

Mapping Chinese Cross-border Finance: Actors, Networks and Institutional Development

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In memory of Gisela Weise whose fortitude, compassion for others and life-long thirst for discovery and learning remain my source of motivation.

And to Jana and Michael Töpfer whose love and support has allowed me to pursue opportunities that they themselves did not have.

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ABSTRACT

This research project explores the rise of Chinese cross-border finance. Cross-border investment programmes have been at the heart of China's financial liberalisation. Yet, we know little about what drives the expansion of these new market entry channels and the effects they have on global finance. This thesis explores the role that formal and informal institutions play in China's financial system, by addressing three main research goals: (1) to rethink analytical frameworks of global financial networks, by shifting the focus to channels of state power; (2) to investigate how such formal institutions shape competitive hierarchies in financial markets, both inside and outside of China; (3) to demonstrate that informal institutions such as a common cultural identity are equally important to explain behaviour and outcomes in Chinese cross-border finance. The thesis pursues this agenda through four substantive papers, each with its own subset of research goals and findings.

The papers follow a three-fold structure. The thesis begins with an analytical focus on agents (micro-level), by examining the evolution of state-firm relations in Chinese cross-border finance. The first paper develops a politically sensitive framework of global financial networks, which conceptualises how bargaining dynamics within China's party-state shape competitive hierarchies in Chinese capital markets. Drawing on these theoretical insights, the second paper breaks new empirical ground, by explaining the asymmetrical nature of market access criteria for foreign investors. The third paper zooms out on the global consequences that Chinese state control has for money centres (macro-level). It sheds light on how state-firm relations shaped London's development as the first Western offshore trading centre for Chinese currency. The fourth paper shifts the attention to the role of informal social institutions in Chinese equity markets. It presents the first empirical study of how a common cultural identity with Mainland China governs the behaviour of different investor categories (group-level).

The thesis distils the following findings: Bargaining conflicts *inside* the Chinese party-state have a decisive impact on competitive outcomes and behaviour in Chinese cross-border finance, both domestically and globally. Strategic state interests form an interdependent relationship with the resources supplied by foreign investors and domestic corporate players. Domestically, these resource interdependencies explain the asymmetrical nature of market access under China's cross-border investment schemes. Globally, the shift in state-firm bargaining dynamics from strategic alignment to an increasing bifurcation of interests explains the patchy integration of RMB finance into London's financial architectures. Informal social institutions equally shape competitive outcomes in China's capital markets. Whilst the literature identifies shared cultural identity as a source of local information advantage, this thesis finds the opposite: A common cultural background with national Chinese investors reduces information asymmetries for foreign investors but it does not equate to local information advantages. Overall, the four substantive papers add up to a multifaceted yet integrated perspective on the drivers, dynamics and consequences of Chinese cross-border finance. They clarify that the intersection of formal state governance and informal social forces is essential for understanding how the spread of neoliberal market forces unfolds across Chinese capital markets. This thesis thus affirms that space and place remain central to our understanding of financial market outcomes.

CHAPTER 1

Introduction

The shift of global financial assets towards rapidly growing economies in Asia is reshaping international capital markets. With a market value exceeding USD 4 trillion, Mainland China is now the world's second largest stock market and the total size of its capital markets is projected to reach USD 98 trillion by 2030 (CSRI, 2015). Similarly, China's currency, the Renminbi (RMB), is now the fifth most-used currency for international payments and part of the International Monetary Fund's basket of global reserve currencies (IMF, 2015). The on-going financial liberalisation that has accompanied this development has sparked a growing body of finance research on foreign investors in Chinese capital markets. This literature has examined foreign shareholding preferences (Bredin and Liu, 2011), the economic causes and consequences of their investment decisions (Li and Uchida, 2011) and how state ownership affects foreign investor information (Ding et al, 2010). These works have treated the firm as the primary unit of analysis to explain investor behaviour and financial market outcomes. In contrast, the role of the state is viewed as a 'regulator' of such behaviour and outcomes (Bian, 2014). As a result, the role that political bargaining dynamics play in shaping the development of Chinese cross-border finance has been neglected.

The literature on global economic networks in political economy and economic geography has provided a more nuanced appreciation of the state's role. Recent works highlight the interconnections between firms and 'extra-firm actors' in global production networks (GPN), financial intermediaries in global financial networks (GFN) (Coe and Yeung, 2015; Coe et al, 2014). As one of several 'extra-firm actors', the state is understood as a facilitator of local competitive advantage. Previous works have highlighted the state's role in promoting the 'strategic coupling' between global firms and specific regions (MacKinnon, 2012; Zhang and Peck, 2016). Similarly, GFN research emphasises the state's role as part of 'offshore jurisdictions' and 'financial centres', which provide firms with competitive resources to connect with capital flows (Wójcik and Camilleri, 2015; Coe et al, 2014). By viewing financial markets and the wider economy as fundamentally interconnected networks, the GPN and GFN literatures provide a useful starting point for thinking about the state as a mediator of economic transactions between agents.

