

Still golden?

Cracks are beginning to show in Southeast Asia's tech space but so are counterintuitive bright spots



- ▶ Q&A: Jungle Ventures' Amit Anand
- ▶ The rise, rise (and fall) of crypto
- ▶ GP profile: Falcon House Partners



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AVCJ Southeast Asia conference issue

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Southeast Asia in six trends

1 Robust growth-stage activity

Southeast Asia is seemingly – perhaps temporarily – immune to the weakening sentiment on early and growth-stage technology investment. The region-wide total has fallen for three consecutive quarters, driven by a sizeable drop-off in China and flatlining activity in India. Investment in Southeast Asia, meanwhile, rebounded from USD 2.8bn in the first quarter to USD 3.5bn in the second. This follows deployment of USD 16.4bn in 2021, which represented a threefold increase on the previous year. As buyouts in Southeast Asia of meaningful size

remain an intermittent occurrence, minority equity activity in the technology sector has become a key part of the broader investment ecosystem, with more mature start-ups now viable targets for global and local private equity players. There were about 20 funding rounds of USD 50m or more in 2020. The total surpassed 50 in 2021 and there were 40 more in the first half of 2022, with the likes of Insight Partners, Coatue Management, Accel Partners, Tiger Global Management, and DST Global represented. Will they stick around if the temperature cools?

2 A fundraising challenge

Growtheum Capital Partners has set an aggressive fundraising target. The firm, established by the former head of GIC's direct private equity investment group in Southeast Asia, is seeking USD 750m and has already accumulated approximately USD 400m from non-institutional backers. Should this ambition be realised, the fund would be the largest first-time private equity vehicle raised for deployment in Southeast Asia and one of barely a dozen overall to surpass USD 700m. It underlines the challenges of raising capital for a sub-regional private equity strategy. The annual average total

for the past five years is USD 6bn, the same as the five years before that. Over these two periods, the buyout and growth equity average declined from USD 3.1bn to USD 2.5bn, while venture capital rose from USD 590m to USD 2.1bn. Navis Capital Partners and Northstar Group, historically among the largest private equity players, both raised less in their current vintages than in those preceding. Meanwhile, local venture capital firms are launching growth-stage funds, Southeast Asia-India crossover strategies are proving popular, and Sequoia Capital secured USD 850m for its first stand-alone Southeast Asia vehicle.

3 Temasek spreads its wings

Unlisted assets have served Temasek Holdings well. Exposure has grown fourfold over the past decade, reaching SGD 210bn (USD 151bn), while annual returns have exceeded 10%. As of March, unlisted assets accounted for 52% of the entire portfolio, up from 45% a year earlier. The mainstays of Temasek's unlisted exposure remain privately held Singapore companies such as real estate developer Mapletree and utility SP Group. In percentage terms, however, they have become less significant: they were 58% of SGD 53bn; now they are 36% of SGD 210bn. The fast risers are positions in other private companies

(26%, of which 10% is in early-stage start-ups) and asset management (20%). The latter includes Vertex Holdings, an umbrella entity for various VC operations, and Sevia Holding, which is responsible for Azalea Investment Management, InnoVen Capital, Fullerton Fund Management, and Seatown Holdings International. Vertex's efforts to boost its share of third-party capital are relatively well-established and include tapping the secondary market. Increasingly, the businesses under Sevia are also being encouraged to fill out their product portfolios and become more proactive in engaging with external investors.

4 Singapore vs Hong Kong

Can Singapore supplant Hong Kong as Asia's preeminent private equity hub? The debate has been bubbling away for years, initially shaped by Singapore's proactive approach to taxation and fund structuring. It created tax neutral structures for offshore funds, built up a collection of double taxation agreements and made them accessible, and introduced onshore fund entities. Hong Kong was left playing catchup. More recently, the debate has taken on a political edge as members of the broader financial sector consider the implications of mainland China's tighter

hold on Hong Kong. The head of PE at Alberta Investment Management Corporation (AIMCo) explicitly referenced geopolitical issues when explaining the decision to set up an Asian base in Singapore rather than Hong Kong. Other evidence is largely anecdotal but far-reaching: private wealth moving from Hong Kong to Singapore; Chinese tech companies setting up international headquarters in Singapore; and private equity firms reassessing where additional Asia-based headcount should be located. It remains to be seen how pervasive this trend becomes.

5 Local listing options

Stock exchanges in Southeast Asia have recognised they must embrace local technology companies or watch them go public in other markets. This transition has involved some regulatory adjustments, a loosening of listing requirements, and above all, overcoming a longstanding aversion to pre-profit business models that base valuations on future growth and long-term scope for monetization. Consequently, the Jakarta Stock Exchange accounts for more than 70% of the total proceeds from private equity-backed IPOs in Southeast Asia since the start of 2021. E-commerce platform Bukalapak

went first, raising USD 1.5bn. Ride-hailing platform turned super app GoTo followed with USD 1.1bn. Both are trading at discounts to their IPOs prices (the former substantially, the latter slightly), but industry participants are still bullish about the long-term prospects of local listings. In some cases these will complement listings outside the region, although perhaps not mergers with US special purpose acquisition companies (SPACs). Meanwhile, Singapore is also looking to position itself as a technology IPO destination, rolling out late-stage and pre-IPOs funds and creating a local SPAC structure.

6 Vietnam moves up

There is no question that investors remain bullish on the Vietnam growth story. It possesses many of the qualities that draw GPs to other markets in Southeast Asia – a young upwardly mobile population, huge potential in terms of technology adoption – yet it is politically and structurally different. Based on capital deployed between 2012 and 2016, Vietnam was Southeast Asia's fourth most popular market. In 2017-2021, it placed third, as investment surged 3.5x to USD 9.2bn. Singapore and Indonesia remain significantly larger in US dollar terms, but their growth over the same period was 2.6x and

2.5x, respectively. There is significant interest in all aspects of technology transformation, sometimes from significant investors. In the past 12 months, KKR has backed a small business digitalisation platform KiotVet, Andreessen Horowitz has entered the non-fungible token (NFT) space with Axie Infinity, and TPG has joined those supporting Masan Group's ambitious plan to rethink modern retail through The CrownX. Still, there are obstacles that must be negotiated, notably a patchy track record on exits, a limited number of truly high-quality assets, and a paucity of local private equity talent.

Southeast Asia tech: Resilient with an asterisk

Southeast Asia's booming tech space no longer lends itself to an easy narrative. As start-up fever cools globally, the region charges forward. Cracks are beginning to show but so are counterintuitive bright spots

Rising interest rates coinciding with rising inflation while geopolitical tensions and pandemic aftershocks imperil supply chains for talent, capital, and essential commodities has proven too much for venture capitalists. Globally, start-up funding is estimated to have fallen 19% quarter-on-quarter and 39% year-on-year during the three months June. This isn't happening in Southeast Asia.

The tech investment explosion that characterised 2021 remains on track to repeat itself in 2022. Having jumped 187% to about USD 6.3bn last year, total VC deployment in Southeast Asia had reached USD 3.1bn by the midpoint of 2022. This holds true across early-stage and late-stage markets, according to AVCJ Research, with the latter representing a mix of VC and growth-oriented private equity.

The idea that Southeast Asia is merely lagging the global trend overshadows this phenomenon. But continued bullishness for companies entering the listed markets – typically canaries in the uncertainty coalmine – suggests otherwise. Deloitte Singapore recently noted that proceeds from IPOs on the Singapore Exchange (SGX) reached SGD 572m (USD 406m) in the first half of 2022, up 70% year-on-year.

During the same period, the local tech board, known as Catalyst, tripled its number of IPOs to six while doubling proceeds to an admittedly still paltry SGD 44m. Action on the mainboard included three listings via private equity-backed special purpose acquisition companies (SPACs) that raised a combined USD 528m. These vehicles have yet to find merger targets, but they are looking in the technology sector.

“Tech start-ups in Southeast Asia have



“We see a wave of Southeast Asia unicorns going to the US for listings in search of better liquidity and valuations”

– Darren Ng

been growing remarkably, and we see a wave of Southeast Asia unicorns going to the US for listings in search of better liquidity and valuations,” said Darren Ng, disruptive events advisory deputy leader at Deloitte Singapore.

“This phenomenon may help SGX’s secondary listing market breathe new life, with Southeast Asia companies listed in the US looking to move closer to home to tap investors familiar with their brands and benefit from extended trading hours by trading on more than one exchange with different time zones.”

The great withdrawal

Nevertheless, global investors coping with deflated portfolios in their core markets are said to be scaling back. They are expected to continue their retreat in the second half of the year.

The pull-out of brand-name late-stage investors is mostly anecdotal at this stage, but the anecdotes are vivid. One investor told AVCJ that Tiger Global Management recently pulled out of several Indonesian deals that were on the brink of closing. Tiger Global – a hedge fund that routinely dips into late-stage private rounds – has reportedly seen 52% of its value wiped out this year amid tech stock selloffs.

Further evidence of a growing late-stage vacuum can be inferred from regional tech giants slimming down to make ends meet.

Singapore-headquartered super app Grab, which listed on NASDAQ last December at an enterprise valuation of USD 30.4bn, confirmed last month it would slash 5% of its team. It coincided with financial technology provider StashAway cutting staff by 31% and Sea-owned e-commerce platform Shopee laying off parts of its food delivery and payments teams in Southeast Asia.

The risk here is that if a longstanding growth-stage funding gap in Southeast Asia is exacerbated in the medium term by a drought of fly-in capital, it could effectively decapitate the ecosystem, prompting many global LPs to return to their home markets. The number of Fund IIIs and Fund IVs that have attracted institutional support is growing, but it is unclear if it has hit critical mass.

“There are some green shoots in Southeast Asia, and it’s too early to say whether they’re going to die. As long-term investors, once we start in a

region, there have to be really dire consequences before we’ll move out,” said Sunil Mishra, a partner at Adams Street Partners, which has fewer than 10 GP relationships in Southeast Asia.

“We built out our exposure because we thought the market had reached a certain scale with supply of talent, capital, management teams, and exit avenues. But those things have to be continuous because as an ecosystem play, venture is a relay race. If you drop the baton once, you’ll never finish.”

From this perspective, the key lesson of the global tech rout for Southeast Asia could be that indigenous, on-the-ground growth-stage capital is an indispensable part of the proverbial relay team.



When Asia Partners, one of the only dedicated growth-stage VC investors in Southeast Asia, was set up in 2019, the firm estimated it was 100 times harder for a company to raise a Series C or D round in the region than in the US, and five times harder than in China. Asia Partners put the growth-stage gap at USD 1.1bn.

