

Embracing Market Challenges and Uncertainties

Insights from Exclusive Private Equity Operating Partners Event Series

By Arthur Leung, Fiona Cai, Lydia Tang, Lynn Shao, Luc Liu, Yao Yao

In August and September, Egon Zehnder's Greater China team welcomed more than 20 experienced operating partners and buy-out investors from various private equity funds to gather for an insightful discussion in Shanghai and Hong Kong.

With a challenging fundraising market and subdued investment appetite, portfolio management, value creation and exits have become the core activities that private equity investors focus on as ways to differentiate and deliver value to their LPs. This trend is also reflected in the client engagements and dialogues Egon Zehnder has with private equity investors as they seek advice on various leadership topics related to the Board and management team of portfolio companies. The power and opportunity from bringing industry practitioners closer together becomes apparent to us.

Read on for the discussion highlights:

Making Effective Board and Executive Hiring Decisions

Post-Covid, China has experienced much slower economic growth that many have hoped for, which demands private equity investors to think and influence portfolio companies with a different mindset. "It's about minimizing value destruction, rather than achieving value creation," as one participant described.

There is also mounting pressure to act decisively and fast. All operating partners have come across the dilemma of whether and when to make key executive management changes. Replacing a CEO, in particular, is a major challenge due to existing market knowledge and established internal and external relationships. Many of the participants agreed that timing is key. If someone does not appear to be the best fit for CEO, it is better to make the decision to replace them sooner rather than later. Ideally, a pipeline for CEO and other key positions can be developed before closing of deals. This way, potential CEO candidates can be involved in due diligence as industry advisors, making their transition into executive roles smoother.

When choosing the right candidates, our participants said that it is crucial to spend time on the role specifications at an early stage, while also ensuring mechanical and disciplined measurement of performance and alignment of interests with the key talents throughout the process.

The type of leader that portfolio companies demand has also evolved. “China has a lot of growth leaders, who know how to spend to achieve top line growth. We need CEOs who can also manage cost, and that cannot just be a CFO’s job.” Another participant mentioned the need to have more resilient leaders in China. “It takes a different mindset to weather through a downturn. No one knows how much things may get worse before they get better. It is critical to set the right tone from the top and motivate your team.”

Structuring the right board that can support and guide management can also be a powerful tool. Onboarding experienced independent directors or advisors with the specific skills needed in a downturn not only enriches the discussions in the boardroom, but allows them to act as coaches for the management team.

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Working with Business Founders

Founder-led portfolio companies make up a sizeable part of many private equity firm's portfolios in Greater China. Some participants noted the shift of sentiment of some founders. "Market uncertainties have triggered some founders to think differently about how and where they can grow their business. Some founders' desire to continue running their business is also dampened by policy uncertainties as well as the lack of family succession options," stated one participant. While this, on one hand, opens up potential investment opportunities for private equity firms, it also adds to the challenge for operating partners when working with founders.

Our participants often work with founders under different scenarios, depending on the specific deal structure—single buyout, joint-control with other investors, and minority investment. While joint-control portfolios are more about stakeholder management and minority-stake portfolios are more about indirect influence, operating partners spend the most time with founders of single buyout portfolio companies.

Before entering a buyout deal as the sole investor, private equity funds begin working with the founder on deal structuring and due diligence. Our participants believed it's important that founders are willing to cooperate on transition planning, which is not only about transferring ownership of the company, but also about handing over business relationships and influence power, both internally and externally (e.g., client and supplier relationships). As another participant put: "Whether it's during due diligence or post deal management, talking to the middle management and employees can reveal a lot of real issues that the senior management team may not be willing to tell." Grasping of such issues will play an important role in transition planning.

Paying close attention to details while aligning with founders on the transition plan is a way for operating partners to avoid losing their voice in business operations or clashing with founders after closing of the deal, which would have a devastating impact on the exit agenda.

Said one participant: "Founder-led businesses are of higher risk to manage, but they come with the biggest buyout opportunity in the coming years in China. MNC or large corporate carve-outs are considered lower risk deals, but those are driven by the current wave of strategy restructuring of big corporates – there are limited opportunities and can be competitive.