Nonetheless, the interpretation of the state's role remains limited to a

representative function of territory and regional economic development. Equating the state to legal functions as a 'jurisdiction', 'regulator' and 'extra-firm mediator' echoes the characteristics of liberal market economies, where economic networks operate with relative freedom from state intervention. The trouble with such conceptions is that they neglect how political bargaining shapes processes of capital accumulation. This is especially problematic when it comes to understanding economic outcomes in socialist market economies such as China where the state plays a prominent role. While most works investigating countries with alternative economic models have focused on manufacturing industries, notable exceptions have highlighted network dynamics in the financial sector (Wójcik and Camilleri, 2015; Bassens et al, 2013; Pan et al. 2016). However, even here the focus continues to be on economic relations between firms from different locations. Recent work has therefore called for a more thorough theorisation of the state's role that goes beyond the mediation of corporate behaviour and regional development (Stephenson and Agnew, 2016; Smith 2015).

Specifying the channels of state power and political bargaining is especially important in major non-Western economies such as China. In the country's one-party regime¹, the state not only shapes financial markets; it creates them. At the core of Deng Xiaoping's vision of a modern China was the recognition that the market would play a key role in bringing about fundamental reform (Brown, 2016). Developing a system of financial intermediation would constitute a central element in this endeavour. More than three decades later, the Chinese government has revived the momentum of this vision, by pledging to let markets play a 'decisive role' in the financial sector (SCMP, 2013). At the 2013 Third Plenum, China's top political leaders decided to further open up the domestic financial sector to foreign capital and increase the level of institutional investment. In response, Chinese financial authorities have increasingly eased restrictions under two main cross-border investment channels that allow foreign investors to buy domestic securities: The Qualified Foreign Institutional Investor (QFII) scheme, limited to investment in USD, and its RMB equivalent, the RQFII scheme, which allows RMB funds raised offshore to be invested

¹ The thesis to 'one-party regimes' as single-party systems such as China, which prohibit opposition parties from entering political decision-making.

in domestic securities². As part of these accelerated liberalisation moves, international financial centres (IFCs) such as London and Singapore have established offshore RQFII hubs that enable investors to trade in RMB markets.

However, QFII/RQFII market access for foreign investors and IFCs depends on gaining permission from the Chinese government. By granting privileged market access to some and excluding others, the government directly shapes the competitive hierarchies of firms and money centres. This approval system illustrates where power is located in Chinese cross-border finance, and where it is not: As the main architect of competitive hierarchies, it is the Chinese party-state rather than 'lead' firms and IFCs that shape the spatial distribution of power. This contrasts with the above interpretations of the state's role as a regulator (Bian, 2014), jurisdiction (Coe et al, 2014) and extra-firm facilitator of 'strategic coupling' (Coe and Yeung, 2015). As the QFII/RQFII programmes clarify, the Chinese state is not limited to mediating cross-border capital flows; it creates and controls these flows across different locations. This importance of state control in Chinese capital markets will not only challenge how we think about constellations of power in global finance; it will also require approaching the notion of 'power' through a fundamentally *geographical* lens.

Conventional definitions of power such as 'the ability to get what you want' and 'to get others to want the outcomes you want' (Nye, 2011) are too vague to capture how location-specific context shapes power relations. This thesis therefore proceeds with an understanding of power grounded in economic geography, and two works in particular: John Allen's (2003) 'Lost Geographies of Power' and his recent work on 'Topologies of Power' (2016). The 'lost' geographies he refers to highlight that location plays an essential role in shaping how power is exercised. More recently, Allen (2016) has specified that space can function as a resource and can be stretched in a topological sense to extend control over others in different territories. There are three key insights from Allen's work that are particularly relevant for this thesis: (1) Power comes in the shape of different key *modalities*, which include 'hard' and 'soft' features

² The 2014 Shanghai-Hong Kong Stock Connect Scheme and the 2016 Shenzhen-Hong Kong Stock Connect scheme provide two recent additions in Chinese cross-border finance, which allow foreign investors to trade domestic Chinese stocks.

such as coercion, persuasion or authority based on recognition by others³. (2) Power is not a resource to be wielded in its own right but rather a way of pooling resources through interaction with others. (3) Several power resources can be used simultaneously or in succession. Allen (2016) clarifies that ‘powerful’ agents can draw on resources both inside and outside their own institutional context to achieve their goals. Drawing on these elements, this thesis therefore defines power as an agent’s control over material and non-material resources in bargaining processes that span different agents and locations.

Allen’s conception of power provides a useful foundation for this thesis to examine the power relations in China’s GFN. Its emphasis on power as a relational concept that involves harnessing strategic resources reflects the empirical reality of Chinese capital market development. The Chinese government’s approach to financial liberalisation has combined both proactive and reactive policy experimentation. This process has relied on the decentralised accumulation of new ideas and solutions from domestic and foreign firms as well as government bodies (Heilmann and Perry, 2011). It is in this context that Allen’s conception of power provides a suitable starting point, by directing the focus to how power is *practiced* across space. This thesis applies this focus to the study of China’s capital markets, by examining how cross-border linkages are created and maintained to achieve the Chinese government’s strategic goals.

The interesting question then becomes what sort of cross-border financial space the Chinese party-state seeks to create and through which channels it shapes the behaviour of firms and development of IFCs. To answer these questions, it is necessary to understand how global financial networks are governed in the Chinese context. Any such understanding requires disentangling two main forms of

³ Allen identifies eight key modalities of power, divided into ‘hard’ modalities of power and ‘softer’ modalities. The former includes *authority*, which is based on recognition by others, whereby agents comply because they accept the authority of a government or an organisation as rightful. *Domination* is another ‘hard’ modality, whereby power derives from closing off alternatives that leave others no choice but to comply. *Coercion* is the strongest modality of hard power, which relies on the use of threats and force to achieve compliance. By contrast, ‘softer’ modalities of power are associational that focus on ‘power to’ do something rather than exerting ‘power over’ others. This includes *seduction*, which seeks to get someone to follow one’s preferences whilst being aware that they could refuse to comply. *Manipulation* refers to the intentional concealing of one’s true intentions to achieve compliance. *Inducement* is reward-based to win others over to comply. Finally, *negotiation* and *persuasion* both refer to the attempt to get others to comply, by aligning incentives and reaching a common goal. The former applies to cases where agents have different resources, whereas the latter is typically used when all agents find themselves on an equal playing field.

governance: formal institutional⁴ governance by the Chinese party-state and informal institutional governance through social norms.

