THE ESTABLISHMENT OF THE LOCAL GOVERNMENT INDUSTRIAL INVESTMENT FUND IN CHINA: AN EMPIRICAL STUDY

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Abstract:
The Chinese market is an ever-booming market whereby access to information is becoming more effortless and more manageable. This study aims to analyse the establishment of a local government industrial investment fund in China. A quantitative analysis constitutes this study. The latest literature and previous research on the regulatory system, the business exit mechanism, practitioners, lack of risk prevention and the portfolio of single funds are independent variables based on a model structure. The policy is an intermediate variable, and a non-independent variable is the sustainable promotion of the production of industrial investment funds. The results indicate that there is a partnership between the Local Government Industrial Investment Fund in Henan, China and the Local Government Industrial Investment Fund Growth Fund in Henan, China. This research has also shown that the higher the perceived structure of the supervisory system and the business exit mechanism, the better the policy.

JEL: D25; E22; G18; L50

Keywords: development, industrial investment fund, local government, Henan, China

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1. Introduction

An industrial investment fund is a unique concept in China. It is commonly referred to as venture capital fund and private equity fund abroad, and this is generally directed at unlisted enterprises. This is with high potential to make equity or quasi-equity investment and participate in the operation and management of the invested enterprises (Azam and Moha Asri, 2015; Tham et al., 2017; Udriyah et al., 2019). The objective is to achieve capital appreciation through equity transfer after the investment enterprise matures (Yu et al., 2014). The industrial investment fund has become the core of the financial system in developed countries (Baker & Wurgler, 2002; Zhang et al., 2008). In China, the industrial investment fund began with the establishment of an overseas industrial investment fund. According to the Interim Measures for the Management of Industrial Investment Funds formulated by the former National Development Planning Commission in 2006, Industrial Investment Funds (or Industrial Funds for short) which refers to a system of collective investment sharing benefits and risks of equity investment and management services for unlisted enterprises to set up a fund company by issuing fund shares to most investors (Ting et al., 2011; Chun et al., 2019; Yang et al., 2019). The investment and financing modes of local governments have been gradually adjusted from the single debt-raising mode to the creditor’s rights and equity financing mode. China’s local government industrial investment funds are not only facing ample development space but also will play an increasingly important role in the development of the national economy.

The fund company shall act as the fund manager or entrust the fund manager separately to manage the fund assets and designate the fund trustee to trust the fund assets, engaged in industrial investment such as venture capital, enterprise restructuring investment and infrastructure investment (Azwadi et al., 2013; Jinping, 2016). According to the different areas of investment, industrial investment funds can be divided into venture capital funds, enterprise restructuring investment funds, infrastructure investment funds and other categories. With the promulgation of the Partnership Law of the People’s Republic of China in 2006 and the Interim Measures for the Supervision and Administration of Private Investment Funds in 2014, the organisational form of industrial investment fund is developing in a diversified direction (Ting et al., 2011).

At present, China’s local government industrial investment funds are not only facing ample development space but also will play an increasingly important role in the development of the national economy (Yu, 2016). According to Yinxing (2016), Henan is facing both great opportunities and challenges, and the development of various cities in Henan Province is incredibly essential. Moreover, how to develop the local economy better, industrial investment fund as a medium plays a vital role. The venture capital and industrial investment funds set up in Henan Province in 2018, and there are 20 funds involved, the full scale is 104.2 billion Yuan, mainly invested in extensive data, intelligent manufacturing, pension, agriculture, transportation, culture, tourism and other fields. In
2019, the Henan Provincial Government Office issued Opinions on Further Deepening the Financial Services of Private Enterprises.

At this time, a reasonable and healthy development model of local industrial investment funds is significant for Henan’s economic development. However, according to the current situation of industrial investment of local governments in China, there are still some deficiencies and areas that need to be improved (Zhou, Chan & Song, 2017). Thus, Henan Province is restricted by high cost and narrow channels in the financing process with many obstacles such as financing through the issuance of corporate bonds and bank loans, which lead to high financing cost and difficulties. Henan Province is restricted by the high price and limited channels in the financing process. In recent years, Henan Province has set up more than 40 funds in advanced manufacturing, and modern service industries invested 12.71 billion Yuan. Traditional sectors are facing the predicament of excess capacity, which is mainly manifested in the backward growth mode, the lagging transformation of new and old kinetic energy, and the low quality of the supply system. By the end of 2017, 65 industrial investment funds had been set up in Henan County, totalling 245.067 billion yuan.

