



Targeting Asian Investment Opportunities

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1. Introduction and Background

The attraction of seeking out superior investment returns from well-structured investments in Asia's unique markets has never been stronger. Economies in countries such as China, India, Japan, Korea and Southeast Asia all show the tangible potential to continue their strong track records of economic growth in the years ahead. Savvy investors aiming to capitalize on Asia's growth story therefore look set to continue doing so.

But dig a little deeper and—as those with real in-depth Asian investment experience will tell you—the keys to success in this region's markets are important to grasp; yes, you need the right relationships, but perhaps more importantly, you need to understand and position yourself optimally in terms of the investee's other stakeholders and its regulatory structure.

In this alert, we analyze some of the key areas where investors can seek to develop and capitalize on their own "Asian advantage."



2. Trends and Opportunities

Besides the favorable economic fundamentals of many growth-stage economies across the region, there are a number of important factors and trends in key Asian jurisdictions that—if accessed correctly—can provide tremendous investment opportunities.

China – The Powerhouse Opens Up

The emergence of China onto the world's economic and political stages has been accompanied by corresponding reciprocal imperatives—under the auspices of international trade agreements, the World Trade Organization (WTO) and other multilateral agencies—for Asia's largest economy to open up its markets to further foreign trade and investment.

Last year, China shortened its "negative list" of industries into which foreign investment is restricted and introduced a newly liberalized foreign investment law, promising (i) the treatment of foreign investors on no less favorable terms and (ii) the strengthening of other foreign investment protection measures, including for capital inflows, outflows and technology transfers. On the outbound side, China's Belt & Road Initiative continues to further extend its global reach and influence.



Cash-rich Balance Sheets

Reflecting Asia's famously high personal savings rate, many of the region's corporate groups carry significant levels of cash on their balance sheets. While this can drag down ongoing equity returns, it provides a natural hedge to overall market downside risk, as well as representing a field of opportunity for well-positioned and more active investors, particularly where promoters may seek to access cash balances via privatizations or similar deals to rationalize group structures.

Structural Discounts to Intrinsic Corporate Value

Asia's well-established large-cap listed equity markets in Japan, Hong Kong, Singapore and Korea all feature a significant number of corporate groups that have complex, multilayered listed holding structures—for reasons that in many cases are now purely historical.

These types of structures often obscure the intrinsic value of their underlying businesses, as well as presenting a challenge for their promoters and managers, in terms of their objectives in streamlining returns and maintaining practical control. On the other hand, investors who are able to position themselves as instrumental to these promoters in achieving those objectives can generate significant returns for themselves.

Promoter-led Transactions

Many Asian promoters are super long-term investors. They are often in the best position to properly price in the real ability of their businesses to perform and deliver equity returns over the longer term.

Market down-cycles, event-led downturns (think COVID-19) and other push factors (think United States (U.S.)–China trade tensions), as well as family succession planning events, provide significant scope for promoter-led privatizations and other transactional reorganizations. For well-prepared and well-advised investors, these can be attractive opportunities to share in the premium valuations that can accompany those market moves.

The Migration of Equity Listings from the U.S. to Asia

Many Chinese companies have in the past opted to list on NYSE (New York Stock Exchange) or NASDAQ (Nasdaq Stock Market), tapping into overseas capital at the historically higher U.S. equity valuation levels. However, this trend has now reversed to some extent, given geopolitical and other considerations. The likes of Alibaba, JD.com and NetEase have started to “come home” by way of successful secondary listings on the HKEx (Hong Kong Exchange) for these commercial behemoths that are classified as “large innovative companies” under the listing rules.

There has also been a steady flow of Chinese companies being privatized and de-listed from U.S. markets, with many of those businesses later re-listed on one of the Asian exchanges, often at superior valuations. For example, the formerly NYSE-listed Qihoo 360 was taken private for US\$9 billion in 2016, listing on the Shenzhen Stock Exchange just two years later at a valuation of US\$62 billion.

Policy-led Initiatives

Governments around the region have formulated important initiatives designed to achieve policy-led goals and encourage further globally linked growth through greater market efficiency.

For example, in Japan, the Corporate Governance Code has provided an official stimulus to shareholder engagement activities, including shareholder activism. Meanwhile, across Asia there is increasing focus on matters such as environmental, social and governance (ESG) imperatives, as the region's markets and corporates compete for globally allocated capital. In Hong Kong, there are near-term plans for the launch of the Sustainable and Green Exchange (STAGE) finance platform.