Understanding the role of formal institutions in Chinese capital markets requires unravelling how state control is exercised between different financial authorities and the Politburo of the Chinese Communist Party (CCP), the country's main source of political authority. By contrast, informal institutions require mapping the social norms and relations that guide behaviour within Chinese financial networks. Such informal dimensions are just as important as formal institutions because they form the 'glue' for mutual trust and collaboration in Chinese financial transactions (Luo et al 2012; Robertson, 2015). The trouble is that such informal institutions are difficult to measure, as they are less easily defined and recognised than formal institutions (Ezrow et al, 2015). As a result, research on the social and cultural underpinnings of global economic networks has been largely limited to theoretical work (Ponte and Sturgeon, 2014; Yeung, 2014) and case study research (Saxenian 2008).

Against this backdrop, the research presented in this thesis is guided by a two-fold agenda: to advance our conceptual understanding of and systematically measure how formal and informal institutions shape the development of Chinese cross-border finance. It treats formal and informal institutions as two sides of the same coin because the latter often functions as a substitute for the formal institutions in the Chinese context. For example, strong social bonds in ethnic Chinese networks frequently step in to provide channels of credit access to complement weak formal support from the state (Mitchell, 2003; McNally, 2011). Examining formal state governance in isolation of such informal channels would thus paint an incomplete picture of the drivers behind Chinese cross-border finance. Even worse, it risks attributing too much explanatory power to formal institutions, thus jeopardising the accuracy of inferences. This thesis thus adopts an inclusive perspective to institutional governance, by examining the interplay between formal and informal institutions.

⁴ This thesis defines 'institutions' as formal or informal rules, norms and enforcement mechanisms that are grounded in the common expectations between agents and therefore guide their behaviour. Governance through formal institutions refers to legal rules that are subject to third-party enforcement (Rodrik 2008). This includes, for example, the constitution and area-specific policies that are created and enforced by the state. Defining governance by informal institutions is trickier, as it refers to norms, values and patterns of behaviour. Examples include commonly accepted social conventions and moral codes (North, 1994; Rodrik 2008).

The trouble is that international finance research and the literature on global economic networks currently lack a theoretical foundation to analyse the nexus of formal-informal institutions in China's QFII/RQFII programmes. Previous works have focused mainly on formal state and economic institutions. This includes Chinese financial centres (Lai 2012), financial intermediaries in China (Daniels, 2012) and the geographical linkages between Mainland China's capital markets and overseas stock exchanges (Wójcik and Burger 2010; Karreman and van der Knaap 2012). Recent work has furthermore examined how financial intermediaries help the Chinese government to 'plug' domestic Chinese firms into global financial networks (Wójcik and Camilleri, 2015). This has shed light on the role of intermediation practices such as cross-listing firms on stock exchanges in major IFCs and creating offshore entities in places such as the British Virgin Islands (Haberly and Wójcik, 2013). These works provide useful insights into how formal 'market-creating' institutions such as IFCs reduce transaction costs, by facilitating economic cooperation between the Chinese government and global firms. Yet, the question of how these interact with informal social and cultural institutions remains unanswered.

This thesis seeks to advance the above literature, by combining its emphasis on formal economic institutions with novel insights into the political and social underpinnings of Chinese cross-border finance. This thesis should be read as an attempt to open up a broader agenda on GFN 'with Chinese characteristics'. This focus on China should, however, not be confused with a call for a *sui generis* model of Chinese GFN. Whilst the research presented in this thesis does not lend itself to broader generalisations, the theoretical claims and methods used to study institutional adaptation within GFN apply to any economic system. The underlying premise guiding the analysis throughout is that the global spread of neoliberal economic ideas has given rise to more complex interdependent forms of institutional governance, whereby the state shares rather than concedes authority to non-state actors (O'Neill and Weller, 2016; Büthe and Mattli, 2011). This idea that institutional adaptation reflects shifts in the interrelations between the state, firms and informal social dimensions is not specific to China's GFN but applies to GFN anywhere in the world irrespective of their economic system. Despite the focus on China, this thesis thus provides important insights for the study of GFN more generally.

1.2. Thesis aims, outline and key contributions

This research project explores the rise of Chinese cross-border finance through the lens of China's cross-border investment programmes. Yet, we know little about what drives the expansion of these new market entry channels and the effects they have on global finance. To shed light on these cross-border investment programmes, this thesis investigates the role that formal and informal institutions play in their creation and subsequent development. To this end, the research presented in this thesis addresses three main research goals: (1) to rethink analytical frameworks of global financial networks, by shifting the focus to channels of state power; (2) to investigate how such formal institutions shape competitive hierarchies in financial markets, both inside and outside of China; (3) to demonstrate that informal institutions such as a common cultural identity are equally important to explain behaviour and outcomes in Chinese cross-border finance. To pursue this agenda, the main challenge facing this thesis is to connect a number of interrelated but often separately treated agents, network linkages and geographical settings. To this end, the research is organised into four discrete research papers, each with its own subset of research goals and findings. This approach offers several advantages. It allows for shedding light on concrete yet interconnected manifestations of formal and informal institutional governance. It also enables us to examine how such institutional governance unfolds across different spatial scales, that is, both within Chinese capital markets and in overseas RMB trading centres. What unites the four papers is their common practical goal to map the formal and informal channels that shape the development of Chinese cross-border finance.

