



How Private Equity Can Add Value in China — The Talent Opportunity and Challenge

The private equity (PE) industry in Asia Pacific is recovering from a multi-year slump, with China leading the resurgence. According to a recent PwC report, China saw a 170 percent increase of PE/venture capital deal values in 2015 — compared to only 18 percent globally — reaching U.S. \$197 billion and seizing 48 percent of global market share. In this next phase, general partners will be focused on healthier portfolios, paying particular attention to ownership structure and governance. They are also beginning to pursue creative ways to improve portfolio companies' performance while building path-to-control provisions into acquisition agreements to manage risk. This more activist approach and emphasis on sustainable performance will likely continue in the face of China's slower GDP growth and ongoing evolution from an export-based economy to a consumer-led one. In order for private equity to truly add value and drive performance in today's environment, strong leaders are needed for both portfolio companies and PE operations teams. However, firms are facing a shortage of senior leadership talent on both sides. We will explore this evolving landscape and how private equity firms are overcoming the talent challenge.

ADDING VALUE IN CHINA'S CURRENT LANDSCAPE

Most of the deal themes in China are growth-related, with the technology and consumer sectors accounting for more than half of the deal volume. In addition, the country has seen a jump in outbound deals and increased activity thanks to the opening of state-owned enterprises to private investors, according to PwC. Many are recognizing that private equity can add value to the portfolio company by refining the portfolio company's strategy and, in a total buyout, refresh the leadership team to better align with the company's new direction. Even in scenarios where the PE firm does not take a full ownership stake, it can help identify areas for growth, fill clear skill gaps or help the company build relationships it otherwise may not have access to, such as with multinational corporations.

“When there is a change needed on the management team, if you have built a good relationship with the CEO, then it’s not hard to have a respectful discussion with his or her core team members about a change.”

MANAGING DIRECTOR
AND HEAD OF CHINA,
GLOBAL PE FIRM

The most successful deals are those in which the operations team is involved during the due diligence phase so that change management efforts can begin immediately. “Early focus is key,” said one managing director and head of China for a global PE firm, “we call it ‘fast start,’ and it’s the most important lever. Our operations team must earn credibility upfront. When there is a change needed on the management team, if you have built a good relationship with the CEO, then it’s not hard to have a respectful discussion with his or her core team members about a change.” In deals where the firm is the minority stakeholder, it needs to align with key stakeholders early to pave the way for changes later. Trust also has to be earned with investors, and he says that a key part of earning that trust is providing a realistic picture of what the operations team can — and cannot — help achieve: “We are not a last-minute savior and cannot perform a miracle or conduct a complete turnaround.”

OVERCOMING LEADERSHIP AND TALENT BARRIERS

How PE and portfolio companies will fare going forward largely hinges upon the leadership of each. A significant obstacle on both sides of the equation is a shortage of experienced senior leadership talent.

Chinese companies also tend to be younger than MNCs, and the expertise level of their executives has been outpaced by the rapid expansion of the country's economy. While these leaders recognize problems exist with their own leadership or on their teams, they are unsure of how to address them or develop talent.

MANAGING DIRECTOR
OF A U.S. PE FIRM AND
FORMER TECHNOLOGY
COMPANY CEO

“China MNC heads are not true CEOs,” said a managing director at a U.S. PE firm and former technology company CEO, “they often get things done by influencing the matrix and engaging the network, but don’t actually make any decisions or take ownership themselves.” He observed that Chinese companies also tend to be younger than MNCs, and the expertise level of their executives has been outpaced by the rapid expansion of the country’s economy. While these leaders recognize problems exist with their own leadership or on their teams, they are unsure of how to address them or develop talent, he added. Some organizations have the opposite problem: Leadership verges on autocratic and, as a result, prevents private equity from fully contributing.