Last month, the firm led an USD 80 Series F for ShopBack, an e-commerce rewards start-up with exposure to a looming recession in the form of discretionary spending categories, deferred payments, and point-of-sale consumer credit. The company claims down-market protections in services that help consumers budget for groceries and avoid predatory lending.

“Notwithstanding macro headwinds, fundamental socio-demographic drivers – including an emerging middle class, skyrocketing mobile and broadband internet penetration, and the emergence of a digitally native generation into the workforce – will be the driving force behind the sector in the medium to long term,” said Nick Nash, co-founder of Asia Partners.

Early-stage investors are moving into this space, with the likes of Jungle Ventures, Openspace Ventures, and East Ventures raising growth funds. Questions remain, however, to what extent these efforts could counterbalance an extended absence of global players, whether more regional middle-market or buyout investors are able to participate in pre-IPO deals, and how many more early-stage players can join the party.

Golden Gate Ventures aimed to raise a USD 200m growth fund for Southeast Asia in 2019



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alongside Korea's Hanwha Asset Management. It ended up with less than USD 80m and eventually reclassified the project as an "opportunities fund." The vehicle is now fully deployed, and Golden Gate is squarely focused on early stage, citing more reliable upside amid growing pressure on tech valuations.

"When we invest at seed or Series A, the valuation is well below USD 40m. Whether we end up exiting at USD 1bn or USD 2bn, it's still an amazing outcome for us as a fund. So, we're less affected by these fluctuations," said Michael Lints, a partner at Golden Gate. "We know those [later-stage] valuations are going to be compressed this year, but if we invest early enough, we can have a good outcome."

Like many early-stage players, Golden Gate has not decelerated its pace of deployment this year, but that is in the cards. The foreboding is largely connected to an industrywide sense of déjà vu around the implosion of WeWork in 2019. The episode saw the US co-working start-up retract USD 47bn in valuation in a matter of weeks due to governance problems around a high cash burn consumer-driven model.

Due diligence around defensible competitive advantage, unit economics, and the path to

profitability became more strict, fair-weather investors pressed pause, and valuations retracted. If the current weeding out period follows pattern, these outcomes will creep into the early stages.

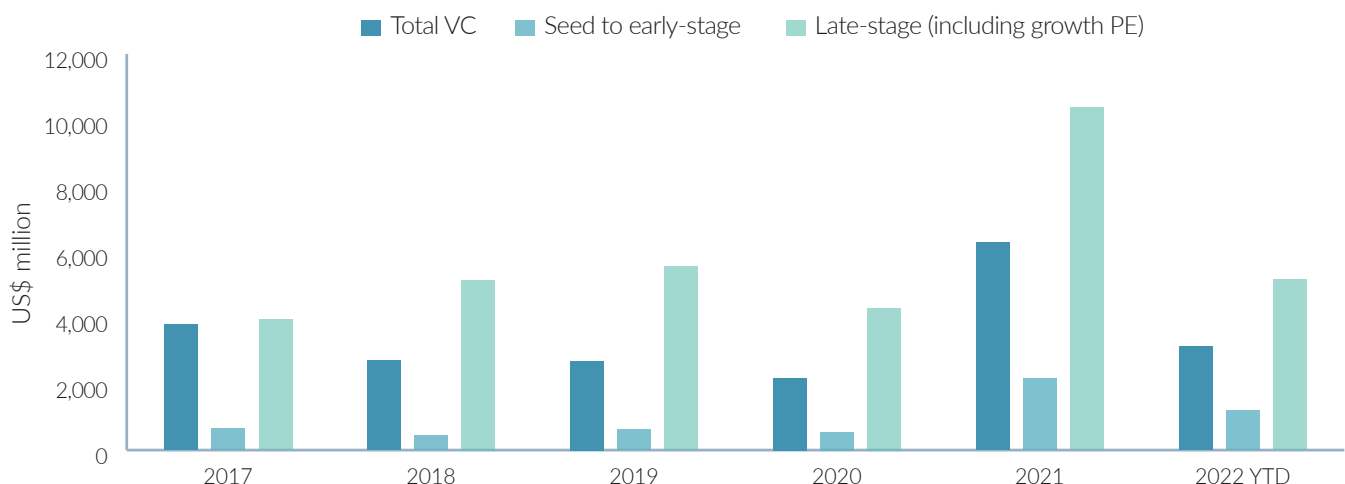
"A lot of investors are seeing things they've not seen in 15 years seen like high inflation and high interest rates together. Down-rounds only happened in textbooks in this venture world. They will clearly happen more. Down is the new flat. Flat is the new up," said one investor. "If your business model is not designed to sustain a focus on profit, it will be very challenging to maintain."

Pan-Southeast Asian early-stage investor Monk's Hill Ventures is juggling these ideas, tracking confidence in the region even as it slows down its pace of deployment.

The GP is currently finalising fundraising for its third fund – Fund II closed on USD 100m in 2020 – with more than 80% of the capital coming from long-term institutions in North America. Family offices and high net worth individuals proved to be more reactive, short term-driven and content to hold cash as the macro situation shakes itself out. It's worth noting that the fund was largely raised last year.

At the same time, Monk's Hill is taking a cautious approach, maintaining a portfolio

Southeast Asia tech investment



Source: AVCJ Research

where 80% to 90% of companies have both growing revenue and positive contribution margins. Flat rounds are starting to come into view, but an economic bounce related to post-COVID tourism and pent-up spending is dominating sentiment.

"We're seeing fewer quality deals that we can get conviction around. There's still a bit of expectation for high valuations, and some founders are deciding to wait out the storm. But directionally, we're going toward a positioning where founders are going to be a lot more flexible on valuations as macro issues hit home," Kuo-Yi Lim, co-founder of Monk's Hill said.

"There's a real sense of uncertainty at this point. People are expecting things to change and more likely worse than better."

Changes afoot?

A shift in valuations and increased scrutiny around financial metrics would not be the only changes in a downturned Southeast Asia. There is a general consensus that the ratio of consumer to enterprise models would tilt toward the latter – and that this is already happening. It will translate into more cross-border transactions by small businesses and investment in the relevant supporting infrastructure.

A new mix of players is also possible. Family offices, while often regarded as more reticent in times of increased uncertainty, are tipped to ramp up their exposure to technology for strategic reasons. Indeed, Singapore's Jungle Ventures closed its fourth early-stage fund last month at USD 600m with about half the corpus coming from family offices, a massive increase on Fund III.

Sector funds and corporate VC are also seen as growing parts of the tech scene in this environment. For example, last month Eurazeo set up a USD 200m Southeast Asia insurance technology fund with a European insurer as the LP.

Meanwhile, high interest rates will limit businesses' ability to take loans from banks, prompting both parties to explore financial technology options. And supply chain disruption, including a migration of industrial capacity to Southeast Asia, could accelerate the downstreaming from broad consumer concepts to regionally specific B2B services.

"This is the best time to be thematic. The key

is to be as strategic as possible to both your LPs and your investees. LPs that are strategic will be interested in what you're investing in, and founders want VCs that can be partners and active supporters," said Victor Chua, a managing partner at Malaysia's Vynn Capital.

"I'm seeing a lot more CVCs [corporate venture capital firms] being set up. There is a bearish feeling and it could be risky. But corporations are not looking at it from a purely financial angle. They're looking at it as a learning process. Rather than put tens of millions into a factory, they might as well experiment."

Corporates, however, are not often flagged as a likely near-term driver of exits, another crucial ingredient in the fate of the Southeast Asian tech scene that remains in question.

An uptick in direct secondary activity – Golden Gate's Lints calls it more alive than ever – could be stoked by increased pressure on valuations. But the key buyers will be specialist funds and family offices, especially in areas like fintech and software-as-a-service (SaaS).

The bigger question is the region's fledgling tech IPO market. Whether companies list overseas or locally, pulling off an IPO has become more challenging, especially in light of weaker valuations for mature tech companies. Furthermore, the market for the SPAC listings that have generated some of Southeast Asia's biggest stories is seen as especially choppy.

Cause for optimism can be seen in Indonesia-based super app GoTo, which raised IDR 15.8trn (USD 1bn) on the Indonesia Stock Exchange in April. But it is tempered by e-commerce platform Bukalapak and Grab. The former completed an Indonesian IPO, the latter merged with a US-listed SPAC – both are trading at more than 75% discounts to their offering prices.

"I think for a number of years, you can live on a promise, but you need to deliver on that promise after a while. That is the next phase for VC in Southeast Asia. Monetisation, if anything, will determine the future success of fundraising," said Brian Lim, a partner at fund-of-funds Pantheon.

"Now will be the time when GPs are truly tested. In many ways, this is when investors will find out who's been able to navigate Southeast Asia in the right way, and who's picked the right horses." ■

Crypto: Something for everyone?

Traditional VCs are becoming more active in Asia's blockchain and web3 space, despite structural and philosophical obstacles to participation. Can they withstand the crypto winter?

When making very early-stage investments, Indonesia-focused VC firm Intudo Ventures likes to confound the consensus view. Few bets seemed more contrarian in autumn 2018 than a cryptocurrency trading platform. Bitcoin was trading around USD 6,500, down two-thirds on its late 2017 peak; by year-end, it was languishing below USD 3,800.

Nevertheless, Intudo persevered with its due diligence on Pintu and announced a pre-Series A round at Harvard Business School's Asia business conference in March 2019.

"We got in at a time when most other VCs were running for the hills. Some founders were running for the hills as well, but Pintu's founder was all-in. For our early-stage investments, where we focus on out-of-favour areas, we are looking for founders who really believe in something that isn't commonly believed," said Eddy Chan, a founding partner at Intudo.

Investing amid a crypto winter had its advantages: Intudo wasn't bidding against others for access and Pintu was able to retain talent because technology unicorns were not recruiting heavily. The company received its license to operate crypto wallet and trading platform services in 2020, augmented its technical talent and forged distributor partnerships, and went from zero to over 4m downloads.

Pintu's mass-market offering resonated in a market where crypto investors have doubled over the past year and now exceed public equities investors. Meanwhile, fundraising continued: a USD 6m Series A closed in May 2021, a USD 35m extension in August, and a USD 133m Series B earlier this month.

The shareholder register has evolved as well. ►



"If there's less hype, the next 6-12 months could be the best time for people to build interesting things"

– Nawaz Ahmed

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Initially, Intudo was accompanied by specialist crypto investors such as Pantera Capital, Coinbase Ventures, and Castle Island Ventures. Lightspeed Venture Partners, a generalist with deep domain expertise, led the Series A extension, and then private equity firm Northstar Group came into the Series B, making its first-ever crypto investment.