These above goals generate a three-fold research structure based on the location, size and scale of research targets investigated in each paper. The thesis begins with a focus on agents (micro-level), by examining the evolution of firm-state relations. The first paper develops a politically sensitive framework of global financial networks, which conceptualises how bargaining dynamics within China's party-state shape competitive hierarchies in Chinese capital markets. Drawing on these theoretical insights, the second paper breaks new empirical ground, by explaining the asymmetrical nature of market access criteria for foreign investors. The third paper zooms out on the global consequences that Chinese state control has for entire money

centres (macro-level). It sheds light on how state-firm relations shape London's development as the first Western offshore trading centre for Chinese currency.

The fourth paper shifts the attention to the role of informal institutions in Chinese equity markets. It presents the first empirical study of how a common cultural background with Mainland China shapes the behaviour of different investor categories toward local investee firms. This focus on common group identity (meso-level) examines the intermediate space between the micro-level (state/firm agents) and the macro-level of analysis (IFCs). It takes up the importance of ethnic Chinese networks discussed above and highlights the implications they have for investor behaviour and corporate governance.

In sum, this three-fold structure at the micro, meso and macro-level of analysis has more than just structural value. The linkages between the four papers add up to a multifaceted yet integrated perspective on Chinese cross-border finance. The remainder of this section provides an overview of the thesis chapters and outlines their respective research goals and contributions.

Chapter 1 provides the introduction and spells out the rationale behind this thesis. It provides an overview of the substantive chapters, by outlining their respective research objectives and methodologies.

Chapter 2 selects three core themes from relevant conceptual literatures for further review. This discussion serves to contextualise the subsequent substantive chapters and establishes an overarching connecting thread between them.

Chapter 3 provides the theoretical backbone of this thesis. It critically reviews theories of global economic networks and extends their application to China's state-controlled financial sector. Global economic networks have provided influential frameworks to analyse how interconnected economic and non-economic agents produce goods and services for international markets. Early works have focused on how 'lead firms' shape regional manufacturing, innovation clusters and trade linkages (Gereffi et al, 2005). More recent approaches have advanced the literature, by highlighting the role of 'extra-firm actors' in facilitating regional competitive advantage (MacKinnon, 2012;

Horner, 2014) and the interrelationship between production processes and global finance (Coe and Yeung, 2015; Coe et al, 2014). Nonetheless, the main emphasis continues to be on economic relations between different locations. The ways in which political bargaining dynamics shape processes of capital accumulation have thus been neglected.

Economic perspectives expose several shortcomings when it comes to analysing China's global financial networks. In the Chinese context, these networks are characterised by conflicts of interest between firms and different levels of government within the Chinese party-state. To capture these bargaining dynamics, chapter 3 exploits the theoretical synergies between GFN frameworks in economic geography, the institutional change literature and theories of Chinese elite politics. This cross-disciplinary approach allows for developing a politically sensitive framework of *state-led* GFN. The framework identifies formal and informal institutional channels that link multi-level bargaining within the Chinese party-state to market outcomes for foreign investors and domestic corporate players. This allows for conceptualising the state's role as a primary architect of GFN and the competitive hierarchies that characterise them. The chapter offers an empirically grounded approach in this respect, as it integrates recent findings on China's QFII/RQFII schemes into the analysis.

In sum, the state-led GFN approach developed in chapter 3 presents a discrete piece of research that stands in its own right. At the same time, it serves to frame the discussion in subsequent empirical chapters. Chapter 4 applies the state-led GFN approach to the analysis of how changes in market access criteria under China's QFII/RQFII programmes. Whilst the remaining empirical chapters present less direct applications of this approach, its conceptual insights still provide a common connecting thread throughout. For example, chapter 5 investigates London's development as an offshore RMB centre, by taking up the theoretical premises on multi-level governance discussed in chapter 3. Similarly, chapter 6 explores how a common cultural background with Mainland China shapes investor behaviour. This links to the theoretical discussion on informal institutional channels presented in chapter 3. In sum, the state-led GFN approach developed in chapter 3 provides the broad conceptual anchor for the empirical investigations that follow.

Chapter 3 has been submitted to *Dialogues in Human Geography* and is currently undergoing a second round of reviewer comments.

Chapter 4 presents the first empirical study that links shifts in state-firm relations to institutional changes in China's QFII/RQFII programmes. Previous studies have highlighted the role of domestic financial reform (Lardy 2002; Schlichting 2008) and external catalysts such as China's WTO membership (Bowles and Wang, 2013) in connecting Chinese capital markets with global financial flows. Studies published in Chinese language have furthermore shown that political favouritism is a major determinant of domestic capital allocation among Chinese firms (Chen et al, 2015; Nan and Meng 2009; Yin et al, 2008). However, the ways in which the internal political decision-making process shapes cross-border capital flows has not yet been explored.