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Facing Challenges in Exits

More than fifty percent of our participants are working on exits targeted for within the next two years. Given current market conditions, some of our participants are exploring innovative financial engineering methods to navigate the environment while they manage expectations regarding the delayed exit timeline.

Broadly speaking, it is a tough environment to exit, because of poor valuation and limited IPO venues for China based companies. Attendees exchanged learnings from select financial innovations—continuation funds or secondary transactions—which could play a key role if certain funds require to deliver earlier DPI.

The participants also discussed what type of management team they need in their portfolio companies before exit. “If the exit strategy is through a trade sale, it’s critical that we adapt the mindset of potential future buyers early and think “How can we make the management team more attractive at sales?” One participant highlighted the complexity and fine balance this requires. “You would like to have a strong management team at sale, but you also don’t want future buyers to worry that the business cannot be run without such a team.” Structuring the right incentive schemes for management team also becomes critical. “Ideally you would like to provide incentive to management that can be realized partially from exit, and also leave further upside should they stay for the new buyer. Having said that, the scheme cannot be too restrictive which limits future buyers ability to make management change depending on their value creation strategy.”

As we rounded up our discussion on exits, another participant noted that some LPs are actually quite understanding about the current environment and the challenge to exits, because they themselves may be managing some direct investments elsewhere. This certainly strikes a less pessimistic tone to our conversation.

“We Are in This Together as an Industry”

As we wrapped up our gathering, almost all participants were grateful for the exchange of ideas and the opportunity to network with each other. The discussions not only provided them with new insights on how to tackle their portfolio challenges but allowed them to appreciate that they are not alone. “When it comes to portfolio management and value creation, I don’t see each other as competitors. I would love to tap the brain of my peer group more in the future,” one participant concluded.

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Hosts



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Arthur Leung leads Egon Zehnder's Private Capital Practice in Asia. He is a trusted strategy advisor to senior leaders on wholesale, investment and private banking, and asset management. Before joining Egon Zehnder, Arthur served as the Head of Regional Strategy & Business Development, APAC Regional Management with Deutsche Bank in Hong Kong and Singapore, where he supported the regional CEO and COO in strategy, governance, and operational matters across 14 markets. Prior to that, he held the role of Group Strategy Director at Standard Chartered Bank in Singapore as a key member of the wholesale banking strategy team after working in investment banking at HSBC in Hong Kong. Arthur launched his career as an accountant at KPMG's audit & assurance and transaction advisory practices in Canada. Arthur holds a Bachelor's of Commerce degree in finance and accounting (with Honors) from Queen's University in Canada and completed an MBA at INSEAD in France and Singapore. He is also a chartered professional accountant registered in Canada. Arthur is married with two children and speaks fluent English, Cantonese, and Mandarin. Outside work, he coaches students and young professionals and is an active member of INSEAD and the Wah Yan Primary and Secondary School's alumni community in Hong Kong and Singapore.

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Based in Hong Kong and Shanghai, Fiona co-leads Egon Zehnder's Financial Services Practice in China, drawing on her extensive experience to help clients in Asia especially Greater China achieve their goals through leadership solutions. She draws on many years of experience in the FinTech, commercial finance, industrial, and healthcare sectors across China and Asia, and possesses broad expertise across corporate finance, strategy development, and investments. Prior to joining Egon Zehnder, Fiona led global strategic investments as the Head of Investment at Lexin (LX), a NASDAQ-listed Chinese FinTech company. Before that she led the Commercial function of GE Capital Working Capital Solutions - Asia Pacific. Earlier, Fiona held various director roles in strategic marketing at GE Capital APAC to drive the regional organic growth after she served GE's industrial businesses for their strategic investments and partnerships in China as a M&A manager. She launched her career at GE in China as a finance management trainee (FMP) and globally as an internal auditor (CAS). Fiona earned a BA in business administration from Nanjing University in China, a master's degree in accounting and finance from the LSE in UK, and an EMBA from the Kellogg School of Management at Northwestern University and the HKUST. She is currently a DBA candidate at the University of Hong Kong and Peking University. Outside work, Fiona has a strong connection with nature and enjoys playing outdoor sports, traveling, painting, and meditating.

