UBS

Legacy and innovation

Family offices help transform and rejuvenate family businesses via private equity investments

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Foreword

For centuries, succession and next generation development has always been at the top of the agenda for family enterprises. What is at the stake is not only a monetary concern of wealth transfer but also the challenging task of preserving family legacy and prosperity for generations to come. Both family businesses and the next generation of successors are constantly looking for ways to transform in order to find their place in a rapidly evolving world.

The next generation, equipped with innovative mindsets and higher risk tolerance, follow their entrepreneurial spirits in ways different from their predecessors. Instead of following their parents' footsteps, many of the next generation are now playing multiple roles in the pursuit of a variety of aspirations, especially in regions with a more vibrant economy. Many of the next generation are eager to explore new frontiers and launch their own ventures while preserving family legacy.

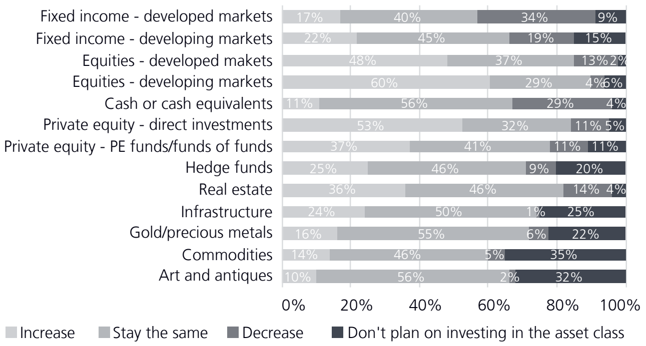
In a world of relatively low fixed income yields, many family offices are looking at growth assets with attractive returns, including private market investments. Some family offices across the Asia Pacific have already initiated their journeys in private equity investments to embrace vigorous growth opportunities at home, while building up credentials and discovering their roles in their family business along the way.

1.0

Large family offices display heightened appetite for private market investments, particularly in the Asia Pacific

Despite intermittent geopolitical and economic uncertainties, UBS Global Family Office Report 2021 shows that large family offices are likely to see private market investments accounting for a high proportion of their alternative asset portfolio[1]. This generally includes private equity, real estate, hedge funds and commodities, as wealthy families look to embrace tomorrow's innovations and disruptions in a different way from traditional public market investments.

Planned changes to asset allocation in the next 5 years



According to UBS Global Family Office Report 2021, 53% respondents plan to increase allocation in direct private equity investments while 32% will retain the same levels of investment. For private equity funds and fund of funds, 37% respondents will increase allocation, while 41% will maintain the same amount of allocation. Only 11% responded that they intend to decrease allocation for both asset categories.

Most family offices with an AUM over US$500 million are sophisticated investors and their heightened appetite for private market investments can be attributed to a number of factors: concerns over high valuations in equity markets, a relatively low yield environment, solid returns from alternative asset classes in 2020, and increased access to direct private equity via private equity secondary markets.

The taste for private markets has always been prevalent in Asia Pacific, particularly in Mainland China. As many founders of wealthy families in Mainland China have built their own businesses from scratch, they have an inherent enthusiasm for playing a major role in growing businesses personally. Participation in private markets allows family businesses to obtain first hand market information, opens up new venture possibilities and creates a platform to meet with the next generation of entrepreneurs and business partners in the process. Another reason specific to families in the Mainland China is that the Chinese stock market is still in the process of maturing and institutionalizing, meaning that there has not been a lot of experience in wealth preservation and growth from the stock market.

Wealthy families may have two types of diversifications involving private market investments, the first being horizontal diversification covering strategic investments related to the core business of the family enterprise, the other being vertical diversification within the family portfolio for the purpose of long-term wealth preservation and appreciation.

"There're two investment offices within my family group, each assigned a different goal and are run independently," noted our Filipino respondent Mr. X, who was a third generation of a prominent wealthy family from the Philippines. His family owns one of the largest family enterprises in Southeast Asia with its core business traded on the Philippine Stock Exchange. "The private equity investments under the public company tend to be directly strategic to the family businesses while the family office tends to make purely financial investments, including two thirds in fixed income investments, and the rest in cash and equity investments." He added that his family is looking to change allocation in order to factor in higher risk exposure and a longer investment horizon.

