Crouching tigers, hidden dragons: Private Equity fund selection in China

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Abstract

We examine the investing behavior of investors in Private Equity (PE) funds in the Chinese market including choice of fund, commitment amount and performance. The Chinese PE market is characterized by information asymmetries, an uncertain regulatory environment, cultural and legal difficulties involved in executing transactions and differing investor risk appetites. The results suggest that foreign investors seek manager and fund characteristics that lessen information asymmetry We find that they are more likely to invest with firms that are more experienced and not government-affiliated. Foreigners are also more likely to invest in larger funds. We show that the size of an investor's commitment amount is determined by fund characteristics such as size, sequence, and stage. In terms of performance, we find some evidence indicating that domestic investor-backed PE funds exit a greater number of companies, and that their exited investments deliver higher returns relative to exits executed by PE funds supported by foreign investors.

Key words: Private equity, Chinese financial markets, investor behavior,

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1. Introduction

The investment preferences of foreign institutional investors in stock markets has attracted considerable research interest (eg Kang and Stulz, 1997; Liu et al.,2014; Covrig et al, 2006; Ferreira and Matos, 2008; McCahery et al, 2016; Chung and Zhang, 2011; Miletkov et al, 2014; Bena et al, 2017).

However, there is little research on the role of foreign investors in Private Equity (PE)[1] funds. PE is an alternative asset market that has grown dramatically over the last two decades. Global PE capital raised has increased from approximately $33 billion in 1995 to a peak of $685 billion in 2008. In 2016, $589 billion was raised by PE funds (Bain and Company, 2017). PE investment is generally characterised by an indirect model whereby investors invest via an intermediary (PE fund). These funds are raised for a specified period (usually 10 years) and are governed by an agreement between the investors (the limited partners) and the principals in the fund (the general partners), which specifies the nature of the fund's activities, the division of the proceeds etc.

The limited research on the investment decisions of investors in PE funds, focuses on domestic investors in developed markets such as the US and Europe. The research either uses qualitative survey evidence (Fried and Hisrich, 1989; Barnes and Menzies, 2005; Groh and Liechtenstein, 2011) or focuses on the relative performance of US PE investors (Hochberg and Rauh, 2013; Lerner et al, 2007; Sensoy et al, 2014). The studies do not consider the geographic source of capital, that is, foreign investors.

We contribute to the research on PE investor behaviour by examining the investment behaviour of PE investors in an emerging market and analysing both foreign and domestic PE investors. We also examine the determinants of the dollar amount that an investor commits to a particular PE fund, which has not been investigated in any market, and the performance of investors. We use data on investments by limited partners in PE funds investing in China. The PE funds

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[1] PE is defined to include venture, growth and buyout investments.

investing in China are managed by domestic, foreign or joint venture managers. China provides a unique setting to study investor behavior. Groh et al. (2012) rank China as the most attractive emerging country (and the twenty-second most attractive country on a global basis) for PE investors, based on the Global Venture Capital and PE Country Attractiveness Index. Foreign investment in China has substantially contributed to the development of the Chinese PE market (Suchard, 2017). The PE market in China is now of a considerable size, with China-focused PE funds raising around US$72 billion and investing circa US$31 billion in 2014 (KPMG, 2017), representing in excess of five percent of the value of PE investments made globally.[2]

However, the Chinese financial markets are relatively immature, are characterized by an uncertain regulatory environment, and there are cultural and legal difficulties involved in executing transactions. These features are compounded by the general lack of transparency evident in the PE asset class. The Chinese stock market is characterized by large information asymmetries between investors (Chakravarty et al., 1998; Chan et al., 2008). Larger information asymmetries are even more likely to exist in the Chinese unlisted PE market, making it difficult for investors to select skilled managers[3] and high performing funds. We first examine the characteristics of investors, PE managers, and PE funds to determine the factors that influence the likelihood that a fund will receive investments from foreign investors, domestic investors, or a combination of both.

We find that compared to local investors, foreign investors are more likely to invest with firms that are more experienced (consistent with Merton, 1987), are not government-affiliated (supported by Fernald and Rogers (2002), who examine the Chinese stock market) and larger funds. The results support the hypothesis that they seek fund characteristics that lessen information asymmetry. Foreign-backed funds are also less likely to be RMB-denominated funds. Joint venture (JV) capital funds, which are funds that receive capital from a combination of foreign and domestic investors, have similar features to foreign funds. One notable exception is that JV funds are more likely to have lower fund sequence numbers, indicating that JV managers rarely raise follow-on funds.

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[2] According to the European Union Chamber of Commerce in China and Bain & Company
[3] That is managers who have concealed talents or expertise- crouching tigers or hidden dragons.

This may be because JV structures are established for a specific 'one-off' purpose, or it may suggest that JV funds are typically unsuccessful unions.

Second, we examine the determinants of the dollar amount that an investor commits to a particular PE fund. We find that the investor's location (foreign vs domestic) and type do not explain the size of their commitment amount, but that certain fund characteristics influence the amount they commit. Larger commitments are made to bigger funds and lower sequence funds, revealing the ease of access of these funds rather than preference. Larger allocations are also made to buyout funds, reflecting the shortage of buyout funds available in China to investors.

Finally, we analyse the performance of investors. Consistent with their informational advantage, we find that funds with domestic investors are likely to exit a greater number of companies (although our result is marginally significant), and that their exited investments generate higher returns. Further, deals exited via an IPO and longer duration deals are likely to generate a higher exit multiple.

This study contributes to the understanding of foreign investor preferences where the literature has mainly focused on investment in stock markets. In addition, we contribute to the limited research that has examined the behavior of PE fund investors, which focuses on developed markets (Europe and the US) and uses qualitative data or examines the relative performance of different types of institutional investor. We provide a quantitative analysis of investor preferences in an emerging PE market and extend the literature on PE investors by examining the preferences of foreign investors in domestic PE markets.

Our study is relevant to both investors and PE funds. The PE market in China is relatively young, and little is known about investor behavior. We offer insights into PE funds, as we identify the manager and fund characteristics sought by investors. We also reveal to investors, the investment biases of a cross-section of institutions investing in China. It is important to understand the factors that influence investors' behaviour, given the increasing significance of foreign investment and the

fact that access to foreign capital differs across markets. Our results are relevant to policy-makers and PE funds in creating an environment conductive to foreign investment.

The remainder of this paper proceeds as follows. Section 2 provides a summary of the structure of the Chinese PE market for investors in PE funds. Section 3 details related literature and our hypotheses. Section 4 describes the data. Section 5 outlines our univariate results, Section 6 discusses our multivariate results and Section 7 concludes.

2. The Structure of the Chinese PE Market

China's PE industry was established in the mid-1980s, when the Chinese government decided that it should develop local high-tech industries (Xiao, 2002). The first fund was established in 1985 by the central government when the State Science and Technology Commission and the Ministry of Finance joined together to create China New Technology Venture Investment Corporation. Local governments followed suit and established their own funds. However, market participants lacked expertise and basic market-supporting institutions (such as clear property rights, freedom of contract, and financial markets) did not exist in the late 1980s and early 1990s. As reform began to open China to foreign investment, the government began to officially encourage foreign PE firms to invest in China in 1995 which triggered the first wave of international capital flow. China's PE industry expanded from 2000, a time period characterized by increased global stock market performance, investor optimism and China's entrance of the World Trade Organization.

Government policy change from 2005 resulted in the gradual revival of domestic PE through the opening of the Small and Medium Enterprise Board, which provided an exit mechanism for domestic PE funds. In addition, the number of renminbi (RMB) denominated funds grew after amendments to the Partnership Enterprise Law in 2006 allowed the use of 'limited partnerships' for PE funds which are commonly used by PE funds in developed markets. Domestic VC firms affiliated to investment banks and securities firms also experienced rapid growth after 2007 as they were previously prohibited from making equity investments in their clients before IPO. In October 2009,

the venture board that was announced in 2000, was finally launched (the Growth Enterprise Board) which introduced a new exit venue for VC investments. In addition, fundraising for domestic funds has benefited from the increased assets of government agencies such as pension funds. Chinese insurance companies have also been allowed to invest up to 10 per cent of their total assets in both domestic and offshore funds since 2010. Further, the introduction of the New Third Board in 2012 offers small businesses a financing alternative and has created a more dynamic, multi-layered capital market.