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Lydia Tang, based in Hong Kong, is active in Egon Zehnder's Financial Services practice focusing on asset management, insurance, banking, blockchain, and fintech. She leverages her deep industry experience to provide leadership advisory, executive search, and talent development services to senior leaders across Asia. Prior to joining the Firm, Lydia served as Vice President of GLG in Hong Kong, carrying out research on public equities across a range of industries including financial services, consumer, technology, healthcare, and industrials. She was also Head of Tours, developing the company's tours strategy and launching this line of services. Lydia began her career in Australia in Ernst & Young's assurance practice. Lydia holds a Bachelor of Commerce degree with a double major in accounting and finance from the University of Queensland. She is a qualified member of the Chartered Accountants Australia & New Zealand, an alumna of the Hong Kong Women's Foundation Mentoring Program and AmCham Hong Kong's Future Leaders Program. She is also involved in Solomon Learning Group (Project M2), a social enterprise devoted to promoting financial literacy in children. Lydia is fluent in English, Cantonese, and Mandarin. Outside of work, Lydia enjoys traveling, exploring good food, sake, and wine while staying active with wakesurfing, basketball, netball, and badminton.

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Lynn Shao leads Egon Zehnder’s Health Practice in China, applying both her deep experience of working as a strategy consultant for clients in life science industry and hands-on experience across strategic marketing, digital innovation and commercial excellence functions in pharmaceutical industry. She is actively involved in Executive Search, Leadership Assessment and Development. Prior to joining Egon Zehnder, Lynn was the Strategic Marketing & Business Operations Director at Sanofi, where her responsibilities included strategic and new product planning, digital innovation, and operations excellence for the company’s diabetes business unit. Before that she served as an Engagement Manager at McKinsey & Co., advising clients in the U.S. and China on market entry, organic and inorganic growth strategies, and post-merger integration. Lynn earned a BS and a Master’s of Management degree from Fudan University in Shanghai and then an MBA from the Wharton Business School at the University of Pennsylvania. Lynn enjoys the beauty of nature by hiking and trekking with friends. She also loves watching documentaries, which feature stories of people from all walks of life.

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Luc Liu is an active member of Egon Zehnder's Industrial Practice. He is prized by both locally operating and multinational companies in diverse sectors for his ability to draw on his deep industry experience to help them identify and develop prime candidates for senior executive positions. Before coming to Egon Zehnder, most recently Luc was General Manager, Corporate Alliance & Digital Ecosystem, Schneider Electric China. Prior to that, he was Head of New Business Unit for Wyeth Nutrition Greater China and Corporate Strategy & BD Director for Nestle Greater China. That was preceded by the position of Head of Strategy and ExCom member for Lafarge China. Earlier, Luc was responsible international business development of China National Building Material International Engineering Co Ltd (CNBM) in Mid-East and Africa. Luc earned his MBA from INSEAD & Tsinghua University and MBus from University of Manchester, MSc from University of Birmingham, BCom from Wuhan University of Technology and also Law Diploma from Wuhan University. Outside of work, he loves reading history books, playing football and travelling with his wife and two children.

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Yao Yao leads Egon Zehnder's Human Resources Practice in China. She is also an active member of Egon Zehnder's Consumer Practice. Based in Shanghai, she serves clients in executive succession, leadership development, management assessment, and executive search. Yao Yao combines a business mindset and deep people insights to help clients identify and develop executives, unlock opportunities to dynamize their enterprises, and overcome organizational inertia. Prior to joining Egon Zehnder, Yao Yao supported entrepreneurs and executive teams as a certified freelance coach. Before that, she founded an international education technology company, which supports educational institutions in China and the U.S. Earlier, Yao Yao served as Amazon's Senior Program Manager with responsibility for global strategy and operations planning. That was preceded by the role of Retail Measurement Service Manager at Nielson. Yao Yao earned a BSc in economics from Shanghai University with honors and an MBA from the Wharton Business School at the University of Pennsylvania. She has qualified as a Professional Certified Coach and Organizational Relationship System Coach. During the past five years she has also studied and practiced existential psychotherapy and is a practiced meditator. Outside work, Yao Yao enjoys the theater and cooking, and works as a volunteer in a nonprofit organization.

About Egon Zehnder

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