By building on the above literature, chapter 4 addresses this research gap, by investigating a the following question: Why have market access criteria under China's QFII/RQFII schemes changed over time and how do such changes affect competition between firms? Underlying this research question is the following political puzzle: Following the launch of the QFII programmes, Chinese regulators sought to keep out short-term speculators and limit market access to long-term investors (Walter and Howie, 2012). It is thus baffling that eligibility criteria and investor approvals in the QFII launch phase did not reflect these policy preferences. Surprisingly, 'sell-side' investors including investment banks and securities companies made up the vast majority of QFII approvals (CSRC, 2004). Compared with 'buy-side' investors who own their assets such as pension funds, 'sell-side' investors are financial intermediaries whose investment horizons are more momentum-driven (Koller, 2010). However, a closer look at the QFII market composition over time reveals a fundamental change. The vast majority of QFII approvals now goes to 'buy-side' investors (see CSRC, 2015).

The U-turn in the type of investors that gets granted QFII approval provides the starting point for the empirical analysis presented in Chapter 4. Its objective is to reconstruct the political decision-making process, by linking the strategic policy preferences to changes in QFII/RQFII criteria. To this end, it draws on the state-led GFN approach developed in chapter 3 and provides an assessment of its empirical validity. The analysis demonstrates that the changes in approval criteria can be explained by

bargaining dynamics between China's top party leaders, administrative authorities and corporate interests. The 2008 global financial crisis triggered fundamental shifts in the resource interdependencies between these agents, which altered the nature of bargaining dynamics. This interplay between internal and external conditions was decisive for understanding how the QFII programmes evolved. The analysis draws on an original dataset that couples 91 multi-stakeholder interviews, database analysis and internal government records. The findings show that institutional change in China's cross-border investment programmes is a *negotiated* economic outcome that bridges interdependent state and market agents. These results have important implications for the study of globalisation and institutional change in non-Western contexts. They not only contrast existing narratives of an all-pervasive Chinese party-state that is resistant to change; they also challenge claims that the global spread of neoliberal market forces has reduced the role of the state in markets.

Chapter 4 was published in the January 2017 issue of the *Review of International Political Economy*.

Chapter 5 shifts the attention from resource interdependencies at the agent level (chapters 3-4) to the global consequences such interdependencies have across space. The chapter takes the rapid global expansion of China's RQFII scheme as its starting point. China's strategy to internationalise the use of its currency has led to the creation of twelve offshore RMB trading centres in less than five years and facilitated the RMB's inclusion into the IMF basket of global reserve currencies in 2015. Through the geographical expansion of RQFII hubs, the RMB is thus beginning to provide global investors with an alternative to the US dollar in global currency markets.

These shifts have direct consequences for reshaping the status quo of established IFC hierarchies. Securing RQFII approval from the Chinese government gives money centres a competitive edge over their rivals, by expanding the scope of IFC capabilities. In other words, it provides IFCs with the exclusive right to use RMB offshore for trade, settlement and RMB-denominated assets. Early RQFII approval also allows more time to develop expertise in new RMB investment products and to integrate them into existing IFC architectures. Combined, these elements increase the

confidence of investors and thus the attractiveness of a money centre as destination for global capital. By extension, unravelling the drivers behind the development of offshore RMB centres is critical if we are to explain competition between money centres in the future.

Given that offshore RMB finance is a relatively new phenomenon, empirical research on this topic remains scarce. Chapter 5 seeks to address this research gap, by presenting the first study of London's RQFII experience. Investigating the case of London is important, as the city was the first Western offshore RMB centre approved by the Chinese government. To examine its development, the chapter develops a politically sensitive reading of IFC development. It traces how the co-evolution of strategic interests among state elites and financial sector agents has shaped the integration of RMB finance into London's financial architecture. By highlighting that interdependencies between different state authorities and firms (micro-level) also apply to entire world cities with major IFCs (macro-level), Chapter 5 thus presents a natural extension of Chapter 4.

Conceptually, the chapter is grounded in political perspectives on global finance that highlight the role of governments in international 'money games' (Agnew 2009, 2012). It also draws on 'mimetic isomorphism' approaches within organisational sociology (DiMaggio and Powell 1983) and their applications to global finance (Djelic and Quack 2007; Bassens et al, 2013). These works highlight how firms adapt 'universal' economic practices to new institutional contexts, by copying the organisational best practice of a recognised local lead firm. Chapter 5 makes a significant conceptual intervention, as it extends the premises of 'mimetic isomorphism' to the analysis of offshore RMB hubs. As London is the first foreign RMB hub established outside China⁵, it forms new testing ground for how RMB finance adapts to Western institutional contexts. As such, there is no 'best practice' to follow and the idea of mimicking an established leader does not apply. It is under these conditions of uncertainty that the analysis presented in Chapter 5 advances explanations of institutional adaptation.

⁵ Hong Kong was the first offshore RMB centre established outside Mainland China. However, as a formal part of Chinese territory, the Mainland Chinese government directly shapes its institutional landscape. Given this special political status, Hong Kong does therefore not provide a template of 'organisational mimicry' for RMB centres located in Western contexts.

The chapter draws on an original dataset of 121 multi-stakeholder interviews conducted between 2013 and 2015 in London and China's main financial and political centres (Shanghai, Beijing, Hong Kong and Shenzhen). The longitudinal analysis reveals that the inclusion of RMB finance into London's IFC structures is characterised by a process of 'selective adaptation'. The findings clarify that what makes this adaptation process 'selective' is the shift from strategic alignment to an increasing divergence of interests in state-private relations. This allows for specifying which features reflect mimicry of 'universal' practices and which are 'context-specific' in the development of new financial product markets. This way, the chapter advances recent applications of 'mimetic isomorphism' within the financial geography literature (Bassens et al, 2013).

