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Challenges and Future Directions in the Institutionalization of Private Equity Fund Management in China

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Abstract: This paper examines the evolution and current status of private equity (PE) fund management in China, highlighting the industry's transition from informal, fragmented practices to a partially institutionalized system. Key challenges in this process include fragmented regulatory oversight, inconsistent policies, weak corporate governance, limited investor protection, talent shortages, and structural market inefficiencies. Drawing on international experiences from the United States and Europe, the study identifies lessons in regulatory frameworks, governance standards, professionalization, and market development that are applicable to China. The paper further outlines future directions for the institutionalization of Chinese PE funds, emphasizing improvements in legal and regulatory systems, enhanced governance and transparency, long-term capital mobilization, talent development, and sustainable market practices, including ESG integration. Strengthening institutional frameworks is essential not only for mitigating risks and protecting investors but also for fostering the long-term stability, efficiency, and competitiveness of China's private equity industry.

Keywords: private equity; institutionalization; regulatory framework; corporate governance; investor protection

1. Introduction

Private equity (PE) funds have become an increasingly significant component of China's capital market over the past two decades. As the economy has shifted from reliance on traditional investment channels to a more diversified and market-oriented structure, PE funds have played an important role in financing innovation, supporting small and medium-sized enterprises, and fostering industrial upgrading. With the rapid expansion of this sector, China has emerged as one of the largest private equity markets in the world, attracting both domestic and international investors. However, this growth has also revealed structural weaknesses, particularly in governance, regulation, and transparency, which threaten the sustainable development of the industry.

The central research question of this paper is why the institutionalization of PE fund management is necessary for China at its current stage of market development. Institutionalization, in this context, refers to the establishment of standardized rules, professional practices, and governance frameworks that reduce systemic risks while enhancing investor confidence and market efficiency. Similar to how digital construction and continuous integration frameworks standardize complex processes to improve efficiency and accountability in other industries [1,2], PE funds also require robust institutionalization to ensure sustainable growth. Without such foundations, expansion may lead to misallocation of resources, insufficient investor protection, and reputational risks that undermine the credibility of the broader financial system.

This paper is structured as follows. Section two outlines the evolution and current status of PE fund management in China. Section three identifies the key challenges hindering the institutionalization process. Section four draws on international experiences to

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provide comparative insights from mature PE markets such as the United States and Europe. Section five discusses future directions for strengthening institutionalization in China, focusing on regulatory reforms, governance enhancement, capital structure improvement, talent development, and sustainable growth strategies. The final section concludes by summarizing the challenges and emphasizing the strategic importance of institutionalization for the long-term health of China's capital markets.

2. Evolution and Current Status of Private Equity Fund Management in China

The development of PE funds in China can be traced back to the early 1990s, when the country began experimenting with market-oriented financial instruments as part of its broader economic reforms. Initially, the industry lacked a clear legal identity, and many PE activities were conducted under the umbrella of trust companies or foreign-invested venture capital firms [3]. During this early stage, the policy environment was characterized by ambiguity, with overlapping jurisdictions among regulators and an underdeveloped legal framework. Nevertheless, the rapid growth of China's economy and the need to channel private capital into high-growth sectors provided fertile ground for the emergence of PE funds. Foreign capital inflows also played a catalytic role, bringing global practices of limited partnership structures and governance norms into the Chinese market.

A more formalized stage of development began in the mid-2000s, when regulatory authorities started to recognize the role of PE funds in supporting innovation and entrepreneurship. The establishment of a national industry association (CSIFA, later restructured as AMAC) marked an important milestone in building a registration and supervisory system for fund managers. Regulatory authorities gradually introduced requirements on fund raising, information disclosure, and investor qualification, laying the groundwork for a more transparent industry environment. These measures reflected a growing awareness of the need to balance market vitality with risk control [4].

In recent years, the institutionalization of PE fund management has entered a more accelerated phase. The implementation of relevant regulatory frameworks has provided a clearer legal foundation for both fund managers and investors. Registration systems have become more standardized, with AMAC playing a central role in overseeing compliance. At the same time, industry practices have started to align more closely with international standards, particularly in areas such as fiduciary duties, reporting requirements, and governance structures. Nevertheless, transparency and governance quality remain uneven, particularly among small- and medium-sized firms. This situation is comparable to challenges in other industries where inconsistent internal control mechanisms limit efficiency and accountability [5,6].

