds that it is natural for them to see Hong Kong as a preferred base for their family offices. However, in future the ability of the semi-autonomous territory to continue to attract this market will hinge on whether Chinese policymakers can put the kind of favourable framework in place that will convince them to stay onshore.

Hong Kong and Singapore aside, Dubai is another family office destination of note. This is due to its rapid development into a financial hub for wealthy families in the Middle East. As Ms. Zeisberger sees it, the United Arab Emirates' roughly central location between West and East caters well to family office demand, not to mention those looking to invest into the Middle East. The Gulf state is also seen as something of a safe haven for regional assets, given long-running political turmoil in surrounding markets.

The Asian angle

Looking ahead, the growth of family offices in Asia depends on continued wealth creation among this affluent super-class in the context of generally vibrant Asian economies. According to the INSEAD report, the number of ultra-high-net-worth-individuals (UHNWIs) – defined as those with net assets in excess of US$100 million* – grew by 116% from 2003 to 2013, driven by the surge in both economic and capital market activities. Wealth creation in China outpaced the rest of the region, with that country's number of UHNWIs increasing by a whopping 378% over the same decade. In comparison with that absolute number, China also led the way, followed by Hong Kong and Singapore, accounting for 7% and 5% of the UHNWI population in Asia respectively.

Even with the recent slowdown in Asian economies, Ms. Zeisberger expects the growth in numbers of those in the affluent bracket to continue at a consistent rate for the next ten to 20 years.

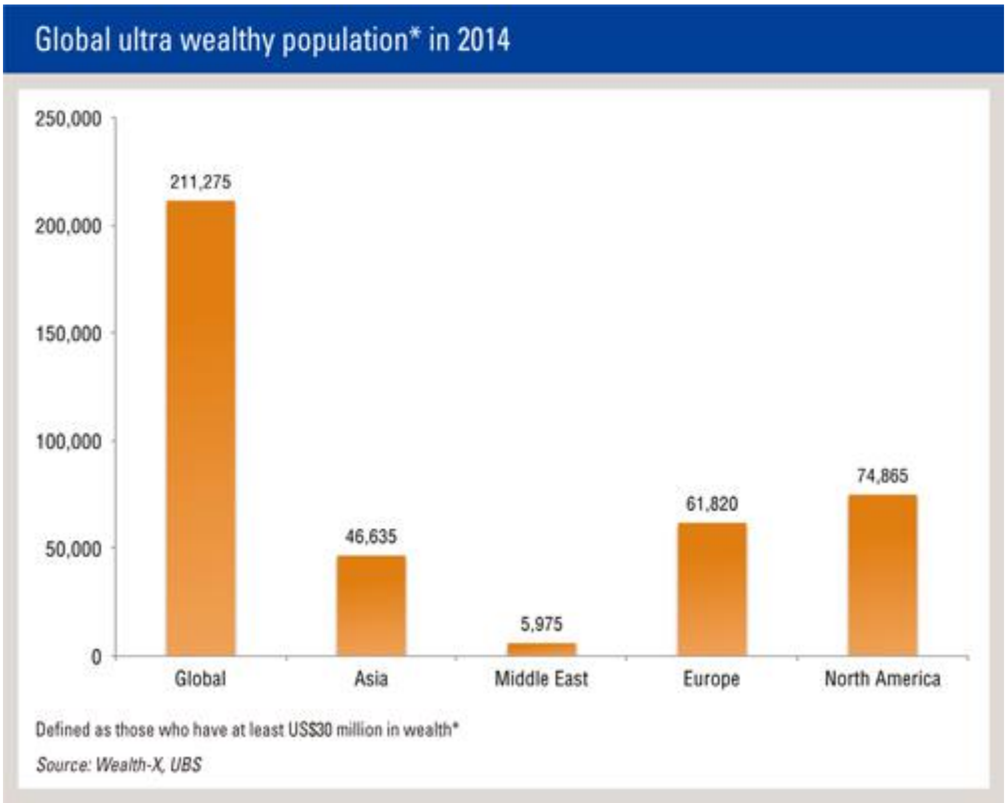
Asian family offices, on the other hand, are still in their infancy, with the sector dominated by single family offices. Given the historical development of this market in Europe, expectations are that the development of multi-family offices will pick up momentum as the industry continues to evolve.