The Growth of Private Equity

Asia-Pacific makes up around a quarter of the global private equity (PE) market, with approximately 15–20 percent of all Asian mergers and acquisitions (M&A) deals involving PE players of one type or another. In this context, investors are able to access PE-led investment opportunities as backers of buyout funds or as selling stakeholders in target businesses.

One standout sector in recent years has been India's rapidly expanding internet and tech sector, which has attracted ever-greater amounts of PE capital. Based on the development and current profiles of the more mature U.S. and European PE markets, the size and participation of PE investors in Asian markets looks set to grow significantly, with an increasing proportion of control deals likely.

3. Optimal Structural and Legal Positioning for Investors

With the right approach and advice, the unique structural and legal factors of each Asian jurisdiction can be used to an investor's advantage, from the initial investment opportunity scoping exercise through to the exit point.

Some of these factors are primarily driven by the structure of the market, such as a greater tendency towards family control over listed and unlisted businesses in comparison to the U.S. or many European markets. Other factors result from the unique features of the legal and regulatory systems, which vary significantly across Asia.

There are a number of areas where knowing how best to navigate key legal and structural issues in the particular Asian jurisdictions concerned can provide a real investment edge—below are some key examples.



Foreign Investment Restrictions

Foreign investment restrictions apply in certain designated “sensitive” or “restricted” sectors of all major Asian economies, but thoughtful structuring solutions are available where an investment opportunity calls for it.

Variable Interest Entity Structures

Variable interest entities (VIEs) have long been used in Asian jurisdictions such as China, Vietnam and the Philippines, allowing an offshore entity, via contractual arrangements, to control and receive the economic benefit of, but not own, an onshore operating business in a restricted sector. Investor acceptance of these structures remains high, with many businesses listed on the HKEx and on U.S. exchanges holding their main business interests in the form of VIEs.

In China, VIE structures are most commonly employed in the technology, media, and telecom (TMT) sector and new economy businesses, but the new foreign investment law also remains silent on the treatment of VIE structures. Despite this legal uncertainty, the market expects the relatively widespread use and acceptance of these structures to continue.

Japan's Foreign Exchange and Foreign Trade Act

Political sensitivities in Japan resulted in the June 2020 Foreign Exchange and Foreign Trade Act (FEFTA) amendments applicable to foreign investment into Japanese restricted sector businesses. Foreign investors are now required to file a prior notification with the Bank of Japan before (i) acquiring a shareholding of 1 percent or more (previously 10 percent) in Japanese-listed companies operating any restricted sector business or (ii) voting in favor of any resolution to appoint a foreign investor (or its closely related persons) as a director, or proposing and voting in favor of any transfer of all or part of the investee company's restricted sector business. Investors' calling for larger share buybacks or higher cash dividends—to boost equity returns—is still unrestricted under FEFTA.

The impact of these amended FEFTA provisions on foreign investment into Japan is still being assessed, but in any event, the changes also include useful exemptions, such as those for equity purchases by certain types of foreign financial investors, which will ease the practical effect of these new requirements.

Public Equity Position Disclosures

Equity ownership disclosure is often one of the first questions considered by overseas investors prior to making a public market investment, particularly if investee engagement is contemplated. Time spent planning how to structure an equity position, as between shares and total return equity swap exposure, or other instruments, can pay strategic dividends as the investment plan unfolds.

In all jurisdictions, the disclosure rules for equity interests are complex, but markets such as Hong Kong and Singapore represent the high-water mark, by requiring most material equity exposure positions—whether shares, total return equity swaps or other

equity exposure instruments—to be publicly disclosed. In other markets, such as Japan and Korea, certain total return equity swaps are not publicly discloseable, provided that careful analysis of the terms and factual situation reveals no ability on the part of the swap holder to control or direct title to or voting of any underlying or hedge position in the form of shares held by the swap counterparty.

For short positions and M&A event-driven trades, there are likely to be additional disclosure considerations. Again, suitable analysis and pre-planning can be a key part of de-risking the regulatory and other aspects of those types of large equity trades.

Shareholder Rights – To Protect and Enhance Investment Returns

Many Asian jurisdictions provide for shareholder rights that are not dissimilar in terms of their utility to investors when compared to the standards applicable in other developed markets such as the U.S. and United Kingdom—including rights to nominate directors, convene shareholder meetings and propose value-transformative shareholder resolutions.