Overall, the evolution of PE fund management in China reflects a trajectory from informal, fragmented practices toward greater institutionalization. Table 1 summarizes the main stages of this evolution, highlighting the regulatory environment, industry characteristics, and key milestones at each stage. The current status can be described as one of partial maturity: while basic legal and supervisory frameworks are in place, significant challenges remain in ensuring consistency, professionalism, and investor protection. This transitional stage provides both opportunities and pressures for the industry to move toward a more fully institutionalized model.

Table 1. Evolution of Private Equity Fund Management in China.

| Stage | Period | Policy Environment | Industry Features | Institutionalization Progress |
|-------------------|-------------------|--|---|--|
| Early Exploration | 1990s–early 2000s | Ambiguous regulation, fragmented oversight | Trust companies, foreign VC participation | Informal structures, limited legal recognition |

| | | | | |
|--------------------|-------------------|---|---|---|
| Formali- zation | Mid- 2000s | Recognition of PE's role in innovation and en- trepreneurship | Growth of domestic PE firms, foreign partnerships | Establishment of AMAC, introduction of registra- tion requirements |
| Acceler- ation | 2013–pre- sent | Securities Investment Fund Law, improved regulatory framework | Rapid increase in fund numbers and AUM | More standardized regis- tration, partial alignment with global practices |

3. Key Challenges in Institutionalization

3.1. Regulatory and Legal Fragmentation

Despite notable progress, the regulatory and legal framework for private equity (PE) in the region remains fragmented. Multiple regulatory authorities oversee different aspects of the industry, often resulting in overlapping jurisdictions and inconsistent enforcement of rules. Regional disparities further exacerbate the problem, as different jurisdictions may implement divergent policies that create uncertainty for fund managers and investors. Moreover, alignment with international standards is limited, which can hinder cross-border investment and restrict the adoption of globally recognized governance and operational practices. Addressing these regulatory inconsistencies is essential to provide a predictable legal environment that can support sustainable growth [7].

3.2. Corporate Governance and Transparency Issues

Corporate governance and transparency continue to be major concerns. Many PE firms operate with weak internal control systems, making them vulnerable to operational risks and potential mismanagement. Conflicts of interest, such as related-party transactions or preferential treatment of certain investors, are not always effectively mitigated. Information disclosure practices are often insufficient, with limited transparency on fund performance, risk exposure, and management decisions. Improving governance structures, implementing standardized reporting practices, and enforcing fiduciary duties are critical steps to build trust among investors and enhance the credibility of the industry [8].

3.3. Capital Accumulation and Investor Protection

Capital accumulation and investor protection present persistent challenges. Attracting long-term, patient capital remains difficult due to market uncertainties and perceived risks. Institutional investors, such as pension funds and insurance companies, are often hesitant to commit large sums without robust legal protections and clear exit mechanisms. In addition, retail investors may face limited avenues to understand fund structures, evaluate risks, and monitor performance [9]. Existing investor protection mechanisms are underdeveloped, and exit channels, including secondary markets and buyout opportunities, are still constrained. Strengthening investor protection, improving disclosure, and diversifying exit options are essential for increasing confidence and capital inflow.

3.4. Talent Shortages and Professionalization Constraints

The scarcity of qualified professionals limits the professionalization of China's PE industry. High-end talent capable of performing complex investment analysis, risk assessment, and portfolio management is in short supply. Furthermore, systematic training programs, certification schemes, and international collaboration initiatives are not yet fully established. Without a strong talent pipeline, firms may struggle to implement advanced investment strategies, manage risks effectively, and adopt global best practices. Promoting talent development and creating clear career pathways are therefore critical for the long-term sustainability of the sector [10].

3.5. Market Structure Challenges

The structural characteristics of the regional PE market also pose obstacles. The industry is highly fragmented, with many small funds competing in a crowded and relatively homogeneous market. This fragmentation can lead to excessive competition, reduced returns, and duplication of investment efforts. Moreover, smaller funds often lack the scale to attract top-tier investors or invest in high-growth opportunities. Encouraging consolidation, supporting larger-scale fund operations, and promoting diversification in investment strategies are necessary to create a more resilient and efficient market ecosystem.