2.1 Investors in China

An aim of this paper is to examine the investment decisions of foreign and domestic investors in China. We define investors as the parties that provide funding to a PE fund manager in order for them to make investments in portfolio companies. Domestic corporations and government agencies were the early investors in Chinese PE, in contrast to developed economies where pension funds, insurance companies and endowments have been the largest PE contributors (Harris, 2010). More recently, changes in regulation have allowed domestic pension funds and insurance companies to invest in PE. Domestic investors in Chinese PE tend to be China's national pension fund (the National Social Security Fund), provincial governments, state-owned enterprises, insurance companies (e.g., China Life), local companies, and high net-worth individuals (UBS 2011). Anecdotally, there are considerable differences between most domestic and non-Chinese investors. Foreign investors are "typical" PE investors who seek to invest in funds that have five-year investment periods, 10-year terms, and that target multiples of two times their invested monies and an internal rate of return of in excess of 16%.[4] Conversely, Chinese investors reportedly seek investments with much shorter holding periods of around one to three years and significantly higher returns (around four times their invested monies). Additionally, investors differ in terms of the level of reporting they expect from their managers. While offshore investors are typically content with receiving quarterly reports,

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[4] According to the Coller Private Equity Winter 2010-11 Barometer, 44% of PE investors surveyed expect returns of 16-20% from the investments their underlying PE managers make in 2010 and 2011. 12% of respondents expect returns of 21-25% whilst 4% anticipate returns to exceed 25%. Other investors were more bearish, with 28% expecting returns in the range of 11-15% and 12% forecasting less than 10% (Coller, 2011).

domestic institutions reportedly require more "hand-holding", such as one-on-one meetings, to receive an update or discuss developments (EMPEA, 2008). According to Lin (2013), Chinese investors also vary from passive foreign investors because they often seek to involve themselves in the decision making of a PE fund and to exert influence over the PE manager.

2.2 PE Managers and Funds in China

The Chinese PE market is complex and difficult to navigate. Rules and laws pertaining to PE funds differ at a provincial level, and there has been a spate of regulatory changes affecting the sector. Both local and foreign PE fund managers operate in China, as well as a number of joint Chinese–foreign ventures.

Global PE managers with Chinese fund offerings tend to be established, independent PE firms. They typically have longer track records than their Chinese counterparts and offer more hands-on skills and value additive capabilities to portfolio firms. They also provide investee companies with increased listing options and access to offshore markets to enable penetration of their product or service, or to undertake cross-border add-on acquisitions (Humphery-Jenner and Suchard, 2013). Conversely, Chinese managers often have strong local networks, including connections with government entities, universities, and corporations. JV funds (often referred to as sino-foreign joint PE funds) are funds that are managed by both a domestic and a foreign manager. Through a JV, foreign partners can gain access to local networks and political connections, while the Chinese partner benefits from a larger capital base and experienced PE skills provided by the foreign partner.

In terms of investment vehicles, the market predominantly comprises RMB and US dollar (Non-RMB-denominated) funds. RMB funds can be either domestic-invested or foreign-invested. Domestic-invested RMB funds have the simplest and fastest government approval processes, are not faced with currency conversion-related issues, and have the ability to invest in most sectors. Foreign-invested RMB funds are denominated in RMB and receive their capital from either foreign investors or a combination of foreign and domestic investors. They may offer some advantages over foreign currency funds, including more expedient regulatory approvals.

Apart from the currency in which they operate, there are other differences between Non-RMB-denominated and RMB-denominated funds. Non-RMB-denominated funds are structured as typical PE funds, sporting 10-year terms, five-year investment periods, and a fund size of around a few hundred million dollars. They usually raise successor funds every two to four years with commitments contributed by investors that are not involved in the management of the fund. In contrast, RMB funds often have a shorter fund life of around five years, a smaller fund size, and typically call capital from their investors much less frequently (two or three times per year). RMB funds also raise successor funds much faster, with fundraisings occurring more often than annually (York, 2008).

3. Literature and Hypotheses

There is an increasing body of research on the Chinese PE market including the characteristics of PE investment (eg Zhang, 2002; Batjargal and Liu, 2004; Ahlstrom and Bruton, 2006; Humphery-Jenner and Suchard, 2013b; Gu and Lu, 2014), cross border deals (eg Wang and Wang, 2011; Dai et al., 2011) and exits by PE investors (eg, Wang and Wang, 2017; Anderson et al, 2017; Li et al, 2016; Otchere and Vong, 2016; Jiang et al, 2014; Tan et al, 2013; Humphery-Jenner and Suchard, 2013a). However, little is known about the investors in PE funds in emerging markets.

Previous studies have examined foreign investment in the Chinese stock market and find that classes of shares in China that are restricted to foreigners typically trade at a discount compared to shares that are available to locals (Bailey, 1994) This price difference has been attributed to various factors, including the risk differential between investors (Ma, 1996), information asymmetry (Chan et al., 2008; Chakravarty et al., 1998), differential supply and demand hypothesis (Stulz and Wasserfallen, 1995; Sun and Tong, 2000), liquidity (Chen et al., 2001), and corporate governance (Tong and Yu, 2012). A recent study of foreign institutional investors in China (Qualified institutional investors) shows that they prefer large, well known firms with some element of state ownership, lower liability levels and greater turnover capacity (Liu et al, 2018).

We posit that, similar to the listed market in China, the information asymmetry hypothesis and the differential risk hypothesis can be extended to explain investor behavior in the unlisted PE market. The information asymmetry hypothesis states that some investors may have an information advantage. Domestic institutions and individuals are arguably better informed than foreigners due to their cultural knowledge and networks (supported by Shukla and Van Inwegen, 1995; Brennan and Cao, 1997; Coval and Moskowitz, 1999; Kang and Stulz, 1997; Hau ,2001; Baik et al., 2010). Conversely, foreigners may be at an advantage due to their experience (Grinblatt and Keloharju, 2000; Froot, et al. 2001). In China, Chan et al. (2008) argue that information asymmetry, which they measure by the price impact coefficient, adverse selection component, and the probability of informed trading, explains the price difference between shares restricted to non-Chinese investors and those available to local investors. Their results are consistent with Chakravarty et al. (1998), who develop a model based on Grossman and Stiglitz (1980), which incorporates market segmentation and asymmetric information, and empirically test their predictions using media coverage as a proxy for information asymmetry.

We use PE manager and fund characteristics to proxy for information asymmetry. In terms of PE manager characteristics, we predict that foreigners are more likely to invest with more experienced PE managers relative to domestic investors. According to Merton's (1987) model, investors will seek to invest in stocks with which they are familiar (investor recognition) due to high information costs. We argue that there is likely to be greater information available on more experienced managers and that foreign PE investors are more likely to be aware of these firms. Additionally, the costs associated with gathering information are likely to be higher for foreigners, suggesting that they are more likely to invest with more experienced managers relative to domestic PE investors.

Moreover, we infer that, relative to domestic investors, foreigners are more likely to invest with non-government-affiliated managers. Fernald and Rogers (2002) observe that foreign investors in China's segmented stock market pay relatively lower prices for firms with high state ownership. Foreigners may shun politically affiliated PE funds for a number of reasons. A government backed fund may have objectives other than financial gain (Manigart et al., 2002). Consequently, it could be

argued that foreigners have less interest in a fund with societal goals, relative to a Chinese investor that may have some vested interest. Fan et al. (2007) find that politically connected publicly listed Chinese firms exhibit poorer performance (as measured by accounting metrics and stock returns) and attribute this to their pursuit of objectives other than firm value maximization Additionally, the investment professionals of a government backed fund may have less relevant PE experience (Leleux and Surlemont, 2003). In this regard, supporting a politically affiliated manager is inconsistent with a foreigner investor's desire to reduce information asymmetry and risk. Lastly, it may be the case that government affiliated PE funds exhibit weaker corporate governance characteristics. Fan et al. (2007) find that the boards of publicly listed firms with politically connected CEOs are more likely to have politically affiliated directors, fewer board members with business experience from unaffiliated firms, and less educated directors.

In terms of fund characteristics, we anticipate that foreign investors will seek to invest in larger funds, as they are associated with less information asymmetry. Gompers and Lerner (1998) find that fund size is determined by past performance and reputation. In the Chinese listed market, Fernald and Rogers (2002) observe that foreign investors in China pay a higher relative price for larger companies (measured by sales). This is also supported by Kang and Stulz (1997) who show that foreign investors in Japan invest primarily in large firms. Similarly, we expect foreigners to seek funds with higher fund sequence numbers. Lerner and Schoar (2004) purport that the sequence number of a fund is a reflection of the historical information that is available on that fund. This would mean that funds with larger sequence numbers are associated with less information asymmetry. This leads to the first hypothesis:

Hypothesis 1: Foreign investors are more likely to invest with more experienced PE managers that are non-government-affiliated and in larger and higher sequence funds to reduce information asymmetry.

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The differential risk hypothesis states that foreigners and local investors differ in their risk appetites (different risk aversion). In particular, Chinese markets are highly speculative, and local investors might be highly risk tolerant (Ma, 1996; Chen et al, 2001; Wang and Jiang, 2004)

We use two fund characteristics - geographical concentration and investment stage to proxy for risk. In terms of geographical concentration, we expect foreign investors to favor funds that allocate more of their commitments to markets outside of China. Foreign investors in China are likely to be less risk tolerant than local investors (Ma, 1996; Chen et al, 2001; Wang and Jiang, 2004) and we anticipate that a foreign investor will seek to reduce risk by investing in more geographically diversified funds. The US empirical evidence suggests that VCs can use international diversification to reduce risk and potentially grow their firm (Knill,2009) and increase returns for seed funds (Humphery Jenner, 2013).

