

# Business Transformation Draws Investors to Japan's Private Equity



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## KEY TAKEAWAYS

- Corporate reforms and shareholder activism are persuading large corporations to divest non-core assets or to return to private ownership, creating opportunities for take private deals
- Companies large and small are embracing digitization, transforming business practices and improving efficiency and productivity, while private equity-backed companies are more willing to look overseas for expansion
- Fundraising in Japan is outpacing other countries in Asia as investors rebalance their allocations in the region, while a growing willingness by founder-led companies to consider private equity as an exit option is further boosting deal making
- Private equity managers with boots on the ground and an understanding of the local culture and language should have the opportunity to invest in well-managed companies at attractive valuations

Corporate reforms that are transforming business practices, coupled with attractive valuations and favorable financing conditions, are lifting the allure of Japan for many private markets investors.

In 2012, when Adams Street made its first Japanese investment, private equity managers in Asia's second-biggest economy collectively raised about \$1 billion,<sup>1</sup> a relatively meagre return for a year of effort. The lack of investor commitment was largely considered to be the result of the country remaining in the grip of stagnation following a stock market crash in late 1989. Investors in 2012 were yet to be convinced that a revitalization plan, dubbed "Abenomics" after its patron, Prime Minister Shinzo Abe, would lift the country out of the "lost decades".

Fast forward another decade or so and the outlook for private markets investors in Japan has fundamentally shifted. Private equity deal value hit a five-year high of \$34.8 billion across 1,553 transactions in 2023,<sup>2</sup> according to Preqin, while fundraising climbed 13.4% from 2022 to \$11.8 billion,<sup>3</sup> defying weaker performance on this metric for other country-specific funds in the region.

Take-private deals accounted for two-thirds of total value in 2023, according to Bain & Co.<sup>4</sup> A key catalyst for this was a March 2023 request by the Tokyo Stock Exchange, backed by the government, for companies to lift their price-to-book ratios to a value of at least one times. This coincided with growing shareholder demands to improve capital efficiency and returns following years of underperformance relative to US and European companies. Together, these twin pressures encouraged publicly listed conglomerates to consider the sale of non-core assets or a return to private ownership in a bid to improve their capital efficiency.

A significant take private deal was the \$15.2 billion buyout of Toshiba Corp in late 2023, led by Japan Industrial Partners. The rationale was that Toshiba will execute a financial and operational turnaround to boost productivity and asset values at exit.

Perhaps the most complete example of such a metamorphosis is Hitachi. In a far-reaching transformation, the company went from having 22 publicly traded units in 2009 to no separately listed subsidiaries today.<sup>5</sup> Hitachi exited sectors including semiconductors, televisions, metals, chemicals and cable making to focus on growth areas including green energy and digitization.

## Embracing Digital Transformation (DX)

Hitachi’s embrace of technology isn’t unique, with companies across Japan using the ongoing digitization of the economy – known by the acronym DX – to transform business operations.

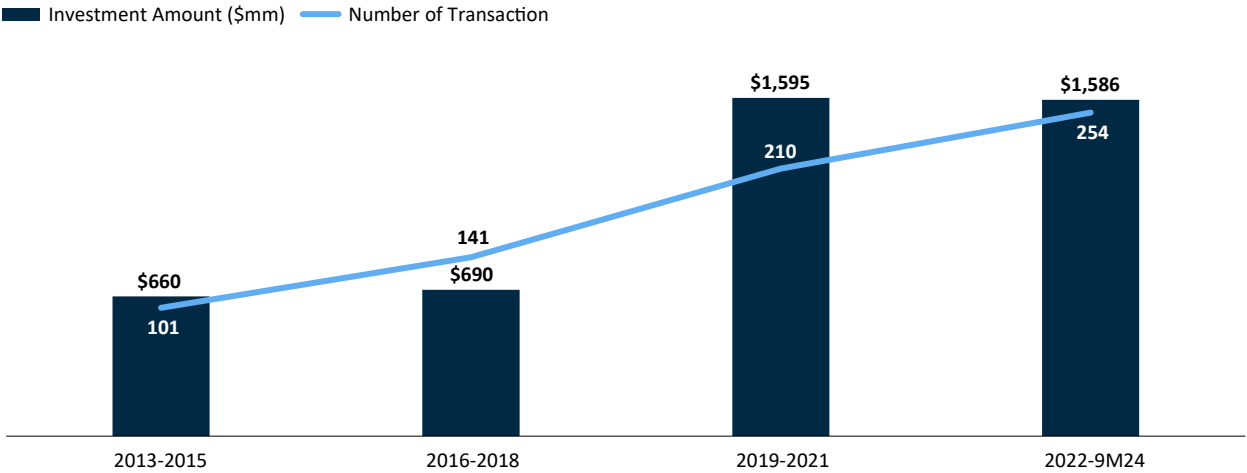
DX isn’t limited to mega corporations. With support from the government, small-and medium-sized enterprises are replacing paper-based systems with Software as a Service (SaaS) solutions that automate everything from payroll management to enterprise resource planning, project management, accounting, marketing, procurement, bookings and other business functions.