These challenges collectively underscore the importance of continued regulatory refinement, enhanced corporate governance, strengthened investor protection, talent development, and market consolidation. Table 2 summarizes the key challenges facing the institutionalization of PE funds in China, highlighting issues related to regulation, governance, capital, talent, and market structure. Addressing these obstacles is essential for fostering a mature, stable, and globally competitive private equity industry.

Table 2. Key Challenges in the Institutionalization of Private Equity Funds in China.

| Challenge Category | Specific Issues |
|-------------------------------------|---|
| Regulatory & Legal Framework | Multiple regulators, inconsistent policies, limited international alignment |
| Corporate Governance & Transparency | Weak internal controls, conflicts of interest, insufficient disclosure |
| Capital & Investor Protection | Difficulty attracting long-term capital, limited investor protection, constrained exit channels |
| Talent & Professionalization | Shortage of qualified professionals, underdeveloped training programs |
| Market Structure | Fragmented funds, intense competition, high homogeneity |

4. International Experiences and Lessons

4.1. Regulatory Frameworks in Developed Markets

The institutionalization of private equity (PE) fund management has been evolving for decades in developed markets such as the United States and Europe, providing valuable lessons for the regional PE sector. In these regions, regulatory frameworks are generally well-defined, with clear legal identities for funds and comprehensive investor protection mechanisms. For example, the United States relies on the Investment Advisers Act and the Securities Act to regulate fund managers, enforce fiduciary duties, and ensure transparency in fundraising, investment activities, and reporting. Similarly, European countries have implemented the Alternative Investment Fund Managers Directive (AIFMD), which establishes harmonized standards for risk management, governance, and disclosure across member states. These regulatory frameworks provide stability, reduce operational risks, and enable cross-border investment.

4.2. Governance and Transparency Practices

A key feature of mature PE markets is the standardization of governance practices. Clear fiduciary responsibilities, robust internal controls, independent oversight, and consistent disclosure requirements mitigate conflicts of interest and improve accountability. Regular reporting, independent audits, and transparent communication with investors are common practices in both the U.S. and European markets. These practices enhance investor confidence and set benchmarks for emerging markets, demonstrating how transparency and governance contribute to the credibility and stability of the industry.

4.3. Professionalization and Talent Development

Professionalization of fund management is another critical aspect. Developed markets emphasize formal training, professional certification, and international collaboration to cultivate skilled professionals capable of handling complex investment structures and managing risk effectively. Programs such as the Chartered Alternative Investment Analyst (CAIA) designation, combined with on-the-job mentoring and exposure to global best practices, ensure a high level of operational competence. For China, similar initiatives can help strengthen the talent pool and promote professionalization throughout the PE sector.

4.4. Market Structure and Operational Practices

Market structure optimization is essential for sustainable development. In mature PE markets, fund consolidation, diversification, and the establishment of secondary markets reduce excessive competition and promote long-term growth. Larger, well-diversified funds are better positioned to attract institutional capital, participate in high-value investment opportunities, and implement sophisticated risk management strategies. Lessons for regional markets include encouraging fund consolidation, supporting diversified investment strategies, and developing exit mechanisms to enhance market stability and competitiveness. Table 3 summarizes selected international experiences in PE institutionalization, highlighting regulatory approaches, key features, and lessons applicable to China.

Table 3. Selected International Experiences in PE Institutionalization and Lessons for China.

| Region | Regulatory Framework | Key Features | Lessons for China |
|---------------|--|---|--|
| United States | Investment Advisers Act, Securities Act | Clear legal identity, fiduciary duties, strong reporting standards | Strengthen legal clarity, enforce fiduciary duties, improve disclosure |
| Europe | Alternative Investment Fund Managers Directive (AIFMD) | Harmonized risk management, governance, disclosure across member states | Adopt standardized governance, risk management, and reporting frameworks |
| Both | Mature professionalization | Formal training, certifications, international best practices | Develop professional training systems, promote international collaboration |

5. Future Directions for Institutionalization in China

Looking ahead, several measures can guide the further institutionalization of private equity (PE) fund management in the regional PE sector, addressing both current challenges and future market opportunities. First, improving the regulatory system and legal framework is essential. A clear and consistent set of policies, harmonized oversight across multiple regulatory authorities, and alignment with international standards can provide a solid foundation for industry growth. Such improvements would reduce legal ambiguities, prevent regulatory arbitrage, and enhance investor confidence, particularly among long-term institutional investors such as pension funds, insurance companies, and sovereign wealth funds. Lessons from developed markets, including the U.S. and Europe, indicate that robust regional legal frameworks not only protect investors but also facilitate cross-border investments and the adoption of global best practices.