Focusing on investment stage, we posit that foreign investors will prefer buyout-focused funds rather than venture- or growth-focused funds. Venture funds invest in riskier early-stage companies that have uncertain outlooks (Chen et al., 2010). This is consistent with Fernald and Rogers' (2002) findings that foreign investors pay relatively less than Chinese residents for listed high-growth companies. Therefore, the second hypothesis is as follows:

Hypothesis 2: Foreign investors are more likely to invest in buyout-focused funds and funds with a smaller allocation to China to reduce risk.

Further, we predict that Chinese investors are likely to outperform foreign investors on their PE investments. In addition to explaining investor preferences, the information asymmetry and risk differential hypotheses can be used to rationalize the relative performance of foreign and domestic investors. Understanding cultural norms and strong networks is extremely important in China (Bian, 1994; Farh et al., 1998; Chua et al., 2009), arguably more so than PE expertise. This means that the informational advantage of domestic investors should lead them to make higher returning PE investments than their foreign counterparts.

Additionally, domestic investors may exhibit better performance as compensation for their risk taking. Ma (1996) suggests that Chinese investors are risk-seeking which should lead them to invest in funds that yield higher returns. Assuming hypothesis 2 is correct, foreign investors should favour funds with less risky attributes including higher sequence funds, larger funds, buyout-focused funds, and funds with a smaller allocation to China. Consequently, the third hypothesis is as follows.

Hypothesis 3: Domestic investors are likely to outperform on their PE investments relative to foreign investors.

4. Data

4.1 Sample

We use a comprehensive dataset of PE funds that invest in China, compiled by the ChinaVenture Group, a research and consulting firm based in China. The data includes information on the PE fund, their managers, the investors that invest in them and the dollar amount that an investor has committed to a PE fund. The sample includes 1,448 PE funds that invest part or all of their portfolio in China and 2,184 investments in PE funds made by 1,234 domestic and foreign investors that is available from 1998 to 2011. These funds are managed by domestic, foreign or joint venture general partners. To be included in the sample, we require each observation to have the necessary control variables used in our analysis. Additionally, we exclude real estate funds and infrastructure funds. We use exchange rates provided by Datastream to convert non-US dollar amounts into US dollars.

Figure 1 and Figure 2 show the distribution of the sample during the period. While the number of new non-RMB funds raised has been relatively stable over time, RMB-denominated funds have experienced a dramatic acceleration in fundraising, particularly since 2007. This surge in RMB funds can be attributed to regulatory changes permitting investment by certain domestic investors, the introduction of favorable amendments to the limited liability structure in China, and the increase in exit channels available for PE investee companies with the formation of the Shenzhen Small and

Medium Enterprise (SME) Board and the ChinaNext Board in 2003 and 2009, respectively (Cao, 2012).

Each of the variables used in this study are defined in Table 1 and explained in more detail as follows.

4.2 Fund Level Variables

We define a fund according to the source of its capital. Offshore Capital Fund is an indicator variable that takes the value of one if a fund's commitments come from purely non-domestic investors, and zero otherwise. Domestic Capital Fund is an indicator variable that equals one if a fund derives its funding from purely domestic investors, and zero otherwise. JV Capital Fund is an indicator variable that takes the value of one if a fund has been funded by a combination of offshore and domestic investors, and zero otherwise. A JV funded fund is typically a PE fund that has been formed by two parties (usually PE managers and/or government entities) that are seeking an alliance in order to enhance their investing ability in China. The onshore party often provides the local knowledge and networks whilst the foreign party offers hands-on PE skills

We also control for other fund characteristics. We capture the experience of the PE manager using the variable *Manager Experience*, which is calculated as the year the fund closed minus the year the PE manager was founded. *Year Manager Founded* refers to the year in which the manager was founded. *Government Affiliated* is an indicator variable that takes the value of one if the fund is government-affiliated, and zero otherwise.[5] *Fund Sequence* refers to the fund sequence number of a PE fund. The first fund raised by a particular PE manager would have a fund sequence number of one, while the next fund would have a fund sequence number of two, and so on. For PE firms that manage multiple PE funds that pursue different strategies (e.g., venture-focused funds and small buyout funds), each strategy is viewed independently for the purpose of the fund sequence variable. Higher sequence funds are often raised by more experienced managers and usually deliver higher returns than

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[5] Government-affiliated funds are defined as the funds of a PE firm that are fully/partly/indirectly owned by a provincial or central government or a state-related organization. The data were hand collected by searching Baidu.com.

funds with lower sequence numbers (Kaplan and Schoar, 2005). To control for fund size, we use *ln(Size)*, which is measured as the natural log of the fund's total commitments in US dollars. *Vintage* refers to the year a fund had its final closing.

Allocation to China is the percentage of fund commitments the PE manager intends to allocate to China. In this context, three types of funds exist: China funds that invest 100 percent of their commitments in mainland China; regional funds that typically allocate the majority of their commitments to mainland China, with the remainder apportioned to other Asian countries; and global funds that assign a small amount of their commitments to China as part of a broader global strategy. These funds are managed by domestic, foreign or joint venture general partners.

The amount that a PE manager intends to allocate to China is likely to be very similar to the amount they actually allocate. PE funds have investment agreements with their investors that are established at the time a fund is raised. These agreements typically stipulate the investment universe for a fund, and there is often limited ability for the manager to deviate from these guidelines.

We also categorize funds by stage. The sample includes funds with a stage focus defined as one of the following: buyout, venture, growth, mezzanine, and multistage. The indicator variable *Buyout* takes the value of one where the fund focuses on buyout-stage investments, and zero otherwise. Similarly, *Venture and Growth* has a value of one where the focus of the fund is venture or growth investing, and zero otherwise. We combine venture and growth investments into a common variable because the terms venture and growth are typically used interchangeably in China, and funds that purport to invest in venture are typically undertaking more growth-style investments. *RMB Denominated* is an indicator variable that takes the value of one if the fund is RMB-denominated, and zero otherwise.

We measure the performance of foreign funds, domestic funds, and JV funds to make inferences about the performance of the investors in those funds. To measure fund performance, we use several measures. *Number of Fund Exits* represents the number of exits executed by a fund. This includes both domestic and offshore exits. We argue that a larger proportion of exited deals are likely

to be good deals as a fund manager may be inclined to keep poor performing investments on their books rather than realize the negative return. We control for *Number of Investments*, which is the number of investments that a fund has made. As an alternative measure of performance, we use the *Proportion of Exited deals*, which is calculated by scaling the number of exits by the number of investments. For the deals where there is available information, we also estimate the *Exit Multiple* of the deal, which is calculated by dividing the value of the deal at exit by the amount invested in the deal.

The descriptive statistics for our sample of funds are provided in Table 2 Panel A. Of the 1,448 PE funds in our sample, 28 percent are funded by offshore investors, 66 percent are funded by domestic investors, and seven percent are funded by a combination of domestic and offshore investors. Seventy percent of the funds (or 1,010) are RMB-denominated, and most of the funds are first-time funds. The average fund was raised in 2008 by a PE manager that was founded in 2002. The mean (median) fund size is US$243 million (US$39 million), showing that our variable is highly skewed. Twenty-three percent of funds have some government-affiliation. In relation to investment stage, the majority of funds are venture- or growth-focused, with only three percent targeting buyout investments. This is not surprising, as debt financing for acquisitions is not freely available in China, making buyout investments difficult to execute. In terms of geographical focus, the average fund allocates 89 percent of its commitments to China, with the remainder of its commitments allocated to other countries in Asia or more globally. Eighty-four percent (1,207) of the funds in our sample allocate their entire commitment to mainland China, 10 percent (149) deploy their commitments more broadly into the Asian region (including greater China), and six percent (92) classify themselves as global funds.

4.3 Investor Level Variables

We define investors by their source of capital. We create an indicator variable called *Offshore Investor*, which has a value of one if an investor derives their funding from overseas, and zero if the investor obtains their funding domestically. To measure the amount an investor has committed to a particular fund, we use *ln(Investor Commitment)*, which is the natural log of the amount an investor

has contributed to a particular fund in US dollars converted at the date of the final fund closing.[6] To account for an investor's funds under management, we use *ln(Investor Capital)*, which is measured as the natural log of an investor's capital under management in US dollars. *Year Investor Founded* refers to the year in which the investor was founded.

We capture the experience of the investor in China using time variant variables. Our first measure, *Investor Number of Investments*, is calculated as the number of investments an investor has made in China. Related to this measure, *First China Investment* is an indicator variable that equals one where the investment being made is the investor's first investment in China. Our second measure, *Experienced China Investor*, is an indicator variable that equals one where an investor has been investing in China for more than five years, with day zero defined as the date of the investor's first investment in China. We use this term because the investment period for most PE funds is five years, and this should give an investor adequate time to improve its understanding of the Chinese market. We also calculate *Investor Years in China*, which measures the number of years between an investor's first and last Chinese PE investment during our sample.