While there may be an inclination to change existing leadership, as minority stakeholders, PE firms have less influence, complicated by the significant shortage of experienced senior executives in China. Thus, according to a partner and managing director at an Asia Pacific PE firm, it’s important for PE firms to invest in people with whom they can successfully work by assessing the key players during due diligence and after the close. Despite a resemblance to Western models, Chinese entrepreneur- and founder-led organizations typically reflect the unique styles of their leaders in ways that are not easy to discern without full immersion, often prompting “tissue rejection” of newly installed executives.

Many PE leaders advise against extensive team overhauls, as the level of disruption they create can often outweigh the benefits. Similarly, it is unlikely the operating team can replace the CEO in these scenarios, as his or her influence shapes the organization. One potential solution is bringing in a chief operating officer with strong execution skills who can support the CEO, but also serve as a potential successor down the line. Private equity firms can shape

talent decisions after they have earned credibility, but they will need to do so in a way that allows outgoing leaders save face, e.g., positioning a shift into a less integral role as a promotion.

THE CRITICAL SKILLS FOR TODAY'S ENVIRONMENT

For portfolio companies

“The economy is tough at the moment. You need a team who can deal with these changes and be open-minded — these attributes used to have an amplifying effect, but they are a necessity now.”

MANAGING DIRECTOR
OF ASIA FOR A
GLOBAL ALTERNATIVE
INVESTMENT FIRM

Many PE players agree that the current economy demands a different type of portfolio company leadership. According to one managing director of Asia for a global alternative investment firm, “The economy is tough at the moment. You need a team who can deal with these changes and be open-minded — these attributes used to have an amplifying effect, but they are a necessity now.” In addition to adaptability and ability to deal with ambiguity, portfolio company leaders need to be able to fit the culture of both the new organization and the private equity firm.

PE leaders say results orientation, drive, intellectual curiosity and entrepreneurial spirit are also vital today. Adding value quickly requires that these senior executives partner effectively with the board and collaborate with the CEO and peers. Beyond strategic mindset, portfolio company CEOs need to excel at talent development amid the current shortage. Regardless of role, portfolio company leaders need realistic expectations when it comes to how quickly they can effect change and the number of stakeholders who need to be involved in key decisions.

Some find that securing talent with these skills is only the first part of the challenge; the next issue is assessing whether leaders actually possess these attributes. “It is one thing to see things on paper, but another to get to know them as characters. How we do this is a challenge,” said one PE leader. Leaders increasingly recognize that cultural alignment can greatly impact business performance, and that poor cultural fit is the most common reason why newly hired executives fail in their first year. In addition to business results, a regional PE firm evaluates portfolio company CEOs on whether they can recruit and develop talent and fit with the organizational culture.

“It is key for operating teams to focus on the bigger picture. Anticipation of changes is the number one criteria for our team so that we can be peers to the CEO.”

MANAGING DIRECTOR
AN HEAD OF CHINA,
GLOBAL PE FIRM

For operations teams

With such multi-faceted challenges facing their portfolio companies, PE firms are increasingly looking for generalists with macro perspective and strong business acumen. “It is key for operating teams to focus on the bigger picture,” said one managing director and head of China. “Anticipation of changes is the number one criteria for our team so that we can be peers to the CEO.”

When assessing a candidate with a strong track record, he advises that PE firms discern which achievements were the result of individual contributions versus the byproduct of the strong organizational processes that typify MNCs. There can be a danger that executives from system-heavy environments think at too high of a level, set the direction and then assume the issue is resolved. PE leaders need to translate strategy into action. At the same time, one managing director observed that leaders who only have consulting experience can lack vital firsthand perspectives from the corporate world; the best operating teams blend talent from both sides. Many noted the importance of relationship-building, especially when the operations team has to have difficult conversations about leadership changes at the portfolio company.

The PE environment in China also requires leaders who have the Executive Intelligence — comprising business, contextual, interpersonal, learning and conceptual intelligence — to grow in the face of new challenges. These dimensions are central to a leader’s capacity to be successful in new, unfamiliar and complex situations — exactly the type of situations in which portfolio company CEOs and operating team leaders are tested.