China’s legal system has not clearly defined the regulatory responsibilities of industrial funds. Henan Province has not established an adequate supervision and management system. Most SMEs are not qualified to meet the requirements of the IPO. The sustainable development of industrial investment funds faces particular challenges. A perfect market exit mechanism is essential for the operation of industrial investment funds. Industrial investment funds usually invest in emerging industries such as high-tech industries. The assessment mechanism of state-owned funds is not perfect. Venture capital needs risk control and has less participation in the investment of enterprises with higher risks in the seed stage. It is impossible to achieve the policy goal of cultivating the whole industrial chain in Henan Province. The main objective of this study is Determinants of a Sustainable Development of the Industrial Investment Fund for the Local Government in Henan, China. This research can conclude that the current local government industrial investment fund structure is most suitable for Henan Province. At present, there are very few domestic research results on the market behaviour, pricing mechanism, competition relationship and corresponding administrative measures. The establishment of local industrial investment funds to adapt to the development of Henan, private capital will be widely attracted to participate in the development and construction of the province. It will help Henan from a significant economic region to a robust economic area. Government industrial investment fund is highly structured, and its internal design is sophisticated. It can absorb and integrate the advantages of traditional industrial investment mode through different transaction designs.

2. Literature Review

Theoretically, The Two-factor Theory (Motivator-Hygiene Theory) was first proposed in 1959 by behaviourist Frederick Herzberg. Those who can bring work actively, satisfaction
and incentive factors called “incentives” can stimulate staff’s work enthusiasm. The improvement of “hygiene factor” can only reduce the dissatisfaction of employees, but it cannot play a motivating role. To stimulate the individual initiative of employees, we must pay attention to “motivation factor”. For any organisation, the enthusiasm of its members is the core motivation and critical factor for the realisation of organisational goals (Rachmawati et al., 2019; Azam and Yusoff, 2020; Azam et al., 2020). The government’s venture capital guidance fund mainly concentrates in the eastern coastal areas. In recent years, the research on sustainable development theory in China is on the rise. Sustainable development is the coordinated interaction of politics, economy, culture and ecological nature. The sustainable development of local government industrial investment funds in China has attracted the attention of scholars (Yu et al., 2014; Azam et al., 2014; Haur et al., 2017; Katukurunda et al., 2019). In developing countries, an industrial investment fund has become the nucleus of the financial system (Zhang et al., 2008). The Industrial Investment Fund in China started with the creation of an industrial investment fund abroad. According to the Interim Steps for the Management of Industrial Investment Funds, drawn up by the former National Development Planning Commission in 2006, Industrial Investment Funds (or Industrial Funds for short) refer to a scheme of mutual investment sharing benefits and equity investment risks and management services for unlisted undertakings, to be formed by issuing a fund company (Ting et al., 2011; Dewi et al., 2019; Nguyen et al., 2019). The fund corporation serves as the fund manager or entrusts the fund manager separately to control the assets of the fund and entrusts the fund trustee with the help of the fund engaged in industrial investment, such as venture capital, investment in the restructuring of companies and investment in infrastructure (Jinping, 2016). Industrial investment funds can be categorised into venture capital funds, investment funds for business restructuring, investment funds for infrastructure and other types depending on the various fields of investment. The organisational form of the industrial investment fund has grown in a diversified direction with the enactment of the Partnership Law of the People’s Republic of China in 2006 and the Interim Steps for the Supervision and Administration of Private Investment Funds in 2014 (Ting et al., 2011).

Local government industrial investments funds in China are currently not only facing sufficient room for growth. Still, they will also play an increasingly important role in the development of the national economy (Yu, 2016; Maghfuriyah et al., 2019; De Silva et al., 2017; Kuruwitaarachchi et al., 2019; Pambreni et al., 2019). Henan faces both great opportunities and challenges, according to Yinxing (2016), and the growth of different cities in Henan Province is significant. Also, the industrial investment fund, as a medium, plays a crucial role in how the local economy will grow better. The venture capital and industrial investment funds set up in Henan Province in 2018, involving 20 funds, totalling 104.2 billion yuan, mainly invested in comprehensive data, smart manufacturing, retirement, agriculture, transport, culture, tourism and other sectors. Opinions on further deepening the financial services of private companies were provided in 2019 by the Henan Provincial Government Office.
Industrial funds are facing many problems, such as speculative arbitrage, open-ended real debts, withdrawal difficulties, and development difficulties. The imperfect market environment of domestic industrial investment funds is attributed to the inadequate government functions, the low degree of market openness. There is an urgent need to deepen reform, expand opening up and improve the multi-level capital market system. If China’s exposure to the outside world is further enhanced, it will significantly promote the development of the capital market, he says. For example, annual surveys show that U.S. investors finance Israeli industrial investment. The source of China’s industrial investment fund is not enough.