[1] Datasource: UBS Evidence Lab / UBS Global Family Office Report 2021

2.0

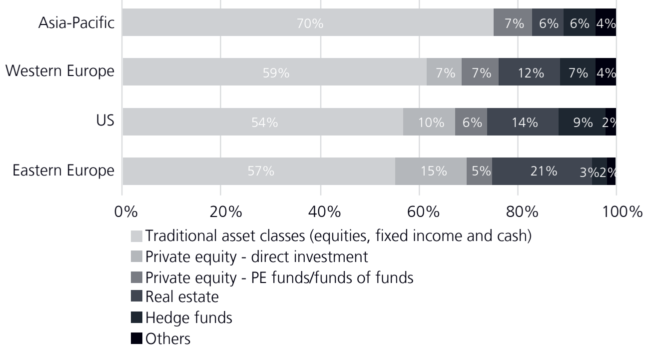
Investment trends of family offices in the Asia Pacific

2.1

Family offices embrace vibrant growth opportunities at home

Traditional asset classes (i.e. equities and fixed income investments and cash) in Asia tend to take up a higher percentage than global average (70% vs. 60%, according to UBS Global Family Office Report 2021) as Asian wealthy families typically allocate a large percentage to public investments in developed markets to diversify from their home regions. Yet, this is changing, with Asian respondents now investing 55% of their portfolio at home.[2] The robustness and resilience of Asian economies, especially China's compelling growth story, continues to lure Asian family offices to long home investments. Being in home markets also allows family offices to play to their strengths in local investment circles, including deal sourcing, fundraising, and making resources available to portfolio companies based on their development need, which they were otherwise not able to leverage in passive investments in traditional asset classes.

Asset allocation of family offices by region



When speaking about the role of family offices in PE and VC deals, Pokman Yiu, director of Hong Kong-based multi-family office Basel Capital and also single family office principal and next generation of a real estate family business, explained that "we don't get involved in their daily operations as the founders know what they're doing. We're there to add value to their business. For example, we can bring in other VCs for the subsequent financing rounds, and bring in some senior contacts from various industries for business development or expansion into new markets. For later-stage companies, we can introduce investment bankers to underwrite IPOs."

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[2] Datasource: UBS Evidence Lab / UBS Global Family Office Report 2021

2.2

Major models of private equity investments adopted by family offices

Private equity investments primarily take the form of three models: direct investment, investing in private equity funds, and fund of funds, with direct investment requiring the most involved execution. While only 30% of family offices reported investment in direct deals in both 2020 and 2021, the percentage of survey respondents investing in both funds and direct deals jumped from 31% in 2020 to 47% in 2021.[3]

Growing interest towards direct investments and private equity funds has been accompanied by calls for more established investment management and advisory functions around family wealth. One factor that drives the development and maturity of the investing functionality of family offices is the level of sophistication of the local PE/VC market.

Many wealthy families and family offices can learn from and emulate the best practices of private equities and venture capital, including formulating investment strategies, devising investment themes for each asset class, and installing risk management and control policies. Using those as a starting point, they then need to customize according to their own investment objectives and competitive edge, and deploy a flexible combination of investment models based on the underlying opportunity.

One key consideration is investment time horizon. "Family wealth management lasts through multiple generations and therefore has a much longer time horizon than most institutional investors," says Jeremy Cheng, researcher with the Center of Family Business at the Chinese University of Hong Kong. "In order to formulate a sustainable approach with a long-term view, such as the balance between wealth growth and preservation, there should be clearly defined investment criteria and performance indicators that cater to the needs of the family from the very beginning."