We define the headquarters (HQs) of an investor according to four regions and create corresponding indicator variables. *HQ Greater China* includes investors with HQs in mainland China, Hong Kong, Macau, and Taiwan. *HQ Americas* includes investors with HQs in the US, Canada, and South America. *HQ Europe* includes investors with HQs in European countries. *HQ Other* includes investors with HQs in Asia (excluding greater China), New Zealand, Australia, South Africa, and the Middle East. We also characterize investors according to their type. We divide investors into *Corporate Investor*, *Government Investor*, and *Financial Investor*. Government-affiliated entities encompass government agencies, sovereign wealth funds, and government matching funds. Financial investor defines fund of funds, public pension funds, universities and endowments, family offices, asset managers, banks and insurance companies, and PE firms. Corporate investor includes corporate

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[6] We take the natural log because the untransformed variable exhibits extreme skewness and kurtosis (4.774 and 33.977), and the log transformed variable is more normally distributed (0.277 and 2.749).

entities, but it is likely to largely encompass high net-worth individuals that make PE investments though their companies.

The descriptive statistics for the sample of investors are provided in Table 2 Panel B. The average (median) investor was founded in 1988 (1998) and has US$24 billion (US$2 billion) under management. On average, each investor makes around two investments in China over the sample period and has been investing in China for approximately one year. Thirty percent of the investors in the sample are offshore investors. Seventy-four percent are headquartered in greater China (including Hong Kong and Taiwan), with 13 percent in the Americas and seven percent elsewhere. The majority of the investor base is defined as corporates, with the remainder being government-affiliated entities and financial investors.

5. Univariate Results

5.1 PE Funds in China

In this section we present univariate statistics of PE funds in the Chinese market. In Table 3 Panel A, we compare the 402 offshore-funded funds in our sample with the 984 domestic-funded funds. We exclude the 98 JV funds for the purposes of this analysis. We find evidence in support of our first two hypotheses and the information asymmetry hypothesis. Funds backed by foreigners are managed by more experienced managers that are less likely to be government-affiliated compared to local funds (consistent with Hypothesis 1). Offshore investors tend to invest in higher sequence number funds and considerably larger funds, with the mean size of a foreign PE fund in China around US$679 million versus US$64 million for a domestic fund. The majority of both foreign and local funds are venture-focused, but a foreign fund is more likely to be buyout-focused relative to a domestic fund (nine percent of foreign funds are buyout-focused compared to 0.9 percent of local funds).

In Table 3 Panel B, we compare the 1,010 RMB denominated funds in our sample with the 438 non-RMB denominated funds. We observe similar patterns as Panel A. We find that RMB-denominated funds tend to be run by less experienced PE managers, are younger (an average vintage

of 2008 compared to 2006 for non-RMB funds), and smaller (average fund size of US$71 million versus US$639 million for non-RMB funds). RMB funds attract less capital because they are typically restricted to raising money from domestic investors and are managed by PE firms with shorter track records (Bläute, 2010). We also find that relative to foreign funds, RMB funds are more likely to be venture- or growth-focused, government-affiliated, and to allocate more of their capital to opportunities in China.

In Table 3 Panel C, we compare the industries in which the funds invest. We classify the industry of the investees in which the funds invest using the National Bureau of Statistics classification system (GB/T 4754-2017 Industrial classification for national economic activities). There is variation in industry across foreign and domestic funds. Domestic funds invest in a significantly higher percentage of investees in the manufacturing sector than foreign funds (45% vs 20%) but a lower percentage of investees in IT (16.65% vs 35.8%) Leasing and Business Services (0.37% vs 0.86%) and Education (0.48% vs 1.71%) than foreign funds. Foreign funds are prohibited from investing in strategic assets of National importance.[7] In our sample, 22% of domestic funds invest in a prohibited industry.

5.2 PE Fund Investors in China

In Table 4, we compare the characteristics of the PE fund investors in the sample. There are 860 domestic investors and 367 foreign investors. Our results indicate that local investors are younger and much smaller than their foreign counterparts. Foreign investors are more likely to be older and larger because they are likely to invest in PE outside their home country only after having gained considerable exposure to the asset class within their home country. In relation to type, domestic investors are mostly corporate entities, while foreign investors are predominantly financial institutions. We note that our category of domestic corporate investors probably includes high net-worth individuals, who often make personal investments through corporations they own. Over the

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7 As set out in the *Catalogue for the Guidance of Foreign Investment Industries.* The catalogue is a legal document listing what industries are open for foreign investors. It has been revised and re-released seven times since its creation in 1995.

sample period, foreign institutions are likely to make more investments in China—on average, close to three compared to around two for their domestic counterparts. Foreign investors in the sample are likely to be more institutional in their investment policies and, following their decision to allocate to PE in China, will invest considerable resources in identifying investments, undertaking due diligence, and investing in PE funds. For Chinese investors, on the other hand, allocation decisions are likely to be driven by relationships and may not be part of a larger strategy to increase their Chinese PE exposure.

5.3 Chinese PE Investments of Foreign and Local Investors

We next compare the investment decisions of foreign and local investors where the sample includes 1,170 investments in PE funds made by domestic investors and 1,007 made by foreigners. Table 5 displays the results and shows that, consistent with Hypothesis 1 and the information asymmetry hypothesis, foreign investors tend to invest in more experienced PE managers and with firms that are not government-affiliated.[8] We also find that foreigners prefer larger funds, higher sequence funds, and funds that allocate less of their commitments to China. Compared to domestic investors, foreigners are more likely to invest in a buyout-focused fund. These findings are consistent with our second hypothesis. Foreign investors also tend to make larger investments into funds (average commitment amount of US$66 million compared to US$25 million for domestic investors).

5.4 Impact of Experience

In Table 6 we examine PE fund investments by experienced investors versus inexperienced investors where experience specifically relates to investing in Chinese PE. In Panel A, we define an experienced investor as one that has made more than one investment in China during the sample period. An inexperienced investor is one that is making its first investment in China. We observe 1,127 investments where the investor is defined as inexperienced and 1,057 observations where the

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[8] It can be argued that a foreign investor's preference to invest with experienced managers is driven by currency as non- RMB denominated funds tend to be managed by more experienced managers. To alleviate this concern, we re-estimate Table 5 when limiting the sample to manager's founded after 2000 (477 GPs) as this period is characterised by growth in domestic PE managers. We, continue to observe that the Year Manager Founded variable is significantly different between foreign and domestic investors.

investor is defined as experienced. We find that experience leads to investments with more experienced managers, in larger funds, and in higher sequence funds. These characteristics are usually associated with more experienced and reputable PE firms. Higher sequence funds are more likely to be oversubscribed and difficult to access. Experienced investors are likely to have established networks through their prior experience, enabling them to access these funds.In addition, experienced investors are more likely to invest in funds with a larger portion of commitments allocated to regions outside of China and to buyout-focused funds, and are less likely to invest in venture and growth funds. More experienced investors commit larger amounts to PE funds, potentially indicating greater conviction in their investment decisions.

As a robustness test, we use an alternative definition of experience, where an investor is experienced if they have been investing in China for more than five years irrespective of the number of investments they have made. We use five years as the investment period for most PE funds is a similar time frame and this should give an institution adequate time to improve their understanding of the Chinese market. In this case, there are 1,525 observations involving inexperienced investors and 659 observations that include experienced investors. The results are in Table 6 Panel B and we observe similar trends as in Panel A with the exception that non experienced investors invest in more JV funds and younger funds.

6. Multivariate Results

6.1 Likelihood of Investment by Foreign and Local Investors

In Table 7, we use a logit model to assess the impact of PE fund characteristics on investments by foreign and local investors. The dependent variable is a binary variable that equals one if a fund derives its capital from foreign investors and is denominated in a non-RMB currency, and zero if a fund is backed by local investors and is denominated in RMB. We include year fixed effects, and t-statistics are adjusted for heteroskedasticity and PE manager clustering.

We find that funds backed by foreign investors tend to be managed by more experienced PE managers and those that do not have a government affiliation, consistent with Hypothesis 1. We also find that offshore capital funds are larger and have higher fund sequence numbers. Further, foreigners are more likely to invest in PE funds with a smaller allocation to China, and they are less likely to invest in venture-focused PE funds (although both these results are marginally significant). The marginal result provides limited support for the risk differential hypothesis.

In Table 8, we report results from the multinomial logit regressions. In this case, we do not limit our sample based on currency. We include year fixed effects, and t-statistics are adjusted for heteroskedasticity and PE manager clustering. For ease of interpretation, we report marginal effects evaluated at the sample mean. The results indicate that having an experienced PE manager serves to increase (decrease) the probability that a fund derives its funding from foreign (domestic) investors. Foreign funding is 36 percent (50 percent) less (more) probable if the PE manager has a government affiliation (consistent with Hypothesis 1). Funds with a smaller (larger) allocation to China are more likely to derive their funding from foreigners (locals). Fund size is also positively (negatively) related to the probability that a fund is backed by foreign (domestic) investors. However, a fund's stage does not affect the probability that a fund has foreign investors.[9] The results provide support for information asymmetry proxied by manager and fund characteristics (more experienced managers, non government affiliated funds and larger funds are more likely to have foreign investors). There is limited support for the risk differential (allocation to China).