China needs to strengthen the control of the capital risk of the industrial investment fund. Most of the guiding funds have weak awareness of performance appraisal and have not formed a standardised performance appraisal system. The supervision of industrial investment funds is not yet unified, so there is a lack of corresponding management. We should draw lessons from China’s national conditions and create the right external conditions for the smooth operation of the industrial investment fund market. It is challenging to provide information support for the development of financial expenditure benefit evaluation. The finance office will take the lead in the preparation and construction, and the Finance Office will act as the investor for the government.

The three is to set up a review expert committee, which is composed of representatives of industrial technology, private equity fund experts and industry responsible units. International equity investment market intermediaries include professional intermediaries involved in the evaluation, rating certification and guarantee. The quantity and quality of these intermediaries are not enough to support China’s industrial investment fund market. The service of the excellent investment market has been developed late, lacking relevant experience and staying at the surface of use, which is not conducive to the development of the whole equity investment market.

Relatively single exit mode is a significant drawback in the operation of China’s industrial investment fund. The orientation of government investment funds is short-term guidance rather than long-term holding. The number of exits is more than three times that of the company’s portal by way of listing. In Taiwan, Hong Kong and other places in China, the gradual liberalisation of the secondary market also provides an excellent exit mechanism for industrial investment funds. The establishment and improvement of the second board market, the progress of property rights trading centre, and the elimination of restrictions on the regular withdrawal will promote the development of Chinese industrial funds.

A fair and healthy development model of local industrial investment funds is essential at this time for Henan’s economic growth. However, given the current situation of industrial investment by local governments in China, there are still some weaknesses and areas that need to be improved (Zhou, Chan & Song, 2017). Thus, in the financing process, Henan Province is restricted by high costs and limited channels, with many barriers, such as financing through the issuance of corporate bonds and bank loans,
leading to increased costs and difficulties in financing. The main objective of this study is to establish the determinants of the sustainable development of the Local Government Industrial Investment Fund in Henan, China.

3. Methods and Methodology

Research into the design process is valuable because it provides a framework for data collection and analysis. Research design can be divided into three types: exploratory, descriptive and experimental. Based on a model framework, this research studies the regulatory mechanism, market exit mechanism, professionals, lack of risk prevention, fund integration as an independent variable, policy as an intermediate variable, and sustainable promotion of industrial investment fund development as a non-independent variable. The design is experimental. The system will include problem domain identification. Data collection, structured questionnaires and data analysis are all part of the research design. Also, quantitative research is a method that mainly relies on quantitative data collection. Qualitative methods are often used in exploratory theoretical construction rather than analytical testing. Many leading authors and researchers believe that quantitative and quantitative research methods are compatible. The essential component of quantitative research is variables, which have different categories or values. Rather than describing variables as a cause, another is the effect, rather than the cause.

4. Findings and Discussion

Reliability analysis is conducted to test the internal consistency of the data set based on Cronbach’s alpha value. The Cronbach’s Alpha of the constructs is over 0.7, which are inside adequate greatness. Subsequently, the reliability of the constructs is confirmed (Nunnally & Bernstein, 1994). After conducting the CFA for measurement models in each variable in the conceptual framework, the combined measurement model is constructed to test the composite scores. Usually, composite reliabilities of greater than 0.60 are satisfactory. Thus, that being the case, composite reliabilities of all the constructs are acceptable.

Similarly, the average variance extracted of more than 0.50 is essential. Consequently, the average variance extracted of all the constructs is significant. Moreover, Average Variance Extracted and Composite Reliability each construct in the measurement model shows an adequate convergent validity and discriminant validity in the model.