The chapter also clarifies that the strategic alignment between state-finance interests is a prerequisite for money centres to leverage the inclusion of RMB finance as a competitive resource within 'world city networks' (Bassens et al, 2010). As a result, the chapter points to significant policy lessons for the development of future RMB business in London and other cities with offshore RMB centres.

Chapter 5 is co-authored with Professor Sarah Hall from Nottingham University and was published in the February 2017 issue of *Regional Studies*.

Chapter 6 shifts attention from formal institutional governance to how informal social institutions shape investor behaviour in Chinese cross-border finance. Focusing on Chinese equity markets, the chapter investigates the role that cultural similarities play in shaping shareholder engagement. The chapter examines 'culture' through the lens of common ethnic Chinese origins. Scholars of ethnic networks have highlighted that shared ethnic ties provides individuals with a collective understanding of cultural norms, values and customs (Huang, 2009). Such a common group identity provides an important foundation for mutual trust and cooperation in Chinese economic transactions (Luo et al, 2012). Echoing these premises, Chinese area studies have shown that ethnic ties equip firms with competitive advantages that facilitate access to important market resources such as cheap credit (Mitchell, 2003; Nan and Meng, 2009; Jean et al, 2011). Whilst these works provide useful insights into the role of

informal institutions, they have focused on foreign direct investment (FDI) and trade flows but neglected the financial sector.

Chapter 6 seeks to extend the empirical scope of the literature, by examining the currently unexplored links between common cultural identity and shareholder behaviour in Chinese equity markets. To this end, it combines the above insights on ethnic networks with cultural perspectives in the behavioural finance literature and corporate governance research. The chapter examines the claim that shared cultural background with target markets provides foreign investors with access to similar information as local investors (Choi et al, 2017). In turn, this translates into similar shareholder behaviour among culturally close investors (Berecha et al, 2014). What unites these works with the ethnic networks literature is that they link a common cultural identity to local information advantage. Chapter 6 exploits their conceptual synergies, by investigating whether common ethnic origins translate into similar behaviour among national Chinese investors and foreign ethnic Chinese investors. The chapter thus bridges the analysis of formal state institutions in shaping the competitive positions of firms (chapter 3-4) and money centres (chapter 5), by showing that informal institutions, too, shape competitive hierarchies in Chinese capital markets.

Focusing on pension funds and insurance companies, the empirical analysis presents the first comparative study of the practices that national Chinese and foreign ethnic Chinese investors use to engage with local target firms. Spanning three years of data collection, the study draws on interviews with investment managers and fund trustees. These are then triangulated with annual reports and participant observation⁶. The findings show that national Chinese investors favour momentum-driven 'alpha' engagement. This approach prioritises short-term premium returns over acting as long-term stewards toward investee firms. In contrast, proactive stewardship behaviour is concentrated among foreign ethnic Chinese investors. Detailed conceptualisations of the different types of shareholder engagement and

⁶ Participant observation is a data collection method, by which an investigator (participant observer) gains a close familiarity with a given group of individuals and their practices, by sharing in its activities. This thesis draws on this method as an additional research technique to gain a deeper understanding of the motivations and practices that drive Chinese investors. To this end, participant observation from shareholder committee meetings at 23 Chinese institutional investors is used to cross-verify the validity of interview findings (see Chapter 6).

classifications of what counts as 'ethnic Chinese' are spelled out later in the methods section. The findings show that the more proactive behaviour of foreign ethnic Chinese investors is not driven by the desire to promote 'good' corporate governance; it reflects the need to acquire more in-depth information about local target companies.

In sum, the chapter challenges cultural proximity claims in the ethnic networks literature. It highlights that a common cultural background with Mainland China may well lower information asymmetries for foreign investors but it does not equate to local information advantages. It is the lasting informational differences between national Chinese and foreign ethnic Chinese investors that matter for how they behave towards local target companies. The findings also challenge 'universal ownership' arguments in the corporate governance literature. These claims assert that institutional investors such as pension funds have long-term asset liabilities and thus adopt long-term shareholding horizons towards the companies they invest in. Chapter 6 therefore has important implications for Western and Chinese corporate governance policies. These policies seek to leverage the long-term horizons of institutional investors as a tool for promoting more accountable corporate governance. The findings presented in chapter 6 highlight the need to rethink such 'long-term' assumptions, as Chinese institutional investors do not adopt long-term shareholding horizons.

Chapter 6 has been co-authored with Professor Jiye Hu from China University of Political Science and Law. It has been submitted to *Corporate Governance: An International Review* and is currently undergoing peer review.

Chapter 7 spells out the conclusion of this thesis. It summarises the main findings of the research project, highlights their broader implications and identifies avenues for future research.

1.2 Methods and Research Design

1.2.1 Four-Paper Design

This thesis presents a collection of four discrete research papers. These are framed with an introduction and conclusion that highlight their overlaps and thus allow the thesis to emerge as an integrated body of research. The four-paper route is adopted for two reasons. First, the field of Chinese cross-border finance is so vast that no single investigation could hope to do full justice to mapping all agents, networks and locations that characterise it. A four-paper design offers the advantage of exploring a series of related but distinct empirical case studies, which are anchored by an overarching conceptual thread (chapter 3). This affords the necessary breadth required for mapping core issues in the still relatively novel research field of Chinese cross-border finance. The four-paper approach adopted in this thesis thus provides the ideal research design to build a conceptual and empirical foundation for future research. It is hoped that this will provide a roadmap for others to delve into future avenues of enquiry and acquire further depth on the topic at hand.

