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Within Sumitomo Trust, we have what we call the Credit Investment Management Department, which consists of twenty people who look only at private equity, venture capital, and buyout funds—with commitments totaling roughly $750 million.

As mentioned earlier, investing in private equity is very labor intensive, and it takes time until you generate good returns, performance, and liquidity. So before you invest, you need to know why you’re going to invest. Consultants and trust bank experts will say many things in order to make private equity one of your investment options, so it’s important to understand the characteristics of the product.

Why did Sumitomo Trust start investing in private equity? There are many reasons, but the firm’s goal is to get a 10 percent return on equity for the funds we get from shareholders and depositors. For trust banks, private equity is an attractive alternative to equity over the long term. When there’s growth in the economy and corporate sector, private equity is a great asset. But how do you go about it? Various factors should be taken into account. First, can it be bought in a small amount? Generally, the minimum investment in a fund is $5 million to $25 million. Second, there are choices as to the style of investment—whether it is top-down or bottom-up—which means there’s a choice in managers. When a manager is good, that manager should show a 10 percent return.

My preference is to diversify, but that may not work in all markets. For example, it’s hard to diversify in yen-denominated assets, so that’s when I handpick a good manager. However, if we’re investing in the United States, Europe, or China, then I would look at assets that achieve a high return. The investment structure depends on the maturity of the market and the capacity of the investor. Some may like to invest in a small fund or a fund of funds, while others will invest more over a longer period.

In Japan, there are two ways to invest in private equity. One is to use a trust bank; the other is to use an investment advisory company. It’s not really that significant one way or the other, but it’s important that the firm devise the right investment program for you. The real difference is in terms of procedure and not much else. It’s important to monitor the inflow and outflow of cash, how much is drawn down, and how the cash is returned. If you determine the trend of cash flow, you’ll start to see some disparity among different managers.

What are the risks? It’s hard to judge the performance of a private equity investment only looking at statistics. In this sense, a bottom-up approach becomes more important. Also, looking at the fine print of a manager’s prospectus is quite hard. Different managers use different numbers to illustrate their performance. We get a lot of prospectuses sent to us, but we don’t read them very much because it’s not so significant to make a decision just from the numbers in the prospectus.

Lastly, a word of caution. Don’t trust every word that an investment banker tells you. It’s important for pension funds interested in private equity to ask other pension funds who are already in the game about their problems. There should be an investor network, so specific issues and experiences can be discussed. Don’t just rely on the information you get from the service vendors.