"Every family is unique and so is every family office, and each family should find the appropriate business model that meets their exact needs. Many Asian families have been active in private equity investments for many decades but have not yet professionalized their investment functions and processes. Many families are now considering setting up their single family office to further professionalize their investment activities. This often involves establishing a proper and structured investment process, hiring a team of professional investment specialists, setting up an appropriate IT infrastructure for portfolio management and reporting purposes, and more importantly establishing a proper governance framework in place to have the right structure for checks and balance. Some family offices tend to adopt an outsourcing model where some of these functions would be outsourced to third parties. For instance, the asset allocation function could be outsourced to external "CIO" such as UBS"

Peter Lee,
Executive Director, Head of Family Advisory APAC at UBS Global Wealth Management

[3] Datasource: UBS Evidence Lab / UBS Global Family Office Report 2021

2.3

Knowledge of underlying markets and access to investment opportunities are key success factors

When it comes to exploring new investment areas, mainland Chinese families are more inclined to bring in trusted investment managers in-house, while family offices in Hong Kong and Southeast Asia tend to be more established, hence more likely to partner with other investors and deploy a combination of all three models (direct, funds, fund of funds) depending on the underlying investments.

"We've been more active in direct investment opportunities, especially in emerging sectors in recent years, and we expect this trend to continue," noted Wenwen Deng, a third generation member of a wealthy family from Guangzhou and a winner of 2020 Hurun China Under 30s To Watch. She founded Wohua Investment Fund, a real estate investment fund that focuses on the restoration and renovation of old city centers in Greater China. "Our family office strategy includes building a team of seasoned professionals from top-tier institutions. We're very selective in choosing the right managers, and once we build mutual trust, we defer to them for the majority of investment decisions and aim for long-term collaboration."

Other family offices may look for help from intermediaries and other peer family offices for expertise in the target investment market and access to funds and opportunities.

Family offices in Southeast Asia are comfortable in collaborating with various institutions. "We look at private equity deals, opportunities recommended by private banks and from private equity funds," says Mr. X, describing his family office strategy. "We rarely do direct investments, and when we do look at direct investments, they do not necessarily come from private banks. We do also speak with other agents as well as the investment targets directly. We have engaged one investment advisor to do a smaller portion of family office portfolio as an experiment, just to see if we can get a different deal flow and also to judge the quality of investment advice compared to private banks."

In relatively developed markets like Hong Kong, some of the next generation seize the career opportunity to become an investment principal themselves. Mr. Yiu had prior working experience in M&A, IPO and debt financing at investment banks for over eight years and so spearheading PE/VC investments in family office became a natural choice. On choosing different models of private equity, Mr. Yiu explained that it would depend on in-house capabilities. "In terms of our investment process, we will identify different themes for each asset class, and for each asset class we will find the right investment approach – whether we can invest into a fund, find a good manager and deploy capital, or co-invest with the fund, or even form a partnership with a GP. And of course we can choose to do it in-house."

"The private equity and venture capital ecosystem in Hong Kong started to take shape in the 1990s, which has been relatively US-centric. Hong Kong family offices are generally more sophisticated compared to other Asian regions (excluding Japan). The PE/VC market in Mainland China did not develop until after 2000s. These Chinese GPs leverage knowledge and practices from developed markets while quickly adapting to local ecosystems and have gradually become more sophisticated."

Francis Liu,
Managing Director,
Head of Wealth Management Taiwan
International and Ultra High Net Worth
APAC Segment Lead at UBS Global Wealth
Management

3.0

Next generations forge new career paths through investing while helping to rejuvenate their family business

Across the Asia Pacific region, billionaire business families are seeing more of the next generation embarking on a career in investing or establish their own start-ups, sometimes in industries outside of their core business, instead of inheriting family businesses. Some of the high profile next generation investors include C Ventures' co-founder Adrian Cheng, Black Hole Capital's founder Zhang Liang and Zhu Yihang, son of Hopson Development's founder in charge of his family investment holding group.[4] The list keeps on getting longer. The goal of establishing investment platforms is not only to obtain financial returns, but also help to evolve the existing family business while forging new paths for the next generation themselves.

"There are two main purposes for family offices to invest in private equity. The first obvious reason is to achieve financial returns. The second reason is less tangible but it is equally or more important than financial returns - it would help the next generation to discover their purpose and passions. We therefore often advise our clients to set up their family offices beyond investment activities. The next generation can really benefit from learning new ideas and skillsets outside of their family business via private equity investments", Peter Lee, Executive Director, Head of Family Advisory APAC at UBS Global Wealth Management, commented.