Paradigm shift

Pintu is not an isolated case. As crypto and blockchain technology-related use cases proliferate across the region, traditional GPs are either dipping a toe in the water or plunging in with dedicated funds or strategies. A return of the crypto winter – bitcoin has halved in the past seven months and is currently trading below USD 30,000 – has dampened sentiment but it won't dissuade everyone.

"We've seen Sequoia Capital doing more out of China, India, and Singapore, Lightspeed and Play Ventures are very active, and AirTree Ventures launched its first crypto vehicle in Australia. Then, in later-stage rounds, we see the likes of Tiger Global and Coatue [Management]," said Nawaz Ahmed, a general partner at New Zealand-based VC firm Global From Day One (GD1).

"Some of these firms have hired crypto specialists, they understand how markets move, and they aren't going to get scared because we are entering a bear market. If there's less hype, the next 6-12 months could be the best time for people to build interesting things."

Ahmed, an angel investor known for his work on the first New Zealand dollar stablecoin, was recruited by GD1 to launch a dedicated crypto and web3 VC fund. The USD 5m vehicle will operate independently of the firm's generalist technology funds, the third of which closed on NZD 130m (USD 84m) last year.

It follows AirTree closing a AUD 50m (USD 35m) crypto vehicle alongside its latest Australia and New Zealand seed and venture capital funds. Southeast Asia-focused Openspace Ventures is targeting USD 30m for a crypto fund, while Taiwan's AppWorks created a web3 sleeve that sits alongside the main fund and allows LPs to double down on certain deals.

AppWorks made its first investment in the space in 2018 and has gone on to back 20 start-ups. BAI

Capital, a spinout from Bertelsmann, started the same year as an extension of its existing financial technology and web2 coverage. Crypto doesn't get its own fund, but it is expected to account for 20% of the main fund corpus. Two lead partners already spend over 40% of their time focused on the area.

"We are very active in fintech, so we see crypto as a new form of asset class across banking, lending, asset management, security, exchanges, and custodian services," said William Zhao, a partner at the firm. In web3, we see blockchain being used to build a new internet. We've invested a lot in web2, especially social networking and content, and we believe web3 applications represent a paradigm shift."

Investment activity region-wide across crypto, blockchain, and web3 roughly tracks fluctuations in bitcoin, with peaks in 2018 and 2021, according to AVCJ Research. However, the quantum of capital deployed has grown exponentially, from USD 1bn in 2018 to USD 3.7bn in 2021. Despite the recent volatility, investment in 2022 to date is just over USD 3bn.

Geographically, deal flow has become more diverse. Half of all transactions in 2018 involved mainland China-based companies, typically bitcoin mining-related businesses. One-third of all capital put to work went to Bitmain, a manufacturer of chips used in bitcoin mining and a failed Hong Kong IPO candidate.

Repeated regulatory crackdowns, culminating last autumn in bans on blockchain mining and all crypto-related transactions, have curtailed mainland China's share of deal flow. Singapore was the main hub of activity in 2021, accounting for 38% of transactions. India was next on 18%.

The logic behind establishing a dedicated crypto fund is both strategic and structural. On a strategic level, the opportunity is arguably so big that it cannot be ignored. Web3 represents the third era of the modern internet, and a reversion to the decentralised, community-governed ethos that defined the first era but was lost in the second as platform internet companies came to dominate traffic and fee streams.

"A new generation of internet services and products can be built so that the value of what is being created can be shared by the builders, creators, and users of the services directly with ►

each other, rather than going to the platform middleman,” Ariana Simpson, a general partner at Andreessen Horowitz, noted last October on backing Vietnam-based non-fungible token (NFT) gaming start-up Axie Infinity.

As for structuring, by engaging with business models where ownership is decentralised by design, VC firms might be stretching the risk profiles of traditional funds. Moreover, investing in tokens rather than equity may test the limits of what is permitted under the terms and conditions of those funds.

There is a generational aspect too. Early proponents of crypto investments are often younger team members whose interest in the space is both personal and professional. Openspace is a case in point, where a small group made investment proposals even as the crypto winter extended into 2019.

A combination of the climate thawing and internal education efforts helped change mindsets. Additional evidence came from within the existing portfolio. Pluang, an Indonesian micro-savings and micro-investment app, was initially a gold-trading platform but expanded quickly into new asset classes. Its crypto service grew 20-fold in six months, enjoying the same tailwinds that propelled Pintu.

“From early 2020, it became clear where the market was going and if we wanted to build a

strategy that was sizeable in 10 years we needed to start immediately,” said Dennis Le, a senior associate at Openspace and an investment committee member for Ocular, the firm’s dedicated crypto strategy.

“The partners encouraged us to raise a separate vehicle that is more flexible in terms of investing in equity or tokens and outside of Southeast Asia. I remember one opportunity didn’t fit into our existing funds and Hian [Goh, the firm’s co-founder] said, ‘If you have high conviction on this, shouldn’t we create a structure to make it work rather than find things that fit into the main strategy?’”

Ocular is led by Amy Zhao, one of the early crypto advocates internally who switched from a role in investor relations. At AppWorks, Ching Tseng, a younger team member who drove many of the initial crypto investments, was promoted to principal and put in charge of the web3 unit.

“The pushback from older, more senior staff wasn’t so much about a lack of faith in the concept. It was more about challenging younger colleagues to communicate and rationalise opportunities in real-world terms. The debates about whether to engage in crypto were part of our training,” Tseng observed.

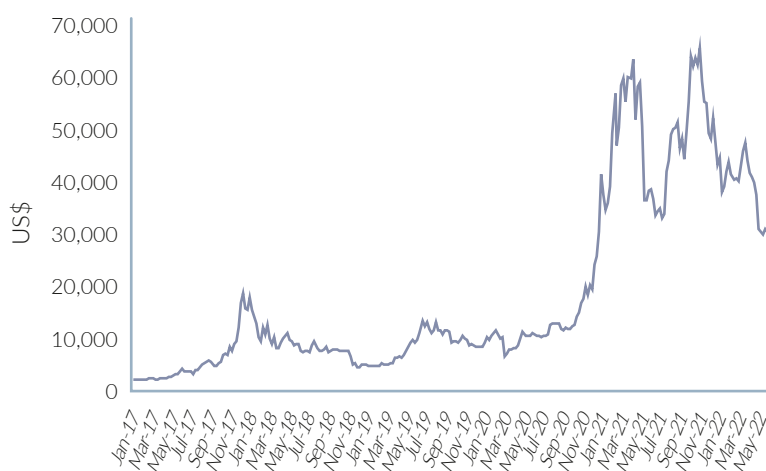
The LP angle

These communication efforts are also crucial when dealing with LPs that are less familiar with crypto. Interest in the space is certainly rising. In Coller Capital’s most recent private equity barometer survey, 30% of LP respondents said they already invested in funds targeting crypto-enabling businesses and 13% expect to make commitments in the next two years.

In addition, the survey found that fewer than 20% of LPs have or want exposure to managers that invest using cryptocurrencies (a definition that may extend to tokens), while one-third are keen to back GPs active in metaverse-related services and products. The implications are clear: on one hand, there is a distrust of unorthodox modes of access; on the other, clear use-case scenarios offer more comfort.

Crypto assets have yet to feature prominently in secondary portfolios assessed by Coller, but Will Yea, a principal at the firm, highlights the importance of business type. “If it’s an exchange, ▶

Bitcoin



Source: Exchange data



we need to think about what is being exchanged, how efficient it is, how it competes against others globally, and the regulatory situation. You can understand that in a way that lines up with what we do every day,” he said.

By extension, most of the capital flowing into the space in Asia has targeted a handful of companies with more proven business models. Half the capital invested so far this year targeted five start-ups: crypto exchange operator FTX, which was valued at USD 25bn at the time; blockchain media and NFT developer Animoca Brands; Ethereum scaling platform Polygon; and exchange operator CoinDCX.

When Openspace launched Ocular Fund, it started pitches by focusing on the macro picture, looking to separate believers from non-believers or identify those who viewed crypto as a structural rather than a secular trend. Among the believers, there were crypto industry participants that wanted to diversify their holdings and relative novices that were curious but uncertain as to how best to get exposure.

“You often get asked, ‘What if everything crashes?’ or ‘We’ve been through cycles, people have made money, are we too late?’ It is important to look at what is driving the current cycle,” said Ocular’s Zhao.

“Openspace has a lot of experience looking

at smaller companies. Web3 and crypto business models are different, but they are trying to solve real-world problems. In that context, it helps to understand consumer behaviour, how to scale companies, and how technology works.”

GD1 has also emphasized the similarities between traditional venture capital and crypto investing. It offers examples of existing portfolio companies, demonstrating legitimate business models, revenue-generation strategies, and user acquisition techniques. Then the GP addresses the logic of token investments, explaining that projects don’t necessarily accrue value at the equity stake level.

“We can invest in tokens or equity. A lot of deals include token warrants so that if at some point the project decides to launch a token, VC investors get a pro-rata allocation. You still have traditional equity ownership and at some point, token ownership will come,” said GD1’s Ahmed. “You risk leaving a lot of value on the table if you are forced to choose between equity and tokens.”

Not all investments are suited to tokens. Ocular organises its mandate into five main categories: decentralised finance (defi), gaming, NFTs and the metaverse, decentralised collaboration platforms, and web3 software-as-a-service (SaaS) tooling and infrastructure. There is also a small allocation for investments in other crypto GPs to get access to ►

deal flow, especially outside Southeast Asia.

Ocular's Zhao contends that tooling and infrastructure – the “picks and shovels” of crypto – are less appropriate for token issuance because companies are essentially employing web2 business models to serve web3 customers. This category is of particular interest to Ocular right now because it tends to offer more price stability than the others during downcycles.

Wisdom of the crowd

Investors identify several due diligence challenges specific to crypto: the best projects often don't need much capital and deals close quickly; the body of existing web3 companies is relatively small, which complicates comparison-based price discovery; and there are many anonymous project sponsors, who argue that the founding team is irrelevant in a decentralised world, but this stymies background checks.

However, arguably the most significant and pervasive is the decentralized autonomous organization (DAO) structure, which is designed to transfer ownership, governance rights, and decision-making responsibility to communities of users. While decentralisation goes to the heart of crypto philosophy, it is at odds with conventional VC expectations for a board seat and a 10% stake.

Ocular has completed eight investments, none of them defi projects. BAI Capital is also steering clear of such opportunities. “Investing in DAOs requires a breakthrough in internal compliance, and we are still on our way. We have yet to invest in any projects with fully decentralised governance because it means giving up protection mechanisms like liquidation preference,” said BAI's Zhao. “But we are evolving.”