In terms of JV funds, we observe that they share many common features with foreign funds. The presence of a more experienced PE manager increases the probability that a fund is established as a JV fund. A JV may be the preferred structure for offshore managers that possess considerable PE investing expertise in developed markets but that lack the networks to solely manage a PE fund in China. The probability of a fund being a JV also increases when the fund size is larger and the allocation to China is smaller. However, unlike foreign funds, having a higher fund sequence number

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[9] As a robustness test, we control for industry fixed effects and whether the fund invested in a restricted industry using the specifications from Table 7 and 8 and find similar results.

decreases the probability of a fund being a JV by 10 percent, potentially indicating that JV structures are being established for a specific purpose as "one-time" funds, or that they are not performing as originally intended.

6.2 Determinants of the Size of a PE Investment

We next examine the dollar commitments made by investors to PE funds to determine their preferences with respect to certain fund characteristics. In Table 9, we undertake ordinary least squares regressions using the log transform of an investor's commitment amount to a particular fund as the dependent variable. We include year fixed effects, and t-statistics are adjusted for heteroskedasticity and investor clustering.

In Table 9 Column 1, we find that there is no distinction between foreigners and domestic investors in terms of the size of their commitment amount. Similarly, the type of investors plays no part in determining the amount an investor commits to a fund. We find that investors are more likely to make smaller commitments when it is their first investment in China, reflecting their general risk-averseness. We also observe that larger commitments are made to bigger funds and lower sequence funds. This is likely due to access rather than preference. Investors are more likely to receive a larger allocation if a fund size is bigger. Similarly, lower sequence funds are less likely to be oversubscribed, meaning that investors are able to allocate the amount they desire to the fund. When a fund is oversubscribed, some investors will be denied access to the fund, while others will be permitted to invest but only a smaller amount than they would usually have preferred (typically referred to as having their allocation scaled back).

We also find that larger allocations are made to buyout funds. This is likely due to the lack of alternatives available among buyout funds, as they do not feature prominently in the Chinese market. Buyout funds comprise a small portion of the Chinese PE market because control deals are difficult to secure and debt is not generally available. We also find that larger allocations are made to JV funds but this result does not hold in robustness tests, as shown in Table 10. In Column 2 Table 9, we introduce interaction terms between the offshore investor and the type of investor. The results are

generally consistent with Column 1, with the exception of type of investor. The coefficient on Financial Investor remains positive, but it is now significant. Financial institutions are likely to be the most sophisticated of investors, and the large allocation amount may signify their conviction in their decision making. However, the interaction term for Offshore Investor and Financial Investor is negative and significant, suggesting that non-Chinese financial institutions are likely to make smaller allocations. This result supports our information asymmetry hypothesis. Domestic investors may make larger allocations as their informational advantage leads them to be less risk-averse, or because they are able to secure larger allocations due to their stronger networks.

In Table 10, as a robustness measure we include an investor's capital under management as a control variable. DaRin and Phalippou (2017) find that larger investors undertake more rigorous due diligence and monitoring of their investments and are treated more favourably by PE managers. This regression severely reduces our sample size as there are only 192 observations where there is data available for an institutions capital under management. As per Table 9, we find that being an offshore investor is not a determinant of the amount an investor allocates to a PE fund. However, we find several differences in respect to investor type. The previous results indicated that financial investors make larger commitments to PE funds. We now find that they make smaller commitments when controlling for their capital under management. We also find that government investors allocate smaller amounts, implying that corporate investors actually make the largest commitments to PE funds, when accounting for their funds under management. The coefficient on Investor Capital is positive and significant, implying that investors with more money make larger commitments. In terms of fund characteristics, the results are generally consistent with Table 9, with the exception of JV funds and First China Investment, which become insignificant. In addition, as an alternative to investor location, we control for investor protection regime. We use a dummy variable for investors from English Common Law countries. The results are consistent with Tables 9 and 10."

6.3 Performance of Investors

We next examine the performance of PE funds in China to determine whether one class of investor outperforms. We consider the performance of domestic capital versus foreign capital funds in

China. In Table 11 Column 1, we proxy performance using the number of domestic and offshore exits executed by a fund.[10] We argue that a larger proportion of exited deals are likely to be better performing deals because fund managers may be inclined to keep poor performing investments on their books rather than realize the negative return. In Column 2, we scale the number of fund exits by the number of fund investments to ensure that the number of investments is not driving our results. For both estimations, we remove JV funds as it is difficult to categorize them as either foreign- or domestic-backed.[11] We control for industry using industry fixed effects.[12]

Consistent with Hypothesis 3, we find some evidence (the coefficients in both regressions are marginally significant) that domestic capital funds are likely to exit a greater number of companies and a greater proportion of their investments. Chinese investors are likely to have an information advantage over foreigners due to their understanding of cultural norms and strong networks (consistent with, for example, Grinblatt and Keloharju(2000) and Dvorák (2005)). Further, we find that the number of investments made by a fund is the strongest determinant of the number of exits.

In Table 12, we use the exit multiple of a deal as a measure of performance. The exit multiple is calculated by dividing the value of the deal at exit by the amount invested in the deal.[13] The sample contains exit data for 336 deals in 220 funds. Of these deals, 236 are exited by domestic funds and 100 are exited by foreign funds. Similar to Table 11, we exclude JV funds. Of the 336 realized investments, 94% are exited via IPO (317 observations) with the remainder exited via merger or acquisition (19 observations). We run an ordinary least squares regression and a Tobit regression with an investment's exit multiple as the dependent variable. The t-statistics are adjusted for heteroskedasticity and PE fund clustering.

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[10] Reliable and consistent historical fund performance data (IRR) is not available for China.

[11] We also remove the six observations for which we have exit information and for which the fund is either foreign-backed and RMB-denominated or domestic-backed and non-RMB-denominated to ensure that these outliers do not drive our results.

[12] As a robustness test, we include a dummy for whether the investment was in a restricted industry and find similar results.

[13] To ensure the reliability of the data, we remove observations where the size of the investment is less than 1 percent of the fund size or greater than 50 percent of the fund size.

In line with Hypothesis 3 and the results from Table 11, we find that investments made by domestic-backed funds have higher returns on exit. This is consistent with the information disadvantage of foreign investors and their preference for PE funds with less-risk seeking characteristics.

Additionally, we observe that deals exited via an IPO are likely to generate a higher exit multiple (as identified in previous literature, including Black and Gilson (1998)). We also find that longer duration deals deliver higher multiples of cost. "Quick flips", where a manager exits via an IPO soon after investment, are very common in China. Investments with longer holding periods may therefore give a manager additional time to implement value-adding initiatives, thereby bolstering their exit multiple. With respect to investment stage, we find that buyout deals are exited at higher exit multiples. This is likely to be attributed to a lack of competition in the space which should translate to higher returns for the limited funds undertaking buyout investments. We also find some evidence that venture deals deliver greater exit multiples. This may be because of the risky nature of these investments, which should lead to a higher return outcome.

Prior to 2005, the regulatory environment (due to the Chinese Government's adoption of the Issuance Quota System and the Channel Restriction System) impacted the ability of a firm to undertake a public offering (Liu et al., 2012). To address these concerns, in unreported results we constrain the sample in Table 12 to exits made in 2005 onwards. Our results remain unchanged.

7. Conclusion

We examine the investing behavior of both foreign and domestic investors in PE funds investing China using a large dataset of PE funds and their investors. Large information asymmetries exist in the Chinese unlisted PE market because of the immaturity and lack of transparency of the PE market, the uncertain regulatory environment, and the important role of cultural sensitivities and networks in executing transactions.

The results reveal several biases exhibited by investors. We find that offshore investors are more likely to invest with firms that are more experienced and not government-affiliated. Foreigners are also more likely to invest in larger funds consistent with the view that they seek to invest in funds with attributes that reduce their information disadvantage. We also examine the determinants of the dollar amount that an investor commits to a particular PE fund. We find that the size of the commitment amount is influenced by fund characteristics such as size, sequence number, and whether the fund is buyout-focused. In terms of performance, we find some evidence to indicate that PE funds backed by domestic investors exit a greater number of companies. Additionally, investments exited by domestic-backed funds generate higher returns relative to exits executed by foreign-backed firms.

These results contribute to the recent research on the behavior of foreign intuitional investors in general and to the preferences of PE fund investors in an emerging market. We suggest that future research considers not only institutional type, but also the geographic location of investors (domestic versus foreign) in PE funds.

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Figures
Summary Distribution by Fund Vintage Year

The sample consists of 1,448 PE funds managed by 804 managers and 2,184 PE investments made by 1,234 investors between 1998 and 2011. In Figure 1 and Figure 2 we report the distribution of our sample based on the fund closing date and divide the sample into RMB denominated funds and non-RMB denominated funds. Figure 1 displays the distribution of the 1,010 RMB funds and the 438 non-RMB funds in our sample. Figure 2 displays the distribution of the 2,184 PE fund investments, of which 1,032 are investments in RMB funds and 1,152 are investments in non RMB funds.