Careful analysis is often required prior to the exercise of any shareholder rights, in order to head off any unintended repercussions, such as public disclosure or mandatory offer requirements that can flow from several shareholders acting in a concerted manner to achieve a common, perhaps control-seeking, objective. For example, in Japan, two or more otherwise independent shareholders that have agreed to jointly exercise shareholder rights can be classified as “joint holders.” That can trigger aggregated public disclosure obligations for the investors’ shareholdings or foreign investment approval requirements, blowing an investment strategy off course if those consequences were not properly anticipated.

That said, many of these shareholder rights have proved to be effective tools for shareholders, particularly where more proactive engagement with the investee is called for. In those situations, investors will need to pre-plan the nature of their equity holding to ensure that the relevant shareholder rights can be exercised in accordance with the applicable statutory provisions.

Independent Shareholder Rights in Privatization Transactions

For investors engaged in merger arbitrage or similar activities in the public M&A markets across Asia, it is important to understand the key shareholder or other

approval thresholds that will be impactful as regards the terms and deliverability of the transaction(s) in hand.

Taking the privatization of listed companies by controlling shareholders as an example:

- Hong Kong: It is common for promoter-led privatizations to be undertaken by way of a scheme of arrangement, being a court-supervised takeover arrangement that binds all target shareholders once they vote it through by the required majority. Under the Hong Kong Takeovers Code, such a transaction is subject to minority protections—over and above the basic legal requirements of a scheme of arrangement—including a condition that not more than 10 percent of the votes attaching to all disinterested shares are cast against the privatization scheme.
- Singapore: The approach to minority shareholder protection in this context is to require approval of the privatization proposals by at least 75 percent of the votes cast by independent shareholders.
- Japan: Privatizations can be achieved by way of a statutory merger, which is subject to approval by a majority of at least two-thirds of the votes cast by shareholders. While there is no additional voting requirement prescribed by law, additional safeguards are often included in the terms of the transaction or its implementation. The bidding promoter and the target company board include these terms so as to ensure “fairness” in the transaction and head off challenges from disgruntled minority shareholders that may be unwillingly crammed down into the merger deal. One such safeguard is the inclusion of a majority-of-minority (MOMI) condition in the deal terms, requiring the privatization transaction to be approved by a majority of shareholders who are independent of the controlling shareholder bidder.

We also see differing approaches to the protection of minority shareholders being taken by the in-country securities regulators in this context. For example, the Securities and Exchange Board of India can be publicly interventionist at times, whereas the Japanese Financial Services Authority tends to take a less high-profile approach.

Capitalizing on Equity Shifts from the U.S. to Asia

As the world’s securities exchanges look to attract the best and most valuable emerging tech unicorns, biotech firms and similarly innovative businesses, Chinese companies are at the forefront of global shifts in equity

capital. International investors are able to access a large universe of Chinese businesses listed on regional equity markets such as Hong Kong and Singapore, as well as markets farther afield in the U.S. and Europe.

Asia's equity exchanges have scrambled to amend their rules to accommodate and attract returning Chinese companies. Many of those businesses operate in the technology and new economy sectors and come with dual-class U.S.-style share structures that were previously not welcome on exchanges like HKEx and SGX (Singapore Exchange Limited). The adjusted rules for those exchanges now provide suitable exceptions to the previously inviolate one-share-one-vote principle, paving the way for those returnee companies. In addition, a new NASDAQ-style board for technology

companies was launched by the Shanghai Stock Exchange in mid-2019.

For investors in U.S.-listed Chinese take-private targets, they will be able to benefit from the value underpinning for minority shareholders provided by rules such as post-merger fair value appraisal rights.

Additionally, as investors in companies like Alibaba and NetEase have found, selecting the right business at the right time, as it dual-lists in Hong Kong, can represent a tremendous value opportunity as leading Chinese groups position for their next stage of growth.

4. Developing the Investment Edge

By employing the optimal approach to positioning and structuring investments, well-prepared investors can seek out and capitalize on a broad spectrum of attractive opportunities across Asia's diverse markets.

Incisive, well-informed analysis of the important commercial and legal factors—from inception to exit—is crucial to gaining that valuable edge for investment success in Asia.



About our Asia Practice

Our Asia practice, with offices located in Beijing, Hong Kong and Singapore, serves both Asia-based clients seeking international representation and U.S. and international clients interested in initiating or expanding enterprises in any Asian jurisdiction. Akin Gump's Asia practice offers clients advice and counsel in more than 85 practices linked across offices in Europe, the Middle East, the Commonwealth of Independent States (CIS) and the United States, while focusing on its own core strengths: pan-Asian M&A, energy, transactions, private equity, finance and financial restructuring, investment fund formation and international trade.

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