Regulations Hindering Private Equity Investment

– Perspectives of US Venture Capital –

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WARBURG PINCUS

Warburg Pincus (WP)

- One of the largest private equity firms
- Founded 30 years ago
- Invested in 450 deals over the last 30 years
- Large capital funds
  - Outstanding investments: $11 billion, Funds available: $5 billion
  - Investment per deal: $10 million to $500 million
- A group of 100 specialists in various industries such as IT, Healthcare, Financial Services, Business Services, Energy, and Real Estate from early stage to LBO/turn around situations
- Superior performance
- New York, Silicon Valley, London, Munich, Hong Kong, Tokyo, Singapore, Seoul, Beijing
- Active investments in Japan since April 1999

WP's Investment Philosophy

- Select outstanding management team to create value
- Active engagements in portfolio companies' management
  - Participate in board of directors
  - Strategic input
  - Equity stake of 20% - 80%
- Long-term investment – Investment period of 5 years or more
- Not asset acquisitions, but investments in corporations
- Return from capital gain, not from dividends or interest
- Investor – Not a manager of day-to-day operations
- Public or private companies, all phases of business
- Interest aligned among partners, with management teams and LPs

Difficulty in Investing in Japan

- Stakeholder capitalism as opposed to shareholder capitalism
- Lack of corporate governance
- Low level of information disclosure
- In principle, if it is not written in law, it is prohibited
- Uncertainty of tax treatment

Corporate Governance / Lack of Disclosure

- US:
  - ERISA laws require executing voting rights at general shareholders meeting
  - A detailed agenda and proposals are sent 60 days in advance; investors are given sufficient time to review and make decisions
- Japan:
  - Trustees, insurance companies, and assets managers, not pension fund managers, execute voting rights
  - Agenda for shareholder meeting without details is sent only 2 weeks before a general meeting
  - Directors of the board consist of internal employees
  - CEO’s full discretion and non-disclosure of compensation of directors result in lack of corporate governance from shareholders view

Areas of Improvement in Revised Commercial Code

- Flexibility of issuance of different classes of shares
- Abolition of limitation on parties to whom a company can grant stock options
- Change regulation on minimum asset per share
- Abolition of upper limitation on the number of shares a company can issue
- Lift of ban on pre-IPO equity financing

Areas Where Continued Regulation Changes Are Necessary

- Minimum capital requirement (currently 10 million yen for K.K.)
- Subsequent incorporation: Difficulty in incorporating by contributing assets in lieu of cash; court-appointed inspector’s investigation is required for acquisition of assets worth 5% or more of capital within 2 years from incorporation
- Dividends in kind: Payment-in-Kind Securities (Interest and dividends are paid in form of security) are deemed impossible in Japan
- Corporate mergers and divisions: Issue/distribution of the following other than voting securities
  - Subsidiary Stock, Convertible Bonds, Preferred Stock
  - Cash-out Merger (Distribution of cash, not stock, for absorption mergers)
- Can exemptions be made for “comprehensive transfer” of contracts in spin-offs?
- Commercial banks’ ability to obtain collateral on demand has hindered development of corporate bond market.