Figure 1: Distribution of PE Funds
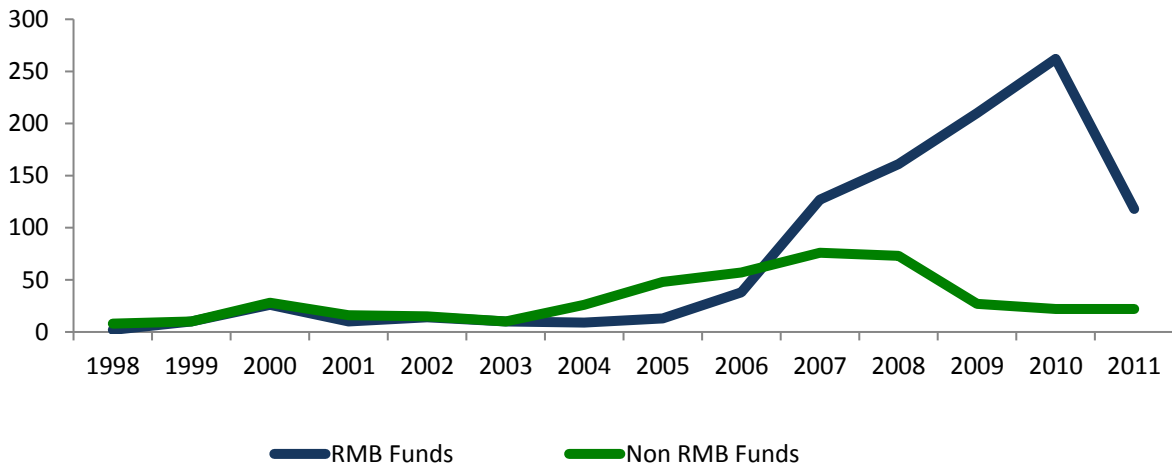
Figure 2: Distribution of PE Fund Investments made by Investors
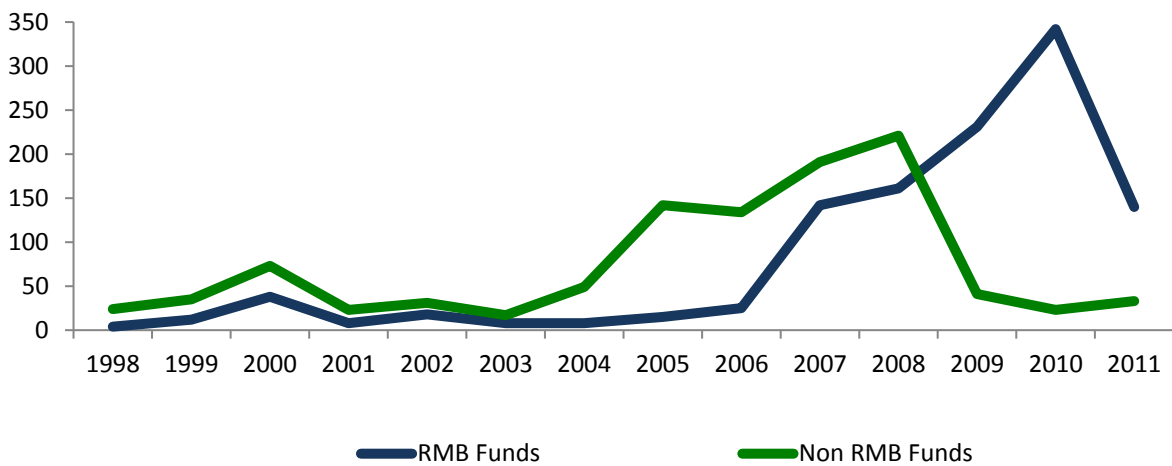
Table 1
Variable Definitions

Fund Variable	Definition
I(Offshore Capital Fund)	An indicator variable that equals one if a fund's commitments come from non-domestic investors
I(Domestic Capital Fund)	An indicator variable that equals one if a fund's commitments come from domestic investors
I(JV Capital Fund)	An indicator variable that equals one if a fund has been funded by a combination of offshore and domestic investors
I(Government Affiliation)	An indicator variable that equals one if the fund is government-affiliated
Year Manager Founded	The year the PE manager was founded
Manager Experience	The year the PE fund closed minus the year the PE manager was founded
Fund Sequence	The fund sequence number of a PE fund
ln(Size)	The natural log of the PE fund's size in US dollars
Vintage	The year a fund had its final closing
Allocation to China	The percentage of fund commitments intended to be allocated to China
I(Buyout)	An indicator variable that equals one if a fund focuses on buyout-stage investments
I(Venture and Growth)	An indicator variable that equals one if a fund focuses on venture- or growth-stage investments
I(RMB Denominated)	An indicator variable that equals one if the fund is RMB-denominated
Number of Fund Exits	The number of exits executed by a PE fund
Number of Fund Investments	The number of investments made by a PE fund
Proportion of Exited deals	The number of fund exits divided by the number of fund investments
Exit Multiple	The value of the deal at exit divided by the amount invested in the deal

Investor Variable	Definition
ln(Investor Commitment)	The natural log of the amount the investor has contributed to a particular fund in US dollars converted at the date of the final fund closing
I(Offshore Investor)	An indicator variable that equals one if the investor derives their funding from overseas
Year Investor Founded	The year the investor was founded
ln(Investor Capital)	The natural log of the investor's capital under management in US dollars
Investor Years in China	The number of years between an investor's latest and first Chinese PE investment during the sample period
Investor Number of Investments	The number of investments an investor has made in China during the sample period
First China Investment	An indicator variable that equals one if the investment being made is the investor's first investment in China
Experienced China Investor	An indicator variable that equals one if an investor has been investing in China for more than five years
I(HQ Greater China)	An indicator variable that equals one if an investor's headquarters (HQs) is in mainland China, Hong Kong, Macau or Taiwan
I(HQ Americas)	An indicator variable that equals one if an investor's HQs is in the US, Canada or South America
I(HQ Europe)	An indicator variable that equals one if an investor's HQs is in Europe
I(HQ Other)	An indicator variable that equals one if an investor's HQs is in Asia (excluding greater China), New Zealand, Australia, South Africa or the Middle East
I(Corporate)	An indicator variable that equals one if the investor is a corporate entity
I(Government)	An indicator variable that equals one if the investor is a government-affiliated entity
I(Financial)	An indicator variable that equals one if the investor is a financial investor

Table 2
Descriptive Statistics

This table contains summary statistics of the sample. Panel A displays fund level descriptive statistics and Panel B displays investor level descriptive statistics. Table 1 contains the variable definitions.

Panel A: Fund Level Descriptive Statistics

Variable	Obs	Mean	Standard Deviation	Median
Investor Commitment ($m)	776	38.032	83.923	9.275
Year Manager Founded	1207	2002	9.401	2004
Fund Sequence	1448	1.366	1.149	1.000
Size ($m)	1448	242.642	949.969	38.747
I(RMB Denominated)	1448	0.698	0.459	1.000
I(Offshore Capital Fund)	1448	0.278	0.448	0.000
I(Domestic Capital Fund)	1448	0.655	0.476	1.000
I(JV Capital Fund)	1448	0.068	0.251	0.000
I(Buyout)	1448	0.032	0.177	0.000
I(Venture and Growth)	1448	0.898	0.302	1.000
Allocation to China	1448	88.914	26.739	100.000
Vintage	1448	2008	2.988	2008
I(Government Affiliation)	1448	0.230	0.421	0.000

Panel B: Investor Level Descriptive Statistics

Variable	Obs	Mean	Standard Deviation	Median
I(Offshore Investor)	1227	0.299	0.458	0.000
Year Investor Founded	948	1988	26.660	1998
Investor Capital ($m)	210	24000	63000	2175
Investor Commitment ($m)	439	22.246	62.579	6.184
Investor Years in China	1234	1.069	2.443	0.000
Investor Number of Investments	1234	2.083	2.836	1.000
Headquarters of Investor				
I(HQ Greater China)	1234	0.739	0.439	1.000
I(HQ Americas)	1234	0.125	0.331	0.000
I(HQ Europe)	1234	0.071	0.257	0.000
I(HQ Other)	1234	0.065	0.246	0.000
Type of Investor				
I(Corporate)	1234	0.528	0.499	1.000
I(Government)	1234	0.091	0.287	0.000
I(Financial)	1234	0.382	0.486	0.000

Table 3
Differences in the Characteristics of Funds

This table compares the characteristics of Offshore Capital Funds to Domestic Capital Funds and RMB funds versus non-RMB denominated funds. Table 1 contains the variable definitions. For continuous variables, we test the significance of differences between means (medians) using t-tests (Mann–Whitney tests). For the binary variables, we compare proportions and medians (chi square test). Superscripts ***,** and * denote significance at the 1%, 5% and 10% level, respectively.