In this sense, there is not necessarily opposition to the principle of decentralised governance, more an acceptance that adaption takes time. AirTree got there faster than most. Defi, DAOs, and NFTs are central to its web3 strategy; one of its first two investments, decentralised derivatives platform Zeta, was a subscription to tokens governed by DAO.

John Henderson, a partner at AirTree, stressed the importance of being an active player in communities by participating in governance votes and making governance proposals. Traditional VCs in the US have demonstrated an ability to be influential despite holding a smaller economic interest. It suggested GPs could help remove inefficiencies in Asian DAOs by performing the same role.

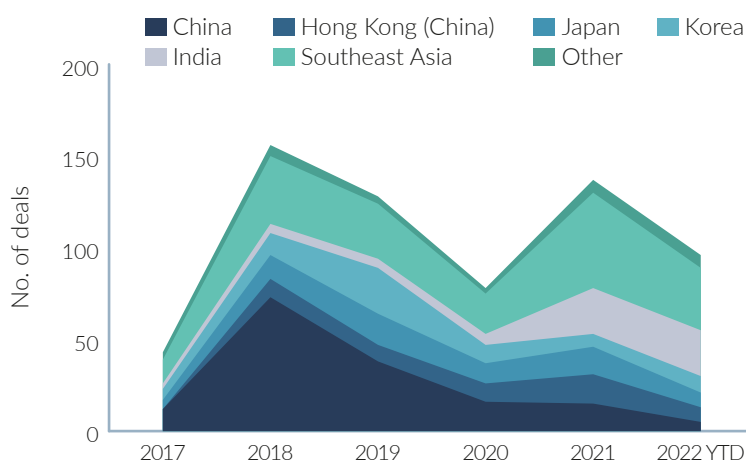
AppWorks also advocates for the structure, arguing that it changes the relationship between companies and stakeholders in a positive way, even if it means investors have smaller positions.

“GPs exert influence with smaller stakes by being indispensable in terms of networking with other blockchain companies. This is essential for ecosystem building,” said Tseng. “In addition, blockchain start-ups tend to need lots of research, media and back-office advisory support. That can be offered in exchange for more exposure to future upside if not a greater percentage holding.”

This points to how traditional VC investors can make operational contributions in a crypto context. Crypto-native value creation typically involves providing liquidity to tokens once they go live on marketplaces and validating operating nodes for decentralised blockchain applications. However, when companies are in fast-growth mode there are all kinds of practical needs as well.

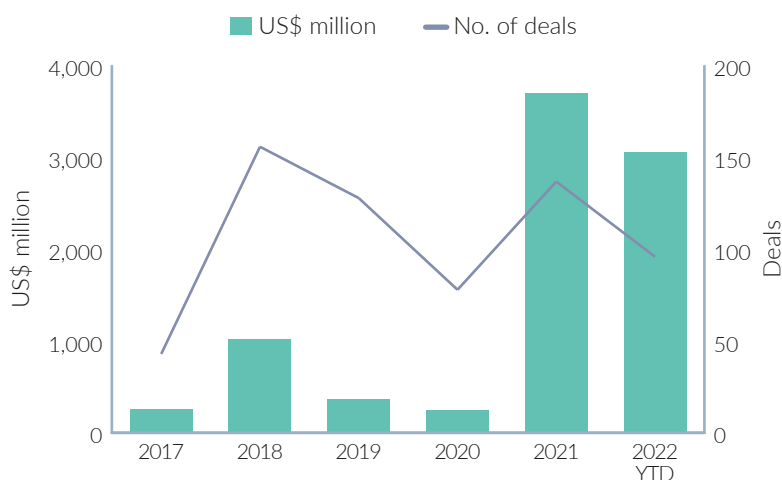
“Crypto-native investors from trading backgrounds bring a certain skill set to projects. But these are often venture-style projects, with ▶

PE investment in Asia crypto, blockchain, and web3 by location



Source: AVCJ Research

PE investment in Asia crypto, blockchain, and web3



Source: AVCJ Research

a long road and a valley of death,” said AirTree’s Henderson.

“Organisation building, team building and recruitment, setting up systems and processes, marketing, working with regulators, comms and PR support, governance participation, node operation – we had most of this set up already and have added to our capabilities to add value to our Web3 investments.”

Work in progress

In Asia, especially, crypto is still in its nascent stages. Comparisons are readily drawn with internet-based technology in the late 1990s and early 2000s, given the rising user adoption, plethora of unproven ideas, uncertainty around regulation, and willingness to work around rules where they do exist. It is generally agreed that crypto will be very relevant 10 years from now, but little consensus as to exactly how.

Having taken a step into the unknown with Pintu, Intudo is now wary of an industry it believes has become bloated by an excess of capital and hype. Chan notes there are too many founders peddling copycat business models and too many “non-independent thinking VCs” chasing them. The firm has yet to make another crypto investment and it has resisted proposals to raise a dedicated crypto fund.

“It’s good to see more firms leaning into this,

but are they genuine investors or is it just a land grab?” Chan added. “If it’s a pureplay strategy, I get it. If it’s a generalist firm adding another item to the menu when they don’t have the right people and expertise, I get nervous. Where were they in previous downturns? People launch vehicles when something is hot, and then it’s not.”

While expectations may have run ahead of reality, contributing to asset price bubbles, infrastructure and applications are being built in the background. Regulation remains an unknown, but Ocular’s Zhao believes greater participation and innovation will see cycles moderate over time, resulting in an industry that is “more professional, more usable, and with a more acceptable risk-reward.”

There is already evidence of global market leaders using M&A to create powerbases, with the likes of Coinbase, Crypto.com, and FTX making acquisitions and facilitating exits for early-stage investors. Coinbase, an exchange, made the jump to a public listing, and it remains to be seen what happens if – or when – NFT marketplaces, where tokens account for the bulk of balance sheets, try to do the same.

Peter Sanborn, a former managing partner of PayPal Ventures who recently joined Singapore-based fintech investor Arbor Ventures, disputes the notion that traditional VCs are moving too quickly into crypto. However, he admits that many start-ups have emerged on the back of a two-year bull market and now it is a question of how they think about branching out and achieving sustainability.

One solution, in a fintech context, is developing hybrid business models that serve both traditional and web3 clients. Taxbit, a PayPal Ventures portfolio company, achieved this by developing an automated tax reporting tool for crypto users and then repurposing it for mainstream financial institutions.

“It allows them to expand and diversify the addressable target market,” Sanborn said. “I think you’ll see more crossover players in fintech infrastructure where they essentially utilise crypto as a trojan horse or as a wedge to get back to helping reinvent traditional financial services architecture. If crypto is coming down or seeing pockets of volatility, this allows companies to build a more resilient business.” ■

Q&A:

Jungle Ventures' Amit Anand

Singapore's Jungle Ventures has closed its fourth early-stage tech fund on USD 600m, shattering an initial target of USD 350m. Amit Anand, a founding partner at the firm, unpacks the achievement

Q: How do you explain the jump in fund size?

A: This surprised us. There was significantly more capital and interested LPs we had to say no to. Even today, we keep getting pinged about it. There's something to be said for the maturity of the ecosystem and Jungle as an institution, having been around for 10 years. I would like to say that a rising tide lifts all boats, but it's really the boat that is built the largest and strongest and sturdiest that benefits the most.

Q: What gives you confidence it's not oversized?

A: I think we are at the right size. Jungle was the first fund to pitch to both founders and LPs the idea of Southeast Asia and India as one market. In some ways, we were vindicated when Sequoia, Accel, GGV, Lightspeed, and other global franchises started doing the same thing. Our peer group has less to do with local funds and more to do with funds investing across Southeast Asia and India. And in that context, our number puts us in the top three funds for that combined opportunity.

Q: What was it like getting the LP advisory committee (LPAC) to sign off on such a large increase?

A: We believe in radical transparency. We display a portfolio scorecard to our LPAC every quarter and have a deep conversation on it. This is an LPAC that has been with us for the last two vintages and built comfort on our approach to portfolio construction and conflict management. We had one-on-one conversations around the first close [USD 225m in September 2021] when we could ►



“I would like to say that a rising tide lifts all boats, but it's really the boat that is built the largest and strongest and sturdiest that benefits the most”

see the interest was large. We leaned on our core LPs – Temasek, IFC [International Finance Corporation], and others – and got feedback from them. They invest in 50-100 GPs globally, so this is not the first time they've seen this problem. We just went for one LPAC expansion, and it had unanimous approval.

Q: What's behind the greater interest from LPs?

A: It's been a pivotal year. There are a significant number of new LPs, both financial institutions and family offices, that invested in the region for the first time – not just in Jungle but across the board. The appreciation of the large opportunity was always there. The key difference is how large and meaningful the ecosystem has become. From Jungle's perspective, about 50% of the capital came from new LPs, a fairly diversified mix of large global financial institutions, family offices, and sovereign wealth funds. Europe and the Middle East are probably the two big geographies in terms of growth of capital.

Q: How has the LP mix changed?

A: From day one, Jungle has been very keen on global, regional, and local family offices, but this time around, they constitute almost 50% of our LP base. It's a huge jump and a significant portion of them are coming from Asia. We think family office money can be more than just capital. The promoters have a lot of experience and networks that can benefit our portfolio companies. They can be potential acquirers as well. We do well with family offices because we have this built-to-last philosophy. They appreciate that because they themselves are business builders.

Q: By Fund IV, many venture capital firms want to graduate beyond Asian family offices toward more global financial institutions. Is that a flawed aspiration?

A: I don't know if it's flawed. From our perspective, it's more relevant to our markets. Asian family offices' wealth has been created in this region, their success, their fame, and networks are here. In many ways, they see technology start-ups as a

way to continue to bet on markets that they know so well. From a mindset perspective, family offices were initially harder to get, but I certainly think that our fortunes are tied in that we're all operating in these regions. They can see the disruption or the enablement that the start-up ecosystem is doing better than the global financial institutions.

Q: Was there any consideration of splitting the fund into early-stage and growth vehicles?

A: We've never done that, and I don't think we ever will. Our belief is always that you must be best at something if you want to be the number one player in any market. Founders come to us when they want their first cheque, and there's a reason for that. The early stages are business building times, when the founder is still thinking, 'Who can help me?' They know that in our concentrated portfolio, they have literally 3-4 times more capital than their peers. That value proposition is what has made us among the top 2-3 early-stage venture firms in the region.

Q: What's the secret to picking winners?