Younger generations usually have different areas of interests from their predecessors and are more open-minded in terms of embracing innovation and disruptive technologies. Getting involved in the investment process gives the next generation extensive exposure in learning about business, industries and operations. Next generation learn side by side with professional managers, whether in-house or outsourced vendors, throughout the investment process, while building up and extending family networks in the underlying space.

Both Mr. X and Mr. Yiu position themselves as investment managers of their respective family offices in the long-run and admit the importance of deal execution experience as a key training process. Mr. X comments that "learning by doing has been helpful… personally speaking, I always find practice and hands-on experience more efficient than learning from theories."

Mr. Yiu highlights some key success factors for the next generation to become expert investors in the alternative space. "Accumulate knowledge and a network in order to get to know and learn from the best investors, form an advisory board comprising of a team of industry experts, and spend time learning from GP and networking with LP." Deal execution provides a one-stop shop learning platform.

[4] Shu Su, Jiali Zhou, "I quit taking over family business, and start an investment career quietly," https://news.pedaily.cn/202104/470698.shtml, PE Daily, April 30, 2021

"The next generation are not only a readily available 'extra pair of hands', but also a valuable sounding board or source of fresh ideas. Let them make and learn from their mistakes before taking the helm of the larger organization. They may not be ready to take over key strategic operations at the moment, but they would likely to be in a better position to lead in the next disruption."

William Chou,
Deloitte Private Asia Pacific Leader and Global Family Enterprise Leader

Chinese wealthy families, however, take a different approach for educating and grooming next generation. "My parents always reserved a seat for me during board meetings when I was growing up," recounted Ms. Deng. "I also worked in the real estate industry prior to joining the family business."

The next generation, whose fresh perspectives naturally make them a driving force of innovation, are more likely to play a bigger role as the 'intrapreneurial change agent' in first- and second-generation family businesses. In family businesses where the founding generation is still active and possess a strong entrepreneurial drive, high risk tolerance and an openness towards change, new ideas are not just tolerated but encouraged by family leaders.[5] The idea of wealth creation is much more appealing in developing regions such as Asia Pacific where most family enterprises are within three generations, whereas in Europe the next generation are often of the sixth or seventh generation.

Ms. Deng's family businesses are in education, property development and hospitality. With the younger generation taking an interest in finance, the third generation are exploring new business models, including the introduction of real estate funds that leverages fund financing, and help transform the existing business. "My parents have always been very open-minded with business ideas from my generation. They even encourage me to take a try with cryptocurrency as a learning experience, even though I personally think it has yet to become a viable investment theme," commented Ms. Deng.

[5] UBS, "Voices of next gens: Family wealth at the crossroads of legacy and impact," May 2021.

4.0

Conclusion

Most prominent wealthy families in the Asia Pacific are showing greater interests in growth assets with attractive returns, particularly in private equity investments, and we expect this trend to continue as these families embrace robust growth opportunities in the region. Private equity investments allow wealthy families and their family offices to leverage their home advantage to provide portfolio companies with local resources (social capital), and also present effective training space for the next generation of family leaders to build up track records and realize their own business vision.

Family offices across the Asia Pacific are at different development stages, with those based in Hong Kong being the more sophisticated in the region (excluding Japan). However, replicating the best practices from mature markets will not be sufficient for wealthy families in the developing markets. The challenges that lie ahead include finding unique paths and sustainable investment models customized for the local market, especially in rapidly evolving economies with intensifying competition and lingering uncertainties about the pandemic.

We summarize the following steps to success as wealthy families define and refine their private market investment protocols:

- Institutionalize investment activities and strengthen the investment functionality through the set-up of family offices
- Learn from the best and brightest investors, but also find your own edge and path tailored to the local market and investment ecosystem
- Deploy a flexible investment model and leverage resources from peers and third party advisors to accumulate knowledge of underlying markets and gain access to investment opportunities

With the founding generation embracing a mindset of wealth creation and openness towards change and with the help of family office professionals, private equity investments will certainly provide next generations with effective means of development, a chance to expand their family business territories and the foundations from which to lead in the future.

Acknowledgement /Contributors

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