Panel A: Offshore Capital Funds versus Domestic Capital Funds

Variable	Offshore Funds		Domestic Funds		Comparison of Means or Proportions	Comparison of Medians
	Mean	Median	Mean	Median		
Year Manager Founded	1995	1992	2005	2007	-9.455***	-15.000***
Fund Sequence	2.184	1.000	1.044	1.000	1.140***	0.000***
Size (US$m)	678.514	100.000	64.405	18.894	614.109***	81.106***
I(Buyout)	0.092	0.000	0.009	0.000	0.083***	0.000***
I(Venture and Growth)	0.791	1.000	0.940	1.000	-0.149***	0.000***
Allocation to China	61.893	20.000	99.911	100.000	-38.018***	-80.000***
Vintage	2006	2004	2008	2009	-2.517***	-5.000***
I(Government Affiliated)	0.040	0.000	0.315	0.000	-0.275***	0.000***
I(RMB Denominated)	0.017	0.000	0.992	1.000	-0.975***	-1.000***

Panel B: RMB denominated funds versus non-RMB denominated funds

Variable	Non-RMB Funds		RMB Funds		Comparison of Means or Proportions	Comparison of Medians
	Mean	Median	Mean	Median		
Year Manager Founded	1996	1999	2005	2007	-8.774***	-8.000***
Fund Sequence	2.112	1.000	1.043	1.000	1.069***	0.000***
Size (US$m)	638.864	227.500	70.816	21.574	568.048***	205.926***
I(Offshore Capital Fund)	0.902	1.000	0.007	0.000	0.895***	1.000***
I(Domestic Capital Fund)	0.018	0.000	0.931	1.000	-0.912***	-1.000***
I(JV Capital Fund)	0.080	0.000	0.062	0.000	0.018	0.000
I(Buyout)	0.089	0.000	0.008	0.000	0.081***	0.000***
I(Venture and Growth)	0.795	1.000	0.944	1.000	-0.149***	0.000***
Allocation to China	63.838	80.000	99.788	100.000	-35.950***	-20.000***
Vintage	2006	2007	2008	2009	-2.447***	-2.000***
I(Government Affiliated)	0.062	0.000	0.303	0.000	-0.241***	0.000***

Panel C: Industry by fund type

Industry	All	Domestic Funds	Offshore Funds
Manufacturing	30.97	45.13	19.95
Wholesale and retail	19.99	19.01	19.15
Hotel Restaurant	1.15	0.67	1.23
IT	27.05	16.65	35.81
Real Estate	1.18	0.93	2.35
Media & Sport	5.05	3.68	5.14
Agriculture	2.34	3.03	1.85
Energy	3.35	2.98	4.04
Environment Infrastructure	2.36	2.44	2.03

Transport	0.90	1.18	0.99
Finance	2.01	2.25	3.24
Leasing and business services	0.79	0.37	0.78
Education	1.51	0.48	1.71
Construction	0.13	0.25	0.03
Mining	0.20	0.53	0.24
Research	0.06	0.06	0.03
Medical Services	0.97	0.37	1.44

Table 4
Differences in the Characteristics of Investor

This table compares the characteristics of foreign investors to domestic investors. Table 1 contains the variable definitions. For continuous variables, we test the significance of differences between means (medians) using t-tests (Mann–Whitney tests). For the binary variables, we compare proportions and medians (chi square test). Superscripts ***,** and * denote significance at the 1%, 5% and 10% level, respectively.

Variable	Foreign Investors		Domestic Investors		Comparison of means or proportion	Comparison of medians
	Mean	Median	Mean	Median		
Year Investor Founded	1968	1981	1996	1999	28.353***	18.000***
Investor Capital ($m)	36314	7750	3254	147	-33060***	-7750***
Investor Commitment ($m)	30.403	11.000	21.250	4.583	-9.153	-6.417***
Investor Years in China	2.134	0.000	0.620	0.000	-1.514***	0.000***
Investor Number of Investments	2.924	1.000	1.730	1.000	-1.194***	0.000***
Headquarters of Investor						
I(Greater China)	0.123	0.000	1.000	1.000	0.877***	1.000***
I(Americas)	0.420	0.000	0.000	0.000	-0.420***	0.000***
I(Europe)	0.240	0.000	0.000	0.000	-0.240***	0.000***
I(Other)	0.218	0.000	0.000	0.000	-0.218***	0.000***
Type of Investor						
I(Corporate)	0.232	0.000	0.652	1.000	0.420***	1.000***
I(Government)	0.035	0.000	0.115	0.000	0.080***	0.000***
I(Financial)	0.733	1.000	0.233	0.000	-0.500 ***	-1.000***

Table 5
Differences in the Characteristics of Fund Investment by Investor Type

This table compares the characteristics of PE fund investments by investor type. We divide investors into domestic investors and foreign investors. We compare investment by domestic and foreign investors in both Panels. Table 1 contains the variable definitions. For continuous variables, we test the significance of differences between means (medians) using t-tests (Mann–Whitney tests). For the binary variables, we compare proportions and medians (chi square test). Superscripts ***,** and * denote significance at the 1%, 5% and 10% level, respectively.

Variable	Investment by Domestic Investors		Investment by Foreign Investors		Comparison of Means or Proportions	Comparison of Medians
	Mean	Median	Mean	Median		
Investor Commitment (US$m)	24.884	6.184	65.570	25.000	-40.686***	-18.816***
Year Manager Founded	2005	2007	1997	2000	7.251***	7.000***
Fund Sequence	1.026	1.000	2.329	2.000	-1.303***	-1.000***
Size (US$m)	116.790	33.884	941.508	360.000	-824.718***	-326.116***
I(JV Capital Fund)	0.106	0.000	0.072	0.000	0.034***	0.000***
I(Buyout)	0.012	0.000	0.202	0.000	-0.190***	0.000***
I(Venture and Growth)	0.939	1.000	0.693	1.000	0.246***	0.000***
Allocation to China	99.624	100.000	65.497	80.000	34.127***	20.000***
Vintage	2008	2009	2006	2006	2.700***	3.000***
I(Government Affiliated)	0.412	0.000	0.112	0.000	0.300***	0.000***
I(RMB Denominated)	0.955	1.000	0.028	0.000	0.927***	1.000***

Table 6
Differences in the Characteristics of Investors by Experience

This table compares the characteristics of experienced and inexperienced investors in the sample and their PE fund investments. We divide investors into domestic investors and foreign investors. In Panel A experienced investors are those that have made more than one investment in China while inexperienced investors are those that have made one investment in China. In Panel B experienced investors are those that have been investing in China for five or more years and inexperienced investors are those that have been investing in China for less than five years. Table 1 contains the variable definitions. For continuous variables, we test the significance of differences between means (medians) using t-tests (Mann–Whitney tests). For the binary variables, we compare proportions and medians (chi square test). Superscripts ***,** and * denote significance at the 1%, 5% and 10% level, respectively.

Panel A: Investment by Investors using First China Investment as a Measure of Experience

Variable	Investment by Experienced Investors		Investment by Non-experienced Investors		Comparison of Means or Proportions	Comparison of Medians
	Mean	Median	Mean	Median		
Investor Commitment (US$m)	59.448	17.789	16.394	4.608	43.054 ***	13.181***
Year Manager Founded	2000	2001	2002	2002	-2.093***	-1.000***
Fund Sequence	2.015	1.000	1.263	1.000	0.752***	0.000***
Size (US$m)	756.885	250.000	254.608	45.141	502.277***	204.859***
I(JV Capital Fund)	0.094	0.000	0.089	0.000	0.005	0.000
I(Buyout)	0.150	0.000	0.051	0.000	0.099***	0.000***
I(Venture and Growth)	0.760	1.000	0.888	1.000	-0.128***	0.000***
Allocation to China	77.876	100.000	89.530	100.000	-11.654***	0.000***
Vintage	2007	2008	2007	2008	0.581***	0.000
I(Government Affiliation)	0.235	0.000	0.311	0.000	-0.076***	0.000***
I(RMB denominated)	0.364	0.000	0.681	1.000	-0.317***	-1.000***

Panel B: Investment by Investors using Experienced China Investor as a Measure of Experience

Variable	Investment by Experienced Investors		Investment by Non-experienced Investors		Comparison of Means or Proportions	Comparison of Medians
	Mean	Median	Mean	Median		
Investor Commitment (US$m)	69.321	25.000	24.357	6.005	44.964 ***	18.995***
Year Manager Founded	1998	2000	2003	2004	-5.151***	-4.000***
Fund Sequence	2.360	2.000	1.310	1.000	1.050***	1.000***
Size (US$m)	936.432	350.000	308.106	53.000	628.326***	297.000***
I(JV Capital Fund)	0.071	0.000	0.100	0.000	-0.028**	0.000**
I(Buyout)	0.197	0.000	0.057	0.000	0.140***	0.000***
I(Venture and Growth)	0.707	1.000	0.877	1.000	-0.170***	0.000***
Allocation to China	65.736	100.000	91.734	100.000	-25.998***	0.000***
Vintage	2005	2006	2008	2008	-2.362***	-2.000***
I(Government Affiliation)	0.196	0.000	0.308	0.000	-0.076***	0.000***
I(RMB denominated)	0.215	0.000	0.662	1.000	-0.447***	-1.000***

Table 7
Logit Model Predicting the Source of Capital of a PE Fund
with Fund Currency Constraints

This table contains a logit model that predicts whether a fund obtains its capital from domestic investors or foreign investors. The dependent variable takes the value of one where a fund is foreign-backed and denominated in non-RMB currency, and zero where a fund is domestic backed and denominated in RMB denominated. Table 1 contains the variable definitions. In parentheses are t-statistics based on standard errors adjusted for heteroskedasticity and PE manager clustering. All regressions include year dummies, whose coefficient estimates are suppressed. Superscripts ***,** and * denote significance at the 1%, 5% and 10% level, respectively.