A: We have a team of about 30 people across Southeast Asia and India with close to 250 years of experience in a diverse set of industries. Look at the teams across other funds and you'll see they've either hired these people very recently or they just don't add up in terms of operating experience. I have come to a realisation over hundreds of instances that this is not a market where ideas win – this is a market where execution wins. So, given Jungle's background and the unique processes we've built, we underwrite execution risk much better than our peers.

Q: What about exits?

A: It starts with portfolio construction. It's not obvious how you're going to exit 7-10 years down the road, but it's very important to have frank conversations with the founders and at the board level so they're all aligned. You don't want to be part of a journey where somebody thinks you're going to IPO in 15 years and somebody else thinks we should do a trade sale in 3-5 years. Jungle ►

“COVID has shown us, in emerging markets in particular, the demand is so strong. I think we are maybe better insulated from some of the shocks we’re seeing than developed markets”

has done very well becoming an enabler of that conversation, and as a result, we’ve had literally one exit every year since inception.

Q: Have there been any exits to incoming growth investors?

A: All of our exits have been trade sales. We haven’t done secondaries, but I think it will happen. There’s always been a very high level of interest in secondaries, especially for companies that are planning to IPO, where we’ve seen a lot of growth investors wanting to pick up more equity.

Q: What’s your outlook for IPO exits given the volatility in public markets lately?

A: With every big wave that comes, everyone is affected whether you’re a big or a small boat. But if you look at the latest quarterly reports – and we’re seeing signs already in India – you can start to see the difference between a company that is built to last versus a company that is just riding the wave. You’ll see in the next few months that solid tech companies’ numbers will look up again compared to the others. I’m very confident we still have a vibrant IPO channel. The guys who had decided to go public and paused will go back to the market because IPOs are still one of the best opportunities for people to get access to capital at large scale in these markets.

Q: How do macro pressures around inflation, geopolitics, and rising interest rates influence your outlook?

A: The journeys of early-stage companies are 10 to 20-year journeys. At the point we’re investing these global movements have very little impact on companies. They have to get to 2%, 5%, or 10% of the overall market for these kinds of movements to have an impact. At Jungle, we bring together our LPs and founders quite often to talk about these topics. We’re putting experts in front of them and enabling conversations. But for our companies, these ups and downs don’t mean much in real-time. Maybe they need to be factored in longer term.

Q: But a weaker economy could hurt start-ups that depend on consumer spending power...

A: Yes, but the good news is if you look at the latest reports by any consumer benchmark in the region, there’s no slowing down. The demand side is just relentless in terms of its growth and the appetite for the new things that they can do online or moving some of the offline companies online. It’s also important to realise we are looking at a very different time for humanity compared to the last financial crisis. COVID has shown us, in emerging markets in particular, the demand is so strong. I think we are maybe better insulated from some of the shocks we’re seeing than developed markets.

Q: What are you seeing in terms of market opportunity more broadly?

A: A lot of the talent at the companies that went public or raised significant amounts of growth capital in 2021 is leaving and launching new businesses because this is the best time to start. So, I think it is more vibrant in terms of quality of start-up talent, the kinds of ideas they’re going after, and the insights they’re bringing to the table. It seems like the headiness of 2021 are finally settling down, where fly-by-night operators are no longer competing in the market on the same deals and throwing money at crazy valuations. It’s a much better opportunity for firms like us to invest. ■

Emerging Asia start-ups: Governance revisited

Even a modest cooling off from tech investment euphoria experienced in the peak of the pandemic could reveal big cracks in Asian start-up markets. Diligence efforts are ramping up, but is it enough?

In April, Sequoia Capital India aired some dirty laundry with a blog post condemning instances of “wilful misconduct” and “fraud” in its South and Southeast Asia portfolio. From varying perspectives, it was a symptom of familiar venture market undulations and a harbinger of industrywide governance exposures to come.

“It is easy to think of this issue as ascribed to poor due diligence,” Sequoia said. “But let’s remember that when investments are made at seed or early stage there is hardly a business to diligence. Even later stage investors can face negative surprises, post investment, if there is wilful fraud and intent.”

Still, it is considered likely that Sequoia did not supervise financial audits of the investees in question post-investment, instead leaving it to the companies themselves to engage auditors. It is also considered likely that many other investors backed these companies on the back of Sequoia’s endorsement and assumed due diligence. AVCJ reached out to Sequoia for comment but had received no reply at time of publication.

The episode opens a spectrum of issues, from granular portfolio monitoring practices to understanding the psychology of founders, to the painfully won wisdom that the approval of a brand-name investor is not a bulletproof business validation. Much of the industry considered it a wake-up call about floundering due diligence standards during a period of intense investment.

LPs took to the phones, seeking clarity from managers in the region as to how much time they spent on governance and due diligence. Performance numbers were not on the agenda. Indeed, many of the start-ups under fire are ►



“I don’t often encounter sophisticated established GPs cutting major corners on due diligence”

– Andrew Thompson

considered category winners, among them Zilingo, a fashion social commerce player active across Southeast Asia that raised USD 226m in 2019 at a valuation of USD 970m.

Shailendra Singh, a managing director at Sequoia, recently stood down from the board of Zilingo after questions were raised about the company's accounting practices. The board launched an investigation and suspended CEO Ankiti Bose, who denies any wrongdoing.

"There is a preference to move faster and messier than slower and more accurately. And it's not easy to be accurate every month when things are changing so fast with new are opening up, especially in a business like that where there's a lot of cross-border customers of different sizes," said a former investor in Zilingo.

"What happened there is not uncommon, except how it became public. Sequoia has the most to lose from what I can tell. It seems like a personal issue between a couple of people, which is very unfortunate."

Fanned by FOMO

From a high altitude, the tides of the VC market are heaving predictably. The strong confidence in tech businesses brought about by COVID-19

created momentum in deployment, increasing competition, driving up valuations, and eroding discipline in due diligence.

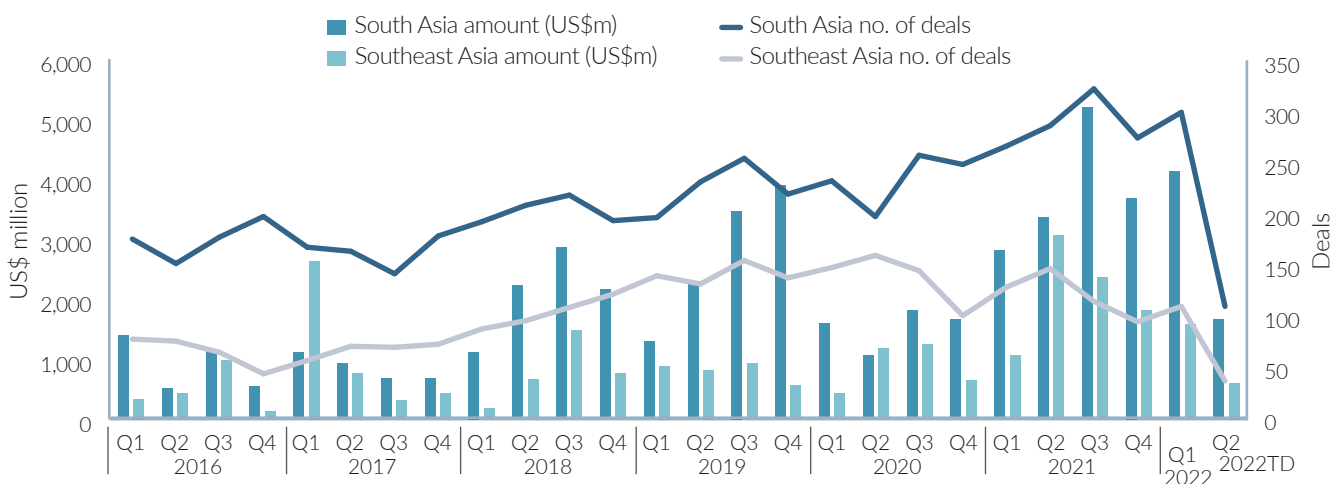
The risk of not investing had to be weighed against the risk of flying relatively blind; some VC firms are said to have spent as little as one week assessing companies before investment during this period. Many absorbed more risk than they intended, and it will only be a matter of time before these lapses are revealed.

This is playing out as part of a correction rather than a downturn per se. The heady investment activity of the early pandemic is levelling off but sentiment remains relatively bullish.

In South Asia, the climax came in the third quarter of 2021, when total VC investment hit USD 5.2bn, according to AVCJ Research. Southeast Asia peaked three months earlier with USD 3.1bn deployed. These figures were USD 4.1bn and USD 1.6bn, respectively, in the first quarter of 2022 and on track to be similarly robust in the three months to June.

"I don't often encounter sophisticated established GPs cutting major corners in due diligence, whether it's a good or bad market, even if they're under pressure to be quicker and accept greater risk," said Andrew Thompson, ►

South and Southeast Asia VC investment



Source: AVCJ Research

“The good ones are the ones where there is transparency and the maturity to know it’s not a one-man show”

– Dhruv Phophalia

KPMG’s head of private equity for Asia, observing increasing scepticism around high cash burn tech businesses.

“The core GP base will continue doing what they always do as an overheated market normalises, but because there’s less competition, they’ll be under less pressure and it might feel like a downturn.”

There is reason to believe that the phenomenon, although global, will play out more acutely in developing Asia due to inherent governance challenges. One of the biggest obstacles in this vein is the difficulty of securing necessary business approvals in many South and Southeast Asian markets without potentially problematic political connections.

Patrick Yeo, PwC Singapore’s Venture Hub leader, notes that reasonable standards of technical and commercial due diligence in developing Asia are well established, but the region suffers from a lack of resources for financial checks. Along with a generally lower capacity to bear diligence costs, this has contributed to a pronounced tendency to assume the lead investor in a round has done its homework.

At the same time, there is the notion that accounting standards have not been built for the digital ecosystem. This makes companies harder to value, especially in developing markets where comparisons to global companies are harder to justify.

Warning signs

The most pervasive outcomes of these pressures are inflated revenue and a deceptive emphasis on

vanity metrics. The severity of the risk depends on the category. Gaming and education platforms are less susceptible because payments are generally made transparently through gateways. E-commerce and social media, which tend to overstate user traffic, are some of the most egregious offenders.

Another factor is that many start-ups have failed to plan for a more difficult capital raising environment post-pandemic. As their runway shortens, desperation sets in, and creative – even fraudulent – accounting makes its way into the pitch.

Yeo said investors have responded with more focused due diligence efforts in recent months; some have begun to insist companies file an external financial audit as part of their ongoing reporting requirements. Other emerging areas of concern include hoopla around corporate partnerships with little substance, boards controlled by related parties, and founders paying themselves excessive salaries.

