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Letter from Tokyo

Private equity has a role to play in Japan’s reconstruction, but Japanese authorities must work to provide a conducive investment environment, writes Joji Takeuchi.

posted - 01 Jun 2011 00:00 GMT

Two months have passed since March 11th, when the magnitude 9 earthquake hit the northern part of Japan’s main island and an unprecedented tsunami swept everything in the coastal cities in Tohoku area. One of the three nuclear power plants that were on the shorelines of Tohoku, Fukushima #1, developed a serious problem due to the loss of power generators for emergency reactor cooling, a problem that is yet to be solved. This is the largest impediment to the reconstruction of devastated Tohoku area, creating great uncertainty and commanding a lot of government resources.

While it will take years to fix the Fukushima #1 plant, the reconstruction of the damaged area cannot wait. Lifelines have to be created, jobs have to be created and alternative energy sources need to be found to replace the suspended nuclear power plants. Coastal cities that have been completely swept away have to be rebuilt from scratch. The consensus in Tokyo appears to be to create forward-looking disaster-proof eco-cities, while the local governments opt for plans that can be implemented faster.

The reconstruction cost is estimated at $200 billion to $300 billion. But the number will substantially increase with the Fukushima #1-related compensations. There will be capital injections to local banks and there will be a substantial payout of unemployment insurances. And the government has to finance this by increasing its already huge outstanding debts.

It looks certain that the reconstruction process will need to be supported by private capital. There is an urgent need for roads and port facility rehabilitation. Power generation capacity has to be increased – both by fossil fuels and renewable energies. Strong policy incentives towards clean energy, smart grid and other energy saving technologies will be introduced. There is also an urgent need for building hospitals, care homes and schools. A lot of factories and small businesses are severely damaged or swept away, which will force SMEs to turn to equity partners for reconstruction. Larger companies may also look into divestment possibilities.

Some Japanese GPs, including us, have made proposals to the government/ruling party as to how they can be instrumental in the reconstruction process. During the visit by the US Secretary of State in mid-April, an agreement was reached to set up a public-private initiative to back the reconstruction process in Japan. Nikkei newspaper (14 April 2011) reported the initiative as the establishment of a Japan-US joint-reconstruction fund.

Whatever the form of involvement, there is likely to be a substantial role for private equity to play. But the DPJ government must set out policy measures that are truly effective in facilitating private capital inflow. Such measures could include de-regulation and lower tax rates. It could also involve subsidies and incentives in such sectors as infrastructure, healthcare, education, cleantech and renewable energy. This should also be an optimal opportunity for large Japanese public pensions to start private equity and infrastructure investments. For example, co-investments with experienced infrastructure funds should give better efficiency and governance than traditional public works. They could also support private equity funds that are focusing on SME turnarounds and the government can provide a downside protection to such investments. Public pensions can re-circulate under-utilised capital to rebuild Tohoku and rejuvenate hard-hit private sectors across the country.

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