

# Insight into the Development of Private Credit in Asia

Growth of Private Credit in Asia

April 2023



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Traditionally, bank lending has been the dominant source of funding for growth in Asia, but this is increasingly difficult as banks are facing multiple challenges of their own. Banks are scaling back lending unless it is for blue-chip names. Private credit has become an increasingly attractive source of debt finance for business and as an investment strategy for investors looking for diversified and compelling returns. Private credit funds are typically institutional investors such as asset managers or pension funds that step in to fill the financing gap left by traditional banks to support not only distressed situations, but also finance mainstream product lines such as direct lending, mezzanine financing and leveraged loans.

The decades long Asian growth story needs no introduction. According to the International Monetary Fund figures, the Asia-Pacific GDP is growing at 4.2% for 2023 as opposed to 0.3% in Europe and 1% in North America<sup>1</sup>. The private credit market is a particular area of growth in Asia.

Whilst in the past the private credit strategy of the market in Asia has been opportunistic, the strategy is increasingly developing to show more sophistication in line with the market it is servicing. The Asian private credit market is now adopting established structures and strategies seen in more developed private credit markets, laying the foundation to support more structured growth of the private credit market in Asia going forward. This increasing sophistication is exhibited by the private credit market's focus and attention on pricing, ESG and due diligence in line with the expectations of its investors.

In light of the nature of private credit providers, they are generally in a position to be able to offer some different and "out of the box" solutions compared to traditional lenders such as banks that are bound by more rigid policies and products. This is particularly desirable in a market such as the Asia market which often values flexibility of approach. Borrowers are often also willing to pay more to access these flexible financing options.

The smaller nature of private credit funds tends towards an ability for the funds to build closer relationships with borrowers, particularly as there are increased communications and contact involved in the tailored solutions offered by private credit funds.

The nature and structure of private credit funds also often allow for deals to take place quickly which is also viewed as a premium in the fast markets in Asia.

Private credit is not looking to compete with or replace traditional bank lending. Because of their scale and historic role in international financing, banks will remain a cornerstone of the lending system. Where private credit can find its place is most likely with the small medium enterprises (SME) where banks may be more reluctant to lend in the current environment. Market estimates that by 2030, China and India will be home to approximately half of the entire global middle class<sup>2</sup> and the Asian Development Bank Institute estimates that SMEs account for more than 96% of Asian business and provide two out of three jobs in the region<sup>3</sup>. The Asia Pacific region needs a developed non traditional financing system in particular for the SMEs in the region which have substantial aggregate funding requirements.

## Bank Synergies with Private Credit Funds

Banks are however beginning to find opportunities to work together with private credit funds in order to access a new market of borrowers and benefit from the upside of the private credit market flexibility of offerings and consequential beneficial returns. The private credit providers in turn benefit from the bank's broad depth of knowledge and experience. A typical example would be a bank offering working capital for a borrower whilst a private credit fund offers the same borrower a different slug of debt. The bank will be able to take the secured position whilst the private credit fund can take a higher risk position. The private credit fund will benefit from the bank's experience, particularly in areas such as recovery and the bank will benefit from better returns on the lending.

Banks are increasingly finding that they can rely on the due diligence and reporting of private credit funds that is often now of a high standard.

A further area that private credit can benefit banks is where there are demands on banks to relocate back to the USA and Europe, banks can look at setting up their own private credit funds to maintain their access to Asian borrowers in the Asian market.

### Challenges for Private Credit in Asia

Challenges remain in the way of the development of private credit market in Asia as significant barriers to entry still exist for international capital. The Asian corporate fund-raising landscape is geographically fragmented and diverse – while opportunities are generally sourced through its financial centres in Hong Kong, Singapore and Australia, borrowers and assets are mostly derived outside of these jurisdictions e.g. mainland China, Indonesia and other ASEAN countries. This is unlike the US market, which is largely homogenous and allocators have a good understanding of the market.

These inherent challenges mean that entering into the market in Asia is not straight forward. Numerous requirements have to be met, including development of the reach of a business, understanding the structure, enforcement, regulatory and tax regimes, languages, business cultures, local networks and relationships in multiple jurisdictions<sup>4</sup>.

Banks have a natural advantage in the lending market as they hold licenses and are well established to lend money in multiple jurisdictions, whereas smaller private credit funds do not have the same scope of licensing and are often restricted from a licensing or tax perspective in who they can lend to and the jurisdictions in which they can take security.

Another particular area of challenge for the private credit market is finding the right talent in Asia. The private credit market does not offer the same rigid career path as banks due to the undeveloped and more entrepreneurial nature of the market and therefore can be less desirable for the workforce. Banks have whole departments dedicated to servicing one part of a loan such as origination or enforcement on default and team members will often have expertise in one particular part of the process. Private credit providers often have one person overseeing the whole process of a loan who will need to have a detailed understanding of the whole process. This can make it more difficult for talent to be sourced from the banking sector and individuals with the relevant experience are often highly sought after.

The changing market for investment is a further challenge for private credit. Investment can be withdrawn or come with higher pricing under the effects of international market conditions. For example, recent changes in interest rates in the USA are likely to make investment in private credit in Asia look less attractive.

### Conclusion

The private credit sector is able to offer advantages such as flexibility and speed to meet the need of certain borrowers by offering different lending solutions. As the private credit market becomes increasingly sophisticated, our expectation is that the next phase will be for private credit funds to work symbiotically alongside banks providing access for banks to new lending solutions to service borrowers.

<sup>1</sup> International Monetary Fund, Real GDP Growth — Annual percent change. Available from: [https://www.imf.org/external/datamapper/NGDP\\_RPCH@WEO/OEMDC/ADVEC/WEOWORLD](https://www.imf.org/external/datamapper/NGDP_RPCH@WEO/OEMDC/ADVEC/WEOWORLD)  
<sup>2</sup> World Data Lab, Look East instead of West for the future global middle class. Available from: <https://oecddevelopment-matters.org/2019/05/07/look-east-instead-of-west-for-the-future-global-middle-class/>  
<sup>3</sup> Asian Development Bank Institute, The Role of SMEs in Asia and their Difficulties in Accessing Finance. Available from: <https://www.adb.org/sites/default/files/publication/474576/adbi-wp911.pdf>  
<sup>4</sup> Alternative Credit Council, Private Credit in Asia.

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