“It’s no longer the case that if you show a large growth trajectory, they’re going to back you,” Yeo said. “Investors are looking at when are you turning profitable, your governance structure, and how you grow. We are still seeing huge inflows of funds in the VC space in Asia. The issue is that investors are becoming more sophisticated.”

Soft clues about the mindset of founders must not be overlooked in this process, especially where there has been a significant dilution of ownership. After several funding rounds, founder-CEOs left with only scant remaining ownership positions in their companies face psychological barriers around letting go of decision-making and control of day-to-day activities.

To some extent, this is an age issue. Technology start-up founders are typically in their 20s and 30s and lack experience in terms of building companies for resilience across cycles and shocks. They are driven by value and see value as coming from sales. In developing Asia, they are often from rural areas, lacking familiarity with the protocols of venture capital.

“We’ve done due diligence on a lot of different tech businesses in the past couple of years, and we’ve seen that the good ones are the ones where there is transparency and the maturity to know ►

it's not a one-man show," Dhruv Phophalia, an India-based managing director at Alvarez & Marsal focused on disputes and investigations.

"If you're looking to scale up quickly, you have to have the right mindset, the right people on the team, and the experience. And that's not necessarily about being older."

This view helps clarify the idea that exposure of governance shortcomings in the post-pandemic deceleration is not merely a matter of recommitting to financial due diligence – it's about culture and education. Even as late as Series B, board meetings can be informal, ad hoc affairs in developing Asia. Effective mentorship is most often cited as the key missing ingredient.

Stepping up

VCs are generally not equipped to offer more than high-level guidance to start-ups, which leaves them uninvolved in day-to-day accounting, team building, and communications activities. One potential fix is the concept of the external advisor, an ostensibly neutral third-party coach and sounding board on ground-level operations and cultural matters.

In lieu of intense mentoring resources, these issues can be handled by identifying and resolving – or avoiding – them pre-investment. Vikram Utamsingh, Alvarez & Marsal's country leader for India, points to his predominantly private equity client base as an example of how reputation

checks around matters such as team morale and counterparty relations can translate into fewer governance problems down the track.

"Because the big global funds have been here for 15–20 years, they understand that even if they own 90% of a company in this market, they're dependent on individual promoters to drive growth and get their returns," Utamsingh said.

"That's why they're so conservative about the type of person they'll team up with. They're not necessarily walking away because of fraud or misconduct – it could be as simple as how they treat employees."

There is evidence that best practices pursued by these global players around due diligence and governance support are filtering through the local ecosystem to early and growth-stage investors. India's Iron Pillar Capital is a case in point.

The firm typically hires the CFOs and COOs for its portfolio companies. Every company is audited annually by one of the big four accounting firms, and there is a 30-member value-add unit that advises in part on governance. There are seven partners currently responsible for 12 portfolio companies. The idea is that no one partner should cover more than five.

"There's nothing that can trump individual partners having the time to give the founder their ear," said Anand Prasanna, a managing partner at Iron Pillar whose experience includes a stint at Sequoia in the early 2000s. "VC is a business that takes time, and if you try to flip that around and manage so many companies with limited time, that model is going to break down."

This philosophy was not particularly popular during the pandemic investment boom. Iron Pillar, which invests from the Series B to D stages, doesn't like to pay more than single-digit EBITDA multiples and has received significant pushback from emboldened founders in recent months. There were only four deals last year, three of them at single-digit multiples. No investments were made in the first quarter of 2022.

It helps illustrate a difficult reality for investors planning to buckle down on due diligence, governance, and valuations in the current environment.

Ostensibly, the froth in Asia's post-pandemic investment market is subsiding as air comes

"Investors are saying, 'What is the valuation you want to raise in 18 months? I will give you that valuation today.' That kind of conversation is actually happening"

– Anand Prasanna



out of the US tech bubble. “Investor sentiment in Silicon Valley is the most negative since the dot-com crash,” David Sacks, a VC investor and founding COO of PayPal, said last week. Meanwhile, the conflict in Ukraine has offered a nail in the macro coffin, exacerbating long-festered uncertainties around East-West decoupling and supply chain-related economic risks.

The slowdown is still largely theoretical, however. VC confidence remains robust in developing Asia, even in unproven business models. Public markets have not corrected for the shift in mood, and this isn’t expected to happen for another six to nine months. Many start-ups are still focused on maximising valuation rather than optimising quality of capital.

India is perhaps the poster child. Iron Pillar estimates about 100 tech unicorns have been created in the country since January 2020, and there will be 250 by 2025. There is a significant amount of pride in this development, and it is rightly flagged as a benchmark of overall ecosystem maturity and growth.

But the Indian unicorn count is also a kind of

vanity metric all its own – a difficult to substantiate statistic doubtlessly inflated by dubious claims and overzealous investment. Many companies are justifiable members of the club, but many are not, and that is a ratio that has not been clarified.

For Prasanna, the depth of an ecosystem can be more accurately measured in the number of companies that have crossed into USD 100m of revenue and how many are about to achieve profitability. These figures are increasing in developing Asia, but they are still not being factored into valuations.

“Investors are saying, ‘What is the valuation you want to raise in 18 months? I will give you that valuation today.’ That kind of conversation is actually happening,” Prasanna said.

“You’re literally putting the founder on a treadmill and accelerating the treadmill, and that is going to crack at some point. Some people are going to figure out they can’t deliver those metrics and see how they can bend the rules. Investors who invest in companies at unrealistic valuations are fully to blame for what happens in this ecosystem in governance because they’re pushing people to bend rules.” ■

Buy now, pay later: Voodoo economics?

Credit-driven e-commerce is coming to developing Asia with an attractive supply-demand equation and a mix of macro and business-level risks. Start-ups are courting incumbents, not disrupting them

Buy now, pay later (BNPL) is a fundamentally different proposition in developing markets versus developed markets.

Where traditional credit availability is low, BNPL is not just a facilitator of instant gratification and a prop for e-commerce, it's a first foray for the unbanked into the world of credit. Investors interested in financial inclusion should take note, but so should those interested in product-market fit and workable models.

BNPL as a buzzword and business model is expanding rapidly in Asia, attracting increasing levels of venture capital investment, but not on track to be profitable in the region's developing markets.

In Asia's mature economies, the BNPL industry could swing from an overall loss of USD 300m in 2020 to a profit of USD 4.5bn by 2025 if companies make certain corrections to the model, according to Hong Kong's Quinlan & Associates. This includes mainland China.

In South and Southeast Asia, excluding Singapore, the industry will double its losses from USD 400m to USD 800m during the same period, even if models are optimised. If companies maintain the status quo, BNPL losses in the developing region will dive to USD 3.3bn.

Even the largest and most mature BNPL companies globally are still in the red. Revenues are surging but so are costs, especially in the form of loan delinquency. During 2021, US-based Affirm widened its loss from USD 108m to USD 379m, while Sweden's Klarna saw its loss quadruple to SEK 7.1bn (USD 755m).

Asia's standout player, Afterpay, which has a market capitalisation of about AUD 20bn (USD 15bn), is following the same trajectory and leading ►



“Many VCs have gotten themselves into a space that I think is going to crash and burn”

– Benjamin Quinlan

a BNPL rout on the Australian Securities Exchange. The stock tumbled 58% in the 12 months to a trading halt in January, when US-based giant Square was cleared for a USD 29bn acquisition.

The Square deal has done little to improve BNPL sentiment on the exchange. Afterpay's closest local competitors Zip and Latitude – which have market capitalisations around AUD 1bn and AUD 1.8bn, respectively – have seen their share prices fall 80% and 33% in the past year.

"The model with a lot of direct-to-consumer businesses is to generate profit as scale comes in, but I don't see that happening under the current models. It's not a problem of scale – it's a problem of unit economics. That's not going to be solved by having more customers," said Benjamin Quinlan, CEO and managing partner at Quinlan.

"Many VCs have gotten themselves into a space that I think is going to crash and burn. Once the VCs say, 'show me the path to profit or I'll turn off the tap,' you're going to see a lot of these BNPLs go under."

Going large

The presumed strategy for investors in this space is to prioritise scale over profitability so as to be well-positioned for an accelerating consolidation process. Longer term, profitability can come as the BNPL company evolves into – or is absorbed by – a more diversified financial institution, perhaps after exit.

Singapore's Pace Enterprise appears to be among the more straightforward examples of this narrative, having achieved the distinction of being one of the few Asian BNPL operators with a multi-country footprint within a year of launch. The company raised USD 40m in Series A funding in November featuring VC units of Temasek Holdings and United Overseas Bank to grow its user base 25x within 12 months.

Taiwan's AppWorks joined the round. It noted that founder Turochas Fuad – whose experience spans leadership roles at WeWork, Spacemob, HomeAway, and Skype – had the necessary contacts to be competitive during a networking land grab.

"BNPL is in a consolidation stage right now and all the incumbents are doing M&A, so you need the right founder-market fit," said Sophie Chiu, an

associate who led the investment for AppWorks.

"You need a founder with a background and ability to make connections in the industry – not just in terms of acquiring merchants but also getting partnerships with counterparties like banks and payment companies. Making BNPL work as an investment is about having the network and the creativity to expand the business beyond the simple instalment."

Technology represents a difficult variable in this thesis. Tech is not usually seen as a moat in BNPL, which suggests an oligarchy of segment leaders will emerge based on their strengths in networking and raising capital. Digital-age techniques for alternative credit scoring and small-ticket collections are start-ups' main edge, but this is not widely considered sufficiently uncopiable.

Furthermore, incumbent e-commerce platforms and financial institutions already have significant network and user base advantages. If there is no technical hurdle stopping them from setting up their own in-house BNPL systems, it could leave independent start-ups with overwhelming competition and nowhere to go in terms of M&A.

High profile examples of this scenario beginning to play out in Asian e-commerce include the recent launches of Shopee's SPayLater and Grab's PayLater services. In traditional banking, HSBC has enlisted US financial technology supplier Episode Six to develop BNPL capacities in its PayMe app.

Episode Six says its tech allows banks to reclaim revenue being lost to independent BNPL, although it also targets BNPL start-ups as clients. The company – active in the region across Southeast Asia, Japan, and Australia – claims a technical advantage in the ability to adapt to shifts in regulations, payment methodologies, and the types of assets recognised as currency such as crypto.

"Technology can absolutely be a key differentiator depending on how it's applied. Interoperability between payment schemes and providing for convergence between digital wallet offerings and BNPL could be quite interesting, for example," said CEO John Mitchell. "I think any bank can compete with start-ups if they focus and have the technology."