Consulting firms are seeing an uptick in business from companies seeking help with the implementation of digital tools, as they acknowledge that DX not only boosts productivity and efficiency, but also helps address labor shortages caused by Japan’s shrinking population. The country’s workforce is forecast to decline by 20% by 2040.<sup>6</sup>

While Japan has a mature buyout market backed by private equity funds, the SaaS sector has seen active venture capital (VC) activity, with several start-ups growing quickly into sizable platforms. One example is SmartHR, a VC-backed human resources SaaS company that completed a \$140 million Series E raise in June 2024, valuing it at \$1.6 billion.<sup>7</sup> As Figure 1 shows, private equity and VC investment in Japan’s technology sector has grown significantly over the past decade or so. We therefore expect private equity and venture activity in this sector to continue.

**Figure 1: Private Equity and Venture Capital Investments in Japan’s Technology Sector<sup>8</sup>**

Average Investment Amount and Number of Transactions Annually





## Global Expansion

Another cultural shift among Japanese companies in recent years is an increasing willingness to look overseas for expansion. For example, Nippon Steel offered to buy United States Steel Corp. for \$15 billion, while Uniqlo's<sup>9</sup> international apparel business contributed 65% of total revenue in the 12 months through August 2024, compared with 37% in fiscal 2014.

But as with DX, growth abroad isn't limited to the biggest organizations. Smaller, private equity-backed companies are also embracing overseas expansion. In 2022, Owndays, an eyewear retail chain in Japan, merged with Indian peer Lenskart to form Asia's largest eyewear business,<sup>10</sup> while Be Forward, a Japanese used car exporter, mainly targets the Africa market. In food and beverage, Japanese conveyor belt sushi chain Sushiro has expanded in Hong Kong, Taiwan, and other Southeast Asia locations,<sup>11</sup> while Pepper Lunch, a teppanyaki chain (known as hibachi in the US), now has more than 500 restaurants in 15 countries, including the US.<sup>12</sup>

Since operational, regulatory and capital hurdles make entering foreign markets complicated for smaller companies, we believe international expansion is another area where private equity sponsors can step in to provide expertise and resources.

## Local Presence

Assets in Japan-based private capital funds almost doubled in the five years through June 2023 to \$115 billion, according to Preqin,<sup>13</sup> which is likely to increase competition for deals as managers seek to put capital to work. Rising valuations, benchmarked against the surge in public market equivalents on the Nikkei 225, also present a challenge to deal making and increase risk, making it critical for private markets investors to pick their spots carefully and maintain discipline.

Our market observations indicate that larger deals tend to be more competitive, as these transactions are typically auctions with extensive price discovery processes that attract both domestic and global private equity managers. Adams Street, through its managers, therefore focuses primarily on smaller mid-market deals. This sector accounts for over 80% of total private equity activity<sup>14</sup> and, in our experience, attracts less competition, providing the potential for better entry valuations, more value creation levers and greater "upsell" opportunities at exit.

Finally, investors should not overlook the intricate and deep-seated language, culture and social norms that make Japan unique. Through our more than two decades of investing in Japan, we have found that successful investing requires team members on the ground with the ability to access and evaluate investment opportunities through partnerships with local private equity fund managers, and the skills to communicate effectively with executives in the local language.

## Improving Outlook for PE

By embracing technology and corporate reforms, Japanese companies large and small are seeking to transform how they conduct business in the digital era. A key part of that process will likely be an increasing willingness to embrace the capital, strategic insights and operational expertise that private equity can provide.

As global investors rebalance their allocations in the region, we expect Japan's expanding private markets to see more interest. With its long-standing experience in Japan since early 2000, Adams Street is excited about the growing opportunity to back transforming, evolving companies in sectors that stand to benefit from long-term secular tailwinds. ■

1. Source: AVCJ database
2. Source: Preqin "[Alternatives in APAC 2024](#)" April 24, 2024, Page 11
3. Source: Preqin "[Alternatives in APAC 2024](#)" April 24, 2024, Page 4
4. Source: Bain & Co. [Competition to heat up as Japan takes private equity pole position in Asia Pacific](#), May 31, 2024
5. Source: Bloomberg via the Japan Times "[Hitachi reinvents itself in sign of hope for Japan](#)," August 4, 2023
6. Source: World Economic Forum, [Japan's workforce will be 20% smaller by 2040](#), February 12, 2019
7. Source: TechCrunch [Japan's SmartHR raises \\$140M Series E as strong demand for HR tech boosts its ARR to \\$100M](#), July 1, 2024
8. Data source: AVCJ database, sourced on October 21, 2024
9. Based on parent company Fast Retailing Co., Ltd.'s financial reporting
10. Source: Medium "[LENSKART and OWNDAYS combine to form Asia's largest eyewear business and revolutionise the vision care industry](#)" August 1, 2022
11. Source: SeafoodSource [For first time in its history, Sushiro plans more openings abroad than in Japan](#), February 9, 2023
12. Source: [Pepper Lunch Restaurants](#)
13. Source: Preqin, [Fundraising from Japan 2024: A guide to raising capital](#), March 26, 2024
14. Source: Bain Capital; based on the number of transactions as of 2022, and mid-market deals are based on Enterprise Value of less than JPY100bn.

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