	Offshore non-RMB funds vs Domestic Capital RMB Funds
Manager Experience	0.131***
	(3.530)
Fund Sequence	0.996***
	(3.096)
Allocation to China	-0.181*
	(-1.904)
ln(Size)	1.800***
	(9.292)
I(Buyout)	-0.997
	(-0.516)
I(Venture and Growth)	-1.745*
	(-1.923)
I(Government Affiliated)	-3.305***
	(-5.958)
Constant	12.903
	(1.335)
Year fixed effects	Yes
Pseudo R Squared	79.60%
N	1114

Table 8
Multinomial Logit Models Predicting the Source of Capital of a PE Fund

This table contains multinomial logit models that predict whether a fund obtains its capital from domestic investors, foreign investors or a combination of the two. We report marginal effects evaluated at the sample mean. Table 1 contains the variable definitions. In parentheses are z-statistics. All regressions include year dummies, whose coefficient estimates are suppressed. Superscripts ***,** and * denote significance at the 1%, 5% and 10% level, respectively.

Marginal Effects	Offshore Capital Fund	Domestic Capital Fund	JV Capital
Manager Experience	0.016**	-0.030***	0.014***
	(2.418)	(-3.753)	(2.829)
Fund Sequence	0.039	0.065	-0.104**
	(1.334)	(1.144)	(-2.164)
Allocation to China	-0.010**	0.023***	-0.013**
	(-2.170)	(2.704)	(-2.428)
ln(Size)	0.116***	-0.199***	0.084***
	(3.315)	(-5.109)	(2.875)
I(Buyout)	-0.139	0.329	-0.190
	(-0.721)	(1.302)	(-0.867)
I(Venture and Growth)	-0.067	0.088	-0.021
	(-0.478)	(0.414)	(-0.145)
I(Government Affiliated)	-0.357***	0.499***	-0.142
	(-2.986)	(4.101)	(-1.639)
I(RMB Denominated)	-0.874***	1.331***	-0.458***
	(-3.870)	(6.108)	(-3.512)
Year fixed effects	Yes	Yes	Yes
Log Likelihood	-275.051		
Pseudo R Squared	72.54%		
N	1207		

Table 9
Determinants of Investor Commitment Amount

This table contains ordinary least squares estimates. The dependent variable in each case is the log transform of an investors commitment amount to a particular fund. Column 1 and Column 2 examine all funds. Column 2 includes interaction terms. Table 1 contains the variable definitions. In parentheses are t-statistics based on standard errors adjusted for heteroskedasticity and investor clustering. All regressions include year dummies, whose coefficient estimates are suppressed. Superscripts ***,** and * denote significance at the 1%, 5% and 10% level, respectively.

Ln(Investor Commitment Amount)	Commitments by All Investors	Commitments by All investors
I(Offshore Investor)	-0.655	0.521
	(-1.347)	(1.058)
I(Government Investor)	0.034	-0.102
	(0.176)	(-0.555)
I(Financial Investor)	0.149	0.376**
	(0.983)	(2.324)
I(Offshore)* I(Government)		-0.559
		(-1.628)
I(Offshore)* I(Financial)		-1.467***
		(-4.246)
I(First China Investment)	-0.440***	-0.467***
	(-3.619)	(-4.009)
Manager Experience	-0.002	-0.004
	(-0.202)	(-0.529)
Fund Sequence	-0.129***	-0.113***
	(-3.294)	(-3.054)
ln(Size)	0.545***	0.551***
	(12.106)	(12.600)
I(JV Capital Fund)	0.451**	0.333*
	(2.480)	(1.739)
Allocation to China	-0.006	-0.006*
	(-1.584)	(-1.683)
I(Buyout)	0.687***	0.716***
	(3.389)	(3.591)
I(Venture and Growth)	0.244	0.217
	(1.212)	(1.062)
I(Government Affiliated)	0.147	0.166
	(1.214)	(1.358)
I(RMB Denominated)	-0.297	-0.224
	(-0.688)	(-0.516)
Constant	1.627**	1.673**
	(1.992)	(2.114)
Year fixed effects	Yes	Yes
Adjusted R Squared	47.54%	40.88%
N	670	670

Table 10
Robustness: Determinants of Investor Commitment Amount

This table contains ordinary least squares estimates. The dependent variable in each case is the log transform of an investors commitment amount to a particular fund. Column 1 and Column 2 examine all funds. Column 2 includes interaction terms. Table 1 contains the variable definitions. In parentheses are t-statistics based on standard errors adjusted for heteroskedasticity and investor clustering. All regressions include year dummies, whose coefficient estimates are suppressed. Superscripts ***,** and * denote significance at the 1%, 5% and 10% level, respectively.

Investor Commitment	Commitments by All Investors	Commitments by All Investors
I(Offshore Investor)	0.135	1.007
	(0.313)	(1.497)
I(Government Investor)	-1.089***	-0.980***
	(-3.025)	(-3.120)
I(Financial Investor)	-1.057***	-0.744**
	(-3.110)	(-2.317)
I(Offshore)* I(Government)		-0.604
		(-0.955)
I(Offshore)* I(Financial)		-0.945
		(-1.560)
ln(Investor Capital)	0.234***	0.229***
	(3.385)	(3.200)
I(First China Investment)	0.022	-0.000
	(0.080)	(-0.002)
Manager Experience	0.007	0.007
	(0.393)	(0.374)
Fund Sequence	-0.137***	-0.139***
	(-3.078)	(-3.109)
ln(Size)	0.592***	0.599***
	(5.024)	(5.059)
I(JV Capital Fund)	0.245	0.249
	(0.929)	(0.924)
Allocation to China	-0.011**	-0.011**
	(-2.006)	(-1.997)
I(Buyout)	0.636**	0.620**
	(2.457)	(2.468)
I(Venture and Growth)	0.461	0.443
	(1.283)	(1.252)
I(Government Affiliated)	0.320	0.348*
	(1.611)	(1.705)
I(RMB Denominated)	1.035**	1.034**
	(2.297)	(2.215)
Constant	-1.294	-1.521
	(-1.196)	(-1.348)
Year fixed effects	Yes	Yes
Adjusted Rsquared	63.05%	62.87%
N	192	192

Table 11
Determinants of the Number of Fund Exits and Percentage of Fund Exits

Column 1 is an ordered logit and the dependent variable is the number of exits made by a fund. Column 2 is an OLS regression and the dependent variable is the number of exits made by a fund divided by the number of investments made by the fund. Table 1 contains the variable definitions. In parentheses are t-statistics based on standard errors adjusted for heteroskedasticity and PE Manager clustering. All regressions include year dummies, whose coefficient estimates are suppressed. Superscripts ***,** and * denote significance at the 1%, 5% and 10% level, respectively.

Dependent Variable	Number of Exits	Number of Exits/ Number of Investments
I(Domestic Capital Fund)	0.197*	0.245*
	(1.835)	(1.796)
Number of Fund Investments	0.279***	
	(4.500)	
Manager Experience	0.012**	0.023**
	(2.050)	(2.047)
Fund Sequence	-0.016	-0.027
	(-1.056)	(-1.237)
Allocation to China	0.004	-0.001
	(0.308)	(-0.095)
ln(Size)	0.129*	0.047*
	(1.912)	(1.878)
I(Buyout)	-0.209	-0.041
	(-1.266)	(-0.250)
I(Venture and Growth)	0.125	0.062
	(1.048)	(1.378
I(Government Affiliated)	0.038	0.026
	(0.093)	(0.042)
Constant		0.583
		(1.113)
Year fixed effects	Yes	Yes
Industry fixed effects	Yes	Yes
Pseudo R-squared	23.87%	19.43%
N	552	552

Table 12
Determinants of Exit Multiple

The dependent variable in each case is the exit multiple for an investment. Column 1 is an OLS regression and Column 2 is a tobit. Table 1 contains the variable definitions. In parentheses are t-statistics based on standard errors adjusted for heteroskedasticity and PE Fund clustering. All regressions include year dummies. Superscripts ***,** and * denote significance at the 1%, 5% and 10% level, respectively.

Exit Multiple	OLS	Tobit
I(Domestic Capital Fund)	4.786**	4.723**
	(2.160)	(2.571)
IPO	5.286***	5.475***
	(3.156)	(2.789)
Deal Size	-0.120	-0.096
	(-1.250)	(-1.101)
Deal Duration	2.841***	2.374***
	(3.291)	(3.148)
I(Buyout)	8.329**	6.399**
	(2.211)	(2.105)
I(Venture and Growth)	2.138**	2.476*
	(2.067)	(1.787)
I(Government Affiliated)	-0.0240	-0.079
	(-0.089)	(-1.031)
Constant	-9.328***	-11.834**
	(-2.850)	(-2.628)
Year fixed effects	Yes	Yes
Industry fixed effects	Yes	Yes
Pseudo R-squared	7.03%	2.40%
N	336	336