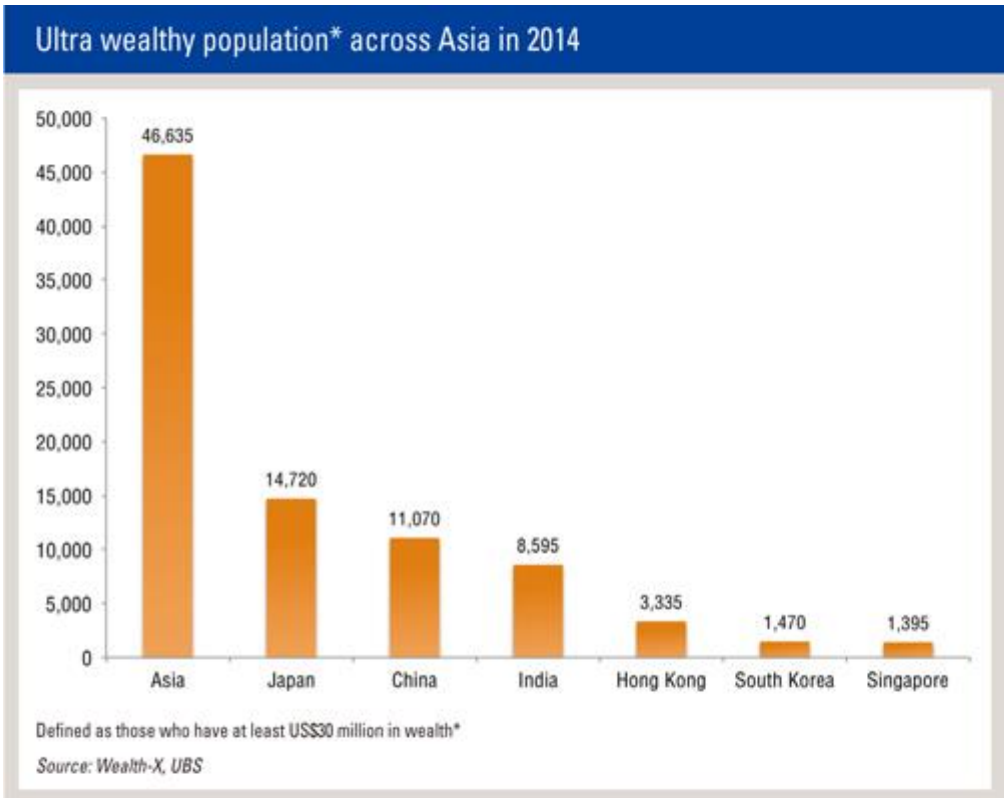
Another trait of Asian family offices is rooted in the wealth transfer stage of the families. The report shows that the majority of Asian single family offices polled manage wealth for families in which either the original wealth creators or the next generation are instrumental in investment decision-making; few are led by the third and fourth generation.

Ms. Zeisberger adds that Asian founders tend to retain tight control over the investment activities of their family offices. At times, this results in a significant investment bias in favour of a particular industry with which they have a solid connection and comfort zone. The downside is that such biases can result in a lack of diversification within a portfolio and so there is a greater concentration of risk.

As for ways to invest, Asian family offices show a clear preference for direct investments in private equity (PE) compared to fund investments. More often than not, this is driven by their desire to forego fees.

"Direct investing obviously gives their families greater control over the timing of the investment entry and exit as well as a higher level of transparency. Of course, it requires a different expertise amongst the investment professionals, such as deal sourcing, execution, pre-deal due diligence, etc. It remains to be seen if Asia's family offices can continue to generate the kind of consistent returns required to attract the right professionals," Ms. Zeisberger points out.





PE investments

Martin Graham

Martin Graham, chairman of Oracle Capital Group, a London-based global multi-family office with Asian clients, tells *Asia Asset Management* that his firm enters into co-investments with its family clients in PE projects. In doing so, the firm takes an active role in sourcing, managing and executing individual PE deals as well as monitoring investment performance.

Mr. Graham explains that appetite for PE deals is driven by their potential to deliver handsome returns: "It is about improving investment returns and diversification. I mean at the moment we are living in an uncertain world. To me, the public markets look overvalued, as there is so much liquidity on the back of quantitative easing. This makes a lot of sense about diversifying the assets from a risk management perspective. You should be doing geographical and asset class diversification, and PE is very good in doing this," he says.

Rupert Chamberlain

Rupert Chamberlain, partner, PE with KPMG China, also sees huge PE investment interest from Hong Kong-based family offices. "For the more established ones, which have been in Hong Kong for many years, I think they have always made PE-type investments. The relatively new ones, which were established in the last ten years and have achieved tremendous wealth in a short period of time, may be exploring different ways in which they will use and invest that wealth," he tells *Asia Asset Management*.

He singles out family offices co-investing in PE as a notable trend, the driver being their increasing sophistication. He adds that these Asian entities are also increasingly likely to team up with their US or European counterparts, aiming to broaden the capital pool for PE investments.

“The type of money they would raise in that context is less likely to be from traditional sources, that is the established limited partners, such as sovereign funds or pension funds. It is more likely to be from other family offices, so you end up creating a multi-family office platform for PE. I can definitely see that. Although some of them have created their family offices to not just do PE, making other investments such as a traditional long-only, hedge-type investments. They feel they can manage other people’s money as well and are often not under the same time pressures to return the capital to their investors,” he continues.

In addition to saving external manager fees, Mr. Chamberlain argues that a major reason for family offices linking up is their lack of enthusiasm for traditional wealth managers. This is a result of the devastating Asian financial crisis, in which many affluent families lost a large chunk of their wealth.

As he sees it, the level of sophistication required of family offices determines the role they take in PE investments. The threshold is generally lower if they act simply as a capital contributor. Still, even a leading family office needs much stronger capabilities if it intends to play a part in strategy formulation for the investee company.

“Family offices will often invest and manage like a general partner from a PE house; they are prepared to do buyouts or, say, buy minority stakes in a company where you then have influence over that company,” Mr. Chamberlain explains. “They will get a dividend from it, but they are participating in that company, helping that company grow and prosper. These factors require a lot more sophistication and management experience.”

Addressing the status quo, Mr. Chamberlain reveals that the more professionally managed multi-family offices have typically developed a strong internal investment team, with a financial controller and chief investment officer on board responsible for taking charge of PE investments.

Interestingly, compared to established PE firms, he believes family offices are, at least to some extent, in a better position to snap up PE deals because they do not grapple with the same regulatory and internal policies as the larger institutions. In addition, having established trust among their investment partners, they can make faster decisions.

“I could see a decision being made much more quickly within a family office PE-type investment. Potentially, they are prepared to take riskier investments as well. Their risk appetite would simply play a role in deciding where they invest. They may be more prepared to invest in those places which have geopolitical challenges.”

In terms of favourite sectors, Mr. Chamberlain cites global real estate, consumer, healthcare and technology as the main areas of interest among family offices searching for fruitful PE investments.

*Note: Discrepancy between UHNWI denotations a result of differing source definitions