1.2.2 Methods

The methodological approach of this thesis is grounded in new economic geography research. This school of thought emphasises the social, cultural and political underpinnings of capital flows and markets. The main methodological goal is to trace networks, which requires a detailed understanding of agents' incentives, characteristics and social practices (Dicken et al, 2001). In-depth qualitative methods allow for investigating such micro-level factors and have thus been selected as the predominant form of inquiry. The trouble is that qualitative research may not be generalisable. Nor may it reflect the complete picture of reality due to potential bias from misinterpretations and faulty or incomplete memory. This has been a particular concern for chapters 4 and 5, which seek to uncover causal processes. For this reason, the method of data triangulation is used in the analysis throughout all four substantive chapters. This approach combines the merits of in-depth qualitative data with the systematic verification afforded by quantitative data. The remainder of this section

spells out the specific methods and data sources used in each substantive chapter.

Chapter 3: Literature Review and Official Document Analysis

The theoretical approach of state-led GFN developed in chapter 3 is based on an extensive review of secondary literature. This includes the literature on GFN in economic geography, theories of Chinese elite politics and the institutional change literature in political economy. The chapter exploits the theoretical synergies between these different bodies of literature and integrates them with recent empirical findings on Chinese cross-border finance. This review of conceptual and empirical literature was then coupled with the analysis of primary sources that the author was able to access as part of Visiting Fellowships at Tsinghua University, Beijing Normal University and Peking University's HSBC Business School (2013-2015). The primary sources include internal government records from key financial decision-makers such as Zhou Xiaochuan (周小川), Dai Xianglong (戴相龙) and the 'Leader's Policymaking Information' (领导决策信息) (Appendix A). This combination of Western and Chinese sources allowed for identifying conceptual synergies and provided a reliable basis for developing an empirically grounded theoretical framework that reflects the local Chinese context.

In sum, the methodological approach adopted in chapter 3 reflects the fundamental method in economic geography of building theories based upon empirical observation rather than the vice versa (Clark 1998). Developing such an 'on-the-ground' perspective is essential for understanding through direct experience the context, interests of and linkages that characterise China's global financial networks.

Chapters 4 and 5: Interviews, Database Analysis and Process-Tracing

Chapters 4 and 5 are empirical in nature and employ a two-step methodological approach. The first step focuses on collecting qualitative data and the second step on gathering quantitative data. In step one, chapter 4 draws on data from 91 multi-stakeholder interviews (Appendix A). Conducted in China, the aim of these was to trace the bargaining dynamics underpinning the changes of China's QFII/RQFII

schemes. In collaboration with co-author Professor Sarah Hall, an additional 46 London-based interviews were carried out for chapter 4, which examines London's rise as the first Western offshore RMB centre. Interviews were held in English or Mandarin depending on the interviewee. The combined dataset counts 121 original multi-stakeholder interviews conducted between 2013 and 2015. This substantial data set allowed for adopting a longitudinal approach to tracing the co-evolution of state and private sector interests across space.

As China's cross-border capital flows are controlled by the state, interviews focused predominantly on officials from the three bodies responsible for administering the QFII/RQFII programmes: the China Securities Regulatory Commission, the State Administration of Foreign Exchange and the Chinese central bank. Based on snowball sampling, the selection of interviewees from these bodies was linked to their professional capacities within relevant departments including the Intermediary and Investment Fund Supervision (证券基金机构监管部), the Capital Account Administration Department (资本项目外汇管理) and the Monetary Policy Department II (货币政策二司).

The formal research affiliations with Tsinghua University, Beijing Normal University, the China University of Law and Political Science and Peking University's HSBC Business School made it possible to tap into a variety of otherwise inaccessible local networks. They provided a useful foundation for snowball sampling the most knowledgeable interviewees and map the strategic interests between different financial authorities. Given the senior positions held by interviewees, the empirical work presented in chapters 3 and 4 relies on the 'close dialogue' techniques developed by Clark (1998). Accordingly, note-taking replaced the use of an audio-recorder to minimise potential 'interviewer effects' (Yin, 2009). Reference was only made to institutional affiliations rather than specific names. This was essential to respect interviewee confidentiality and comply with the ethical guidelines set out by the Research Ethics Framework of UK's Economic and Social Research Council (ESRC, 2011). All interviewees were also covered by a confidentiality agreement with Oxford University and Nottingham University. Whenever it was not possible to arrange personal conversations, interviews were conducted over the phone.

Potential bias may nonetheless be introduced, as some regulators can strategically downplay the knowledge exchange with foreign agents or hide political interference. A number of additional research strategies were used to address these concerns. The first strategy aimed to maximise reliability, by using a field journal to record observations outside the framework of formal interviews such as regulatory changes. The second strategy relied on a pre-set interview protocol to facilitate the systematic comparison of responses and thus ensure that the research process be replicated.