Finding talent with these myriad skills has been a challenge, spurring some to think creatively about how to fill gaps. A senior managing director and a founding partner of a Hong Kong-based alternative investment and advisory company has a team of entrepreneurs-in-residence constituting former executives and CEOs from different industries to help with deal sourcing and portfolio management. The organization also has functional experts who can help support the portfolio company in areas where it is unable to dedicate sufficient resources, such as human resources.

WHAT CAN BE DONE TO DEVELOP LEADERS AND THE TALENT PIPELINE?

Leadership is not a topic that is typically addressed in the Chinese education system, an oversight that can manifest itself later in the corporate world. It can become challenging for PE firms to advise and coach portfolio company leaders on transitioning from the organization's original scale to lead the more complex structures that come with growth, as well as elevating the entire leadership team's skills to match the company's current stage. Resistance to external feedback is also common, presenting another obstacle to leadership development.

“PE can try to help fill in the gaps, such as helping the executive to go from a product leader to a people leader. This requires helping the entrepreneur mature and navigate issues such as conflict resolution.”

MANAGING DIRECTOR
OF A PE FIRM

“PE can try to help fill in the gaps, such as helping the executive to go from a product leader to a people leader. This requires helping the entrepreneur mature and navigate issues such as conflict resolution,” said a PE firm managing director. “Many entrepreneurial CEOs know they have limitations, but don't know exactly what is off and where to get help. They probably had very little feedback in the past.”

Onboarding is an integral component of leadership development, but one that can be overlooked in favor of immediately diving into the day-to-day operations. One PE senior executive recommends checking in with the newly installed leader on a monthly basis to both facilitate onboarding and mitigate early issues. Onboarding should be tailored for the role, the executive's specific development needs and the situation. For example, if the newly installed CEO comes from outside the industry, the onboarding process can include immersion with the product development and marketing functions.

LOOKING AHEAD

It is anticipated that private equity investment in China will continue its upward trajectory. However, PE firms will need to find ways to address the severe talent shortage in order to seize the opportunity. More PE firms are partnering with search firms to not only identify leaders, but also to build their knowledge of the talent market and to improve their talent development processes. To bridge the gap, firms may need to bring in less conventional candidates — and place greater emphasis on assessments for fit with organizational culture in addition to tailored development plans to ensure long-term success. Successful integration of new leaders for both PE firms and their portfolio companies requires they build trust, empower objective decision-making and emphasize the role of strong teams versus individual contributions in delivering results. Finding and cultivating leaders for operating teams and portfolio companies with broad business perspective and experience navigating ambiguity will be critical to adding value.

ABOUT THE AUTHORS

Sherry Ding is based in the Greater China region, and serves as a member of the firm's Private Equity and Consumer practices.

Alice Au is based in the Greater China region, and leads the firm's Financial Services Practice globally, and the Private Equity, and Board and CEO practices in Asia Pacific.

ABOUT SPENCER STUART

At Spencer Stuart, we know how much leadership matters. We are trusted by organizations around the world to help them make the senior-level leadership decisions that have a lasting impact on their enterprises. Through our executive search, board and leadership advisory services, we help build and enhance high-performing teams for select clients ranging from major multinationals to emerging companies to nonprofit institutions.

Privately held since 1956, we focus on delivering knowledge, insight and results through the collaborative efforts of a team of experts — now spanning 56 offices, 30 countries and more than 50 practice specialties. Boards and leaders consistently turn to Spencer Stuart to help address their evolving leadership needs in areas such as senior-level executive search, board recruitment, board effectiveness, succession planning, in-depth senior management assessment and many other facets of organizational effectiveness.

For more information on Spencer Stuart, please visit www.spencerstuart.com and www.spencerstuart.cn.

Social Media @ Spencer Stuart

Stay up to date on the trends and topics that are relevant to your business and career.