Also, professional talents exhibit a positive relationship with Sustainable development. However, lack of risk prevention shows a moderate negative correlation with Sustainable development. As the interactivity increases, the Sustainable Development scores go up as well and vice versa. Interchangeably, single fund portfolio displayed a moderate negative correlation with Sustainable development too.
In testing for multivariate normality, Mardia’s critical ratio was 101.545 (more than 5). Hence, the multivariate normality assumption is not met. Therefore, in the estimation of the coefficients, the bootstrap method was used. Besides that, there is a significant impact ($\beta = 0.266$, $p<0.05$) of Professional talents on the policy. The 95% confidence interval for Professional skills is $[0.153, 0.369]$ whereby the value 0 does not fall within the gap, by and by indicating Professional talents is a significant predictor.

Also, there is a significant impact ($\beta = -0.136$, $p<0.05$) of Single fund portfolio on the policy. The 95% confidence interval for Single fund portfolio is $[-0.226, -0.046]$ whereby the value 0 does not fall within the gap, in a like manner indicating Single fund portfolio is a significant predictor. Furthermore, there is an insignificant impact ($\beta = -0.077$, $p>0.05$) of lack of risk prevention on the policy. The 95% confidence interval for lack of risk prevention is $[-0.173, 0.018]$ whereby the value 0 does not fall within the interval, further indicating a lack of risk prevention is an insignificant predictor. Intriguingly, there is a significant impact ($\beta = 0.873$, $p<0.05$) of Policy on Sustainable development. The 95% confidence interval for the policy is $[0.834, 0.912]$ whereby the value 0 does not fall within the interval, again indicating the system is a significant predictor. On the whole, six out of seven hypothesised paths about direct relationships between the latent variables of the research model has $p$-value less than 0.05. Hence, the significance of the related hypotheses is corroborated (Hair et al., 2010).

Market failure also occurs in innovation and entrepreneurship activities due to the presence of positive externalities, which makes it especially necessary to give full play to the role of the government’s ‘invisible hand’. Political and sustainable development in different locations or countries is found to be similar in some ways and varies from one perspective to another at the same time. Overall, seven factors have been listed related to the growth of the Local Government Industrial Investment Fund in Henan, China and the Local Government Industrial Investment Fund in Henan, China. These variables are identified as the structure of the monitoring system, the business exit process, technical talents, the portfolio of single funds and the lack of risk avoidance. As a result, the first objective of this study is to identify the factors influencing the establishment of an industrial investment fund for the local government in Henan, China. In this report, it is verified that the structure of the supervisory system is the critical factor that stimulates the provincial government’s Industrial Investment Fund for the people in Henan, China. Moreover, it is also corroborated in this study that the business exit mechanism is a significant factor in stimulating the Industrial Investment Fund of the People for the local government in Henan, China. Also, this study reported that technical talent is also a significant factor in the local government’s Industrial Investment Fund strategy in Henan, China. This study confirms that the Local Government Industrial Investment Fund in Henan, China is a critical factor in the policy creation of the Industrial Investment Fund for the Local Government in Henan, China. This study also validates that the relationship between the independent variables and the dependent variable is mediated by the Industrial Investment Fund for the Local Government of Henan, China Creation of the Industrial Investment Fund for the Local Government of Henan, China.
5. Conclusion

The Local Government Industrial Investment Fund in Henan, China failed to mediate the relationship between the Lack of Risk Management and the Local Government Industrial Investment Fund Creation in Henan, China. The disparity in age group and level of education in this study has had a significant effect on the policy creation of the industrial investment fund for the local government in Henan, China. Accordingly, H8 notes that a correlation exists between the Age and Creation of the Local Government Industrial Investment Fund in Henan, China. Correspondingly, it is noted that there is a significant gap in the level of education concerning the development policy of the industrial investment fund for the local government in Henan, China. Foundation/Pre-U education policy histories are found to be distinguishable from PhD/Doctorate holders’ policies about their establishment of the Local Government Industrial Investment Fund in Henan, China. Similarly, H9 notes that an association exists between the level of education and the establishment of an industrial investment fund in Henan, China, for the local government.

This research has shown that the higher the perceived structure of the supervision system and market exit process of the industrial investment fund for the local government in Henan, China, the higher the Industrial Investment Fund policy for the local government in Henan, China. The Chinese market is an ever-booming market were to the point that it had become a requirement; access to information is becoming more effortless and more comfortable. This will encourage the policy to think about or have a complementary view of the local government’s industrial investment fund in Henan, China.

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