Incumbents in e-commerce, payments, and banking will be increasingly incentivised to establish in-house BNPL capacities as the

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Private equity in Japan has been in rude health and although the outlook is still positive, GPs today are faced with challenges resulting from the pandemic and macroeconomic and political factors. However, LP appetite for the asset class continues to expand and for investors that can originate deals at decent entry multiples, in growth sectors and the buyout market, that have the characteristics to thrive in the current environment the ability to continue excelling is present. The world's leading Japan focused private markets forum, unrivalled as the most influential gathering of institutional investors AVCJ once again will convene an ecosystem that has been two decades in the making so you can have full access to the most compelling industry gathering in 2022 from an investment and fundraising perspective.

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market expands in the near term. In Asia alone, BNPL gross merchandise value is set to jump 39% to USD 361bn between 2022 and 2025, according to data from ResearchAndMarkets and Quinlan.

Joshua Chong, a BNPL analyst at Singapore-based fintech research firm Kapronasia, sees the consolidation theme as potentially inhibiting to VC investment in independents. He advises exploration of alternate entries into the market such as white label suppliers of technical infrastructure and B2B BNPL for small businesses that need more flexibility in inventory payments.

"I was under the impression some of the large BNPL companies could leverage the data they have to branch out into different services like larger loans, which could be a road to profitability. But I think that's a weaker argument now that they're more likely to merge with a larger platform," Chong said.

"We've also observed that products tend to be going down to smaller value items, which is unexpected. With Shopee SPayLater, for example, you could purchase a USD 10 pair of shoes over three instalments."

Ultimately, investor headaches in BNPL have more to do with business-level unit economics

than industrywide trends around adoption, demographics targeting, and technology.

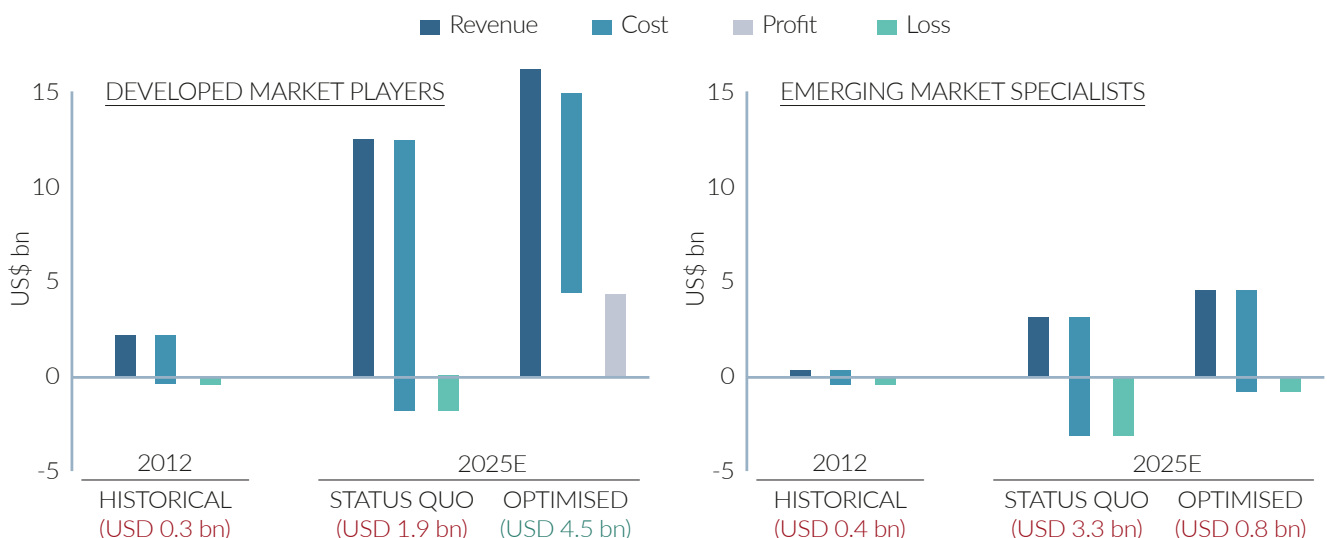
The crux of the issue is that BNPL companies typically charge merchant discount rates (MDRs) rather than interest. These would most likely have to be increased if the macro environment exacerbates costs, further incentivising merchants to develop in-house capacities.

In developing markets, MDRs can be as low as 2%, while delinquency rates can be as high as 7%. Reduced repayment volumes as a result of this spread mean there is less capital available for future credit extension. The shortfall is covered by generating more revenue by processing more transactions, setting up an escalation of the pattern.

The push for top-line growth itself entails significant costs around merchant and customer acquisition in the form of cashback discounts, credit card offers, paid marketing, and brand ambassadors among other gambits. Industry participants contacted by AVCJ estimated average customer acquisition costs (CAC) in the BNPL space in the region were in a range of USD 30-50.

Rocketship, a US-based investor with a significant portfolio in developing Asia, is strongly focused on embedded finance as a theme

Asia BNPL profit opportunity



Source: Quinlan & Associates

and impressed by the region's BNPL upside, suggesting the market could grow 10x in the next 4-5 years. But that's not enough.

"Sometimes, if you're very sticky and have a very high frequency of transaction, and there is scale associated with that high repeatability, then there is a path to profitability. That's the bet that everybody has to finally take," said Madhu Iyer, a partner at Rocketship.

"We have seen a lot of these companies and evaluated them. We don't have any investments yet, which should tell you something, but we continue to stay focused and bullish. It's always been a great category, but we have had a lot of pauses when we've come to looking at the numbers."

India's Simpl aims to crack the numbers issue with a BNPL invoicing product that digitally mimics local retailers' traditional practice of keeping informal "khata" tabs for their customers. These e-commerce accounts cannot exceed about USD 500 in a 15-day period even for the most creditworthy users, nor can they be extended until they are paid off.

Simpl, while not yet profitable, claims positive unit economics, with MDRs around 2.4% against net transaction losses of 1.3% translating into 22% margins. The company raised a USD 40m Series B in December led by US-based Valar Ventures and IA Ventures.

"It's more like Visa than a pay-later company," said CEO Nitya Sharma. "As we scale our business and volume, that 22% will eventually start paying for our cost structure, which is not much. If you're building a network, you'll have network margins, but if you're building consumer finance company,

you'll get consumer finance margins. And you can do both at the same time."

Diversification drive

Most of the fixes for achieving profitability boil down to recognising BNPL as a feature rather than a standalone business. Diversification into other credit products such as payday loans, instalment loans and cash advances will be a natural path forward for the most robust independents. Smaller start-ups will be limited by the associated licensing and compliance hurdles.

The most cited winners in this game in developing Asia include Indonesia's Akulaku and Kredivo. Akulaku has raised around USD 450m in VC funding, claiming a USD 2b valuation last month after an investment from Siam Commercial Bank. Kredivo, also known as Finacel, raised more than USD 460m before agreeing last year to merge with a US-listed special purpose acquisition company (SPAC) at an enterprise valuation of USD 2bn.

India's BNPL leader is arguably Capital Float, which has raised USD 474m in equity and debt from the likes of Sequoia Capital India and Amazon. CEO Sashank Rishyasringa claims the company – which is also active in personal loans and personal finance management services – is already contribution margin positive and on a path to profitability "in the next couple of years."

The key to Capital Float's approach is in its alignment with the financial inclusion ideals of bringing BNPL to the developing world as a tool of upward mobility. The company looks at its market engagement through a lens of affordability rather than convenience.

Basically, BNPL is used as an entry point for reaching out to a population of 100m e-commerce newcomers with no access to credit. The idea is to help them start small with credit lines suitable for groceries and everyday lifestyle products. Bigger-ticket categories such as travel and education can be accommodated over time, eventually leading to the offering of non-BNPL products.

CAC is said to be zero thanks to what Capital Float calls India's first and still largest point-of-purchase instant credit program. The company has a network of 3,000 merchants, including

"Banks provide the capital and we provide 20% skin in the game. That's probably going to be the dominant model"

– Sashank Rishyasringa



Amazon, and some 4m BNPL customers. About 200,000 new customers are added every month purely through at-checkout underwriting.

Rishyasringa said his company – which has a license to lend with the central bank and bears its credit risk – has a loss rate is 1.2% and a gross non-performing asset rate that is “the lowest in the industry by far” at 0.8%. He sees a future for BNPL in further integrations with traditional banks, which are still lagging in their development of capacities around alternative credit scoring and small-ticket debt collection.

“You’re going to see banks are able to build retail loan portfolios with zero costs, but players like us – experts at underwriting and collections and acquisitions – will handle the entire lifecycle of the customer,” Rishyasringa said. “Banks provide the capital and we provide 20% skin in the game. That’s probably going to be the dominant model going forward.”

Credit risks

There are important cultural and behavioural factors in the BNPL-for-developing-Asia paradigm that are yet to play out.

As the region’s first online generations experiment with credit, anecdotal observations are mounting around the emergence of increasingly risk-happy attitudes about spending versus

saving and susceptibility to influencer-driven discretionary shopping via constructs such as social commerce. BNPL could prove a toxic ingredient in this soup.

The risk persists even if the phenomenon stays rooted in small-ticket purchases – which would theoretically limit the damage of defaults – because such a BNPL industry would remain under the radar of regulators. To date, the Philippines is the only market in developing Asia with significant BNPL regulatory supervision.

Currently, most providers do not maintain and share proper records on the indebtedness of their end-users, who can turn to other unwitting credit channels and become overleveraged. From the company perspective, this could backfire by reducing the end-customer’s ability to pay down the original BNPL debt. For the broader industry and society at large, the stakes are much higher.

“You will see a growing middle class in developing Asia, rising into the next segment of being able to purchase more moderately priced and luxury goods. There’s nothing wrong with that. But what’s the mechanism to get there? BNPL is consumption on steroids,” said Quinlan.

“Eventually, when the economy starts to recede – which everyone is thinking will happen at some stage and we’re just wondering when – then how does this all unravel?” ■

GP profile:

Falcon House Partners

Falcon House Partners is one of the few survivors in Indonesia's promising but challenging middle-market private equity space. Being hands-on is part of the secret

When Falcon House Partners set up with an exclusive focus on Indonesia's middle market in 2011, the idea of shifting investment attention from the country's historically commodities-focused economy toward an upwardly mobile consumer market was well established. By that point, consumer demand already represented 60% of the domestic economy.

The Singapore-headquartered GP identified Indonesia as one of the few countries in the world with secularly high GDP growth and a low-debt-to-GDP ratio, which put it on track to outperform seemingly similar markets in the decades to come. Indeed, these advantages are credited with recent successes such as a current account surplus and a quick COVID-19 rebound.