Second, corporate governance and transparency must be reinforced across the industry. Strengthening internal control mechanisms, formalizing fiduciary duties, and ensuring comprehensive, timely, and accurate information disclosure are critical steps. Firms should implement independent oversight committees, regular audits, and standardized reporting frameworks to monitor investment performance, risk exposure, and compliance

with ethical and legal standards. Improved governance and transparency can reduce conflicts of interest, enhance credibility, and create a more stable investment environment, ultimately attracting more sophisticated investors.

Third, attracting long-term capital and developing effective exit channels are essential for sustainable growth. Patient capital is critical for private equity investments, which typically require multi-year horizons to realize value. Policies and market mechanisms that encourage long-term commitments, such as tax incentives, flexible lock-up periods, and the development of secondary markets, can enhance liquidity and provide diversified exit options. Developing robust exit strategies—including public listings, trade sales, and secondary market transactions—ensures investment continuity and strengthens the overall ecosystem of PE investments.

Fourth, talent cultivation and professionalization should be prioritized to address the shortage of highly skilled fund managers and investment professionals. Expanding formal training programs, establishing professional certification systems, and promoting international collaboration can build a workforce capable of handling complex investment structures, managing risks effectively, and implementing sophisticated portfolio strategies. In addition, encouraging knowledge transfer through international exchanges and partnerships can help domestic firms adopt global best practices and enhance their operational efficiency.

Finally, guiding the market toward sustainable development is increasingly important in the context of global investment trends. Integrating environmental, social, and governance (ESG) considerations into investment decisions can ensure that PE activities contribute to long-term value creation, societal benefits, and broader economic sustainability. Incorporating ESG standards not only aligns Chinese PE funds with international norms but also helps attract global investors who prioritize responsible and sustainable investment practices. By implementing these comprehensive measures, the regional private equity industry can achieve higher levels of institutionalization, operational efficiency, and global competitiveness, laying the foundation for a more stable, transparent, and sustainable capital market ecosystem (Table 4).

Table 4. Future Directions for PE Institutionalization in China.

| Direction | Key Measures |
|--|---|
| Regulatory & Legal Improvement | Harmonize policies, strengthen oversight, align with international standards |
| Governance & Transparency | Robust internal controls, fiduciary duties, comprehensive disclosure |
| Long-Term Capital & Exit Mechanisms | Encourage patient capital, develop secondary markets, diversify exit channels |
| Talent Development & Professionalization | Formal training programs, certification, international collaboration |
| Sustainable Market Development | Promote ESG integration, support long-term value creation |

6. Conclusion

In conclusion, the institutionalization of private equity (PE) fund management in the regional PE sector has made substantial progress over the past three decades, yet the industry continues to face multiple, interrelated challenges. Key obstacles include fragmented regulatory oversight across multiple authorities, inconsistent and sometimes conflicting policies, weak corporate governance frameworks, limited mechanisms for investor protection, shortages of skilled professionals, and structural inefficiencies within the market. These challenges can restrict the growth potential of PE funds, hinder the inflow of long-term capital, and limit the adoption of global best practices.

At the same time, these challenges coexist with significant opportunities. The regional PE industry can benefit from the experiences of developed markets, aligning with international regulatory and governance standards, attracting patient and institutional capital, and fostering the professionalization of fund managers. Additionally, encouraging market consolidation, promoting diversified investment strategies, and integrating sustainable investment practices such as environmental, social, and governance (ESG) considerations can help ensure long-term value creation and societal benefits.

Strengthening institutional frameworks, enhancing transparency and governance, investing in talent development, and optimizing market structures are therefore critical steps for the ongoing evolution of China's PE sector. The institutionalization process is not merely a regulatory or operational requirement; it is a strategic imperative that underpins the long-term stability, efficiency, and global competitiveness of the broader capital markets in the region. By addressing these challenges and leveraging available opportunities, the regional private equity industry can continue to mature into a resilient, professional, and internationally aligned sector, contributing to the sustainable development of the broader financial system.

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