"Highly responsible government with disciplined fiscal and monetary policy played a key role in the decision to, quite frankly, dedicate our careers to investing in Indonesia," said Brian O'Connor, a co-founder and managing partner at Falcon House.

"Indonesia has the lowest quarter-to-quarter GDP volatility of any major emerging market, and even compared to many developed markets. This provides a more predictable backdrop for investment."

Nevertheless, the challenges of practicing private equity in Indonesia are easy to infer. In the early years of Falcon House's history, a healthy crop of competitors emerged. Most were unable to raise funds and either vanished or returned to corporate advisory work. Even some of the pre-2011 incumbents no longer exist. Overall, the number of active middle-market GPs has reduced.

Falcon House attributes its longevity not to an ability to pivot but to a steady hand on the tiller. ►



"There are a lot of good minority deals, but you have to have the right structure and alignment with other shareholders"

– Samir Soota

Consumer and healthcare, including B2B models, were the core areas of focus from the beginning, especially in categories where companies could enjoy a multiplier effect on rising GDP.

Core themes include scalable brands, millennials, healthcare transformation, digitisation, buy-and-build, and regional winners. Checks sizes have ticked up slightly over the years; the range is currently USD 25m to USD 60m. There is a preference for control, but significant minority deals are considered.

"If you only do control deals, you're limiting yourself," said Samir Soota, a co-founder and managing partner. "There are a lot of good minority deals available, but you have to have the right structure and alignment with other shareholders."

Voices of experience

O'Connor and Soota have been colleagues and friends since the 1990s, when they also crossed paths with Glenn Yusuf, whose career in Indonesia extends to Citibank's Jakarta office in 1981.

O'Connor's experience in the country is rooted in an 18-year stint with Lehman Brothers, while Soota's has worked for various banking and consulting groups, as well as Principia Management Group, a private equity firm he established as the portfolio-servicing arm of Quvat Management in 2006.

Meanwhile, Yusuf was president-director of Danareska in the 1990s when the investment bank claimed a more than 50% share of local M&A coverage (Soota was a managing director at Danareska at this time). He moved on to the Ministry of Finance where in 1998, as head of financial institutions, he negotiated a landmark debt restructuring deal with the IMF called the Frankfurt Agreement.

Credibility was the key to early pipeline creation and fundraising. Falcon House's debut vehicle launched in March 2012 and reached a first close of USD 100m that August thanks largely to speedy commitments from development finance institutions (DFIs). The US-based Overseas Private Investment Corporation – now the Development Finance Corporation – contributed USD 60m, according to AVCJ Research.

A final close of USD 212.4m came the

following year with support from Germany's DEG, Netherlands-based FMO, the International Finance Corporation (IFC), Swiss Investment Fund for Emerging Markets, and Asia-focused fund-of-funds Emerald Hill Capital Partners. Alexander McCloskey, Falcon House's head of investor relations, is a former partner at Emerald Hill.

Fund II launched in 2015, achieved a first close of USD 200m by year-end and a final close of USD 400m in November 2016. LPs included IFC, which invested USD 25m, FMO (USD 20m), and DEG (USD 16m).

As part of an effort to remain independent in its Indonesian operations, no money was raised from local investors for either fund. Soota noted that international institutional investors were viewed as an untapped pool of capital and a way of avoiding possible conflicts of interest.

"All three partners have skin in the game with a significant GP commitment," Markus Bracht, a vice president at DEG observed, adding that the firm's operational abilities were also an important consideration.

"We see Falcon House being actively involved in portfolio support, and in many cases, this goes beyond board representation, governance advice, HR support, regular interchange and brainstorming on strategic topics."

Value-add resources include a network of 10 operating advisors, offering expertise across areas such as hospital administration and fast-moving consumer goods. Third-party vendors are typically brought in to consult on areas such as legal structuring, licensing, branding, and environmental, social, and governance (ESG) compliance.

Up to 12 professionals can be deployed on a single deal at a given time, half of whom will be Falcon House employees who qualify for carried interest should the investment outperform and the fund achieves its hurdle rate. The staff currently includes 20 professionals. Of these, 11 are primarily focused on deals but regularly engage with the operations team.

There is also a significant in-house communications function, which entails twice-yearly workshops and ideation sessions with portfolio companies in addition to monthly board meetings and annual meetings. When COVID-19 hit, regular LP advisory committee meetings

were augmented with quarterly update calls.

The lockdowns of the early pandemic were Falcon House's biggest challenge to date, a showcase for its portfolio support processes, and a counterargument to the point that longevity in Indonesia is more about staying the course through cycles than emergency manoeuvres.

The biggest move in this vein was the raising of the USD 13m COVID-19 liquidity infusion plan, or CLIP, which included a USD 6m contribution from DEG, plus USD 6m from FMO and USD 1m from Falcon House. This was said to have preserved thousands of jobs and brought the portfolio back to its pre-pandemic valuation.

Mount Scopus, which operates a chain of brick-and-mortar bakeries under the Harvest brand, could have been one of the worst hit companies during lockdown had it not been modernized in the prior two years.

Falcon House acquired a controlling position in the company for USD 15m in 2017 and achieved little growth in the following year as it scouted for a replacement CEO. Retail and food industry veteran Edison Manalu was eventually recruited in 2019. As part of the interview process, he was asked to consider ways of turning around the business.

Manalu recognised Mount Scopus's critical bottlenecks involved inventory and logistics inefficiencies. With support from one of Falcon House's operating advisors, he devised a more centralised distribution and production process – which enhanced quality control – and added a surprisingly absent cold chain function.

Technology was also brought in, including data-providing customer relationship and post-of-

sales systems, as well as updated online ordering options. A single exclusive delivery partnership with ride-hailing platform Gojek was scrapped in favour of a network of 15 delivery partners. Everything was in place ahead of COVID-19.

Online sales jumped from 20% to 45% of revenue, and Manalu believes it can hit 55% in a few years. Since 2019, overall sales have climbed 22% a year while EBITDA has grown 35% a year. During this period, the company pushed deeper into lower-tier cities and the relatively sparsely populated island of Borneo.

"Falcon House accepted and supported my point of view. I was free to manifest the plan, and they only gave big-picture advice. That's the culture," Manalu said. "Chemistry is very important to me. I saw the culture was very open-minded with open communication. That's critical to the whole team. The company is a second family for me. Besides the strong brand of Harvest, that's why I joined."

Falcon House is in the midst of launching a sale process for Mount Scopus but declined to comment. The company is being well received by potential investors, according to a source close to the situation, with the new digital operational model doubtlessly a significant bargaining chip.

"We are seeing a convergence between online and offline, where businesses realise they need to be omnichannel," Soota said. "We've seen this happen in other markets, and we believe it's an area where we can work with companies."

Digitisation dynamics

It's worth noting that in addition to Gojek, Mount Scopus' sales and logistics network includes VC darlings the likes of Grab, Traveloka, Tokopedia, and Shopee. Although Indonesia's mid-market private equity players are thinner on the ground, their portfolios have been supported in recent years by a thriving start-up scene and generally higher rates of economic digitisation.

O'Connor sees local VCs as partners with the ability to build and develop young companies to a point where Falcon House can play a role in their further growth. He also regards the ecosystem as an invaluable resource for targeted marketing that dovetails with consumerism and productivity momentum related to urbanisation.

FALCON HOUSE PARTNERS - AT A GLANCE

Offices	Singapore, Jakarta
Employees	20 professionals, including deal team of 11
Funds	Fund I (2011) \$212.4m Fund II (2015) \$400m
History	Founded in 2011; 12 investments to date
Assets under management	Approx. \$1bn

FALCON HOUSE PARTNERS – KEY PERSONNEL



BRIAN O'CONNOR
Co-founder, managing partner

Active in Indonesia since the early 1990s with Lehman Brothers. Previously vice chairman for Asia at Nomura. Brings capital markets expertise



SAMIR SOOTA
Co-founder, managing partner

Previously with Danareksa and KPMG, where he was CEO of Indonesia financial services. Founded PE firm Principia Management in 2006



GLENN YUSUF
Co-founder, managing partner

Began career in 1981 with Citibank in Indonesia. Previously filled leadership roles at Bank Niaga, Danareksa, and the Ministry of Finance

"It's really important to work with the senior management of companies to make sure that they're fully aware of the all the digital tools that are available to them," O'Connor said. "There's been an evolution of what it means to be a great CEO, CFO, and CMO [chief marketing officer] in Indonesia in the past five years. And we need to help make sure these C-level executives are staying competitive."

Falcon House's latest sizeable deal highlights another angle on VC support for the middle market. The firm led a USD 170m Series B round for transportation, warehousing, and fulfilment player Sicepat, taking a less than 10% stake. It claims the profitable company has graduated past start-up status.

The investment included support from DEG, Kejora Capital, MDI Ventures, Indies Capital, Pavilion Capital, Trihill Capital, and Daiwa Securities. The idea is to fortify an already leading position

locally in the end-to-end logistics segment – including last-mile delivery – while exploring expansions into other Southeast Asian markets.

Sicepat has capacity to deliver more than 1.4m packages a day and is considered one of the few players that can service both traditional e-commerce and social commerce partners. It is banking on projections that Indonesia's e-commerce market will grow 21% a year over the next five years, hitting USD 82bn by 2025. About 25% of that market is expected to be defined as social commerce.

This was the first investment of its kind for Falcon House, which stresses it has no interest in early-stage exposure. But there is scope for more, especially as the lines blur between the VC and PE ends of the asset class locally. As a case in point, one of Falcon House's existing portfolio companies, lifestyle brand Isayama Group, received a USD 18.1m round last month led by East Ventures.

"We certainly see some VC-backed companies that have grown and matured to the point that they fit our strategy and value-add," Soota said. "On the other hand, we're also seeing some VCs doing more than start-ups, and they're interested in the growth and scale of some of our portfolio companies."

The notion of a maturing start-up ecosystem feeding a larger pool of modern, investable midcap businesses comes to Indonesia at the same time as several tectonic shifts in the macro. Most significantly is the idea of industrial capacity and investment dollars moving away from China amidst closed borders and geopolitical friction in favour of Southeast Asia.

Falcon House could leverage this environment soon. The firm has not formally launched its third fund, but feelers are being put out. As part of its annual LP communications routine, the GP's leadership travels to the US and Europe during the northern hemisphere summer to touch base and update on performance.

"The feedback we're getting is that there's been quite a bifurcation in emerging markets in terms of performance," said O'Connor, who is currently in the US. "Dislocations and challenges in China are playing on people's minds. But Southeast Asia, and Indonesia in particular, has attracted attention." ■



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