Third, the validity of responses from QFII/RQFII authorities was cross-checked against local news sources such as *China Daily* and *South China Morning Post* and interviews with key stakeholder groups (Appendix A). On the policy side, these included senior officials from the Hong Kong Securities and Futures Commission as well as the stock exchange committees in Shanghai, Shenzhen and Hong Kong. Interviews also covered the China Association of Public Companies, which is directly linked to the China Securities Regulatory Commission, and government think-tanks such as China's Institute for World Economics and Politics. On the financial sector side, interviewees included senior investment executives from QFII/RQFII-licensed financial institutions such as banks and securities companies as well as Chinese state-owned banks. Relevant financial intermediaries such as Chinese securities law firms and accountancies advising on QFII/RQFII regulation were also included. Scrutinising the interests and practices of diverse financial sector agents was particularly important for chapter 5 to gauge the extent to which RMB finance has been successfully integrated into London's IFC architecture.

In the second step, multi-stakeholder interviews were triangulated with quantitative data obtained from WIND Financial Terminal (资讯), which provides a unified database on inbound QFII capital flows and offshore RQFII capital flows. Exclusive access was obtained to the database for the purpose of this project. This allowed for accessing the full directory of QFII / RQFII approvals including the type of investor and location of RQFII hubs, the timing of license approvals and the size of investment quota allocated to firms and IFCs. Overall, the data sources covered a period of three years (2013-2015). This made it possible to plot QFII/RQFII trends over time and match the longitudinal approach of the interview research in the first step.

The key challenge facing chapters 4 and 5 was to map state-firm relationships over time. Process-tracing provided a suitable method to address this task. This method allowed for matching the multi-stakeholder interviews on Chinese policy interests (step one) with the characteristics of foreign investors (step 2). Beach and Pedersen (2013) distinguish between three distinct variants of process-tracing: theory-testing, theory-building, and explaining idiosyncratic outcomes. Chapters 4 and 5 draw on the theory-testing variant, by tracing whether the resource interdependencies between state elites, firms and IFCs functioned as conceptualised in the respective theory sections. This made it possible to disentangle foreign and domestic corporate interests, map policy interests across different levels of government and link the interplay of these interests to changes in the QFII/RQFII programmes. Such in-depth inquiry of agent motivations provided a reality check of counterfactual scenarios and ensured the responsiveness to omitted variables and alternative explanations throughout the data analysis.

Chapter 6: Interviews and participant observation

Focusing on Chinese equity markets, chapter 6 presents the first empirical study of how cultural similarities shape the behaviour of large institutional investors towards local investee firms. The analysis presented in chapter 6 focuses on comparing national and foreign pension funds and insurance companies. Chinese financial authorities seek to leverage the long-term horizons of these investor types to promote financial stability and more accountable corporate governance (CSRC, 2002). Understanding their shareholder behaviour is thus particularly salient from the perspective of Chinese capital market development.

The main methodological challenge facing this study is to measure the concept of 'culture', which is notoriously difficult given its multi-dimensional nature. For this reason, the chapter investigates cultural similarities through the lens of common ethnic origins. The literature on ethnic networks has highlighted that shared ethnicity enables the identification with a collective group identity based on common cultural values, customs and language (Luo et al, 2012). In turn, this facilitates mutual trust in

economic transactions and familiarity with culturally close target markets (Mitchell, 2003; Yeung, 2014). Common ethnic origins therefore provide a useful proxy to systematically capture key dimensions of common cultural background.

To determine whether a foreign investor counts as 'ethnic Chinese', we used the investor's country of origin as a reference point. To classify as 'common ethnic origins' at least 50% of a country's total population had to be ethnic Chinese. In addition, we also measured whether Chinese is spoken in an investor's home market based on data collected from CIA World Factbook. The specific data sources to implement these coding procedures are spelled out further in chapter 6. Overall, this filtering process yielded four places: Hong Kong, Singapore, Taiwan and Macao. These territories all share a common ethnic background with Mainland China but are classified as 'foreign investors' by the Chinese government (CSRC, 2015).

Investigating how common cultural background shapes investor behaviour requires a thorough understanding of fund managers' motivations and practices towards investee firms. For this reason, chapter 6 adopts an in-depth exploratory approach based on semi-structured telephone interviews with investment managers and fund trustees. These interview responses were then triangulated with corporate annual reports and participant observation of shareholder committee meetings.

This approach offers several advantages. For one, semi-structured interviews allowed respondents to comment on issues not captured in the question catalogue. This avoided 'over-structuring' the conversation and thus inhibiting responses on important additional information. For example, it was possible to tease out that bonus payment cycles shape incentives behind shareholder engagement incentives, which had not previously been included in the question catalogue. This technique also allowed for excluding irrelevant questions and translating technical or context-specific terminology into simpler wording to avoid confusion. Given that this research covered five different geographies (Mainland China, Hong Kong, Singapore, Taiwan, Macao), reliance on telephone interviews also provided a cost and time-efficient alternative to personal interviews. Telephone interviews were also more adaptable than online surveys, as they benefit from a live person administering the questionnaire. This left more room for flexibility in the order of asking questions across cultural settings, thus maximising the validity of responses.

However, like all methods, telephone interviews are subject to bias. Minimising non-response and interviewer bias was intimately tied to understanding the specific cultural setting within which this study was conducted. In Chinese social interactions, trust matters tremendously as a prerequisite for cooperation (Huang, 2009). Respondents were therefore informed in advance about the upcoming interview through co-author Professor Jiye Hu who is a respected voice in China on pension fund governance and insurance companies. Fund managers were given the choice of whether to hold the interview in English or Mandarin. This intercultural research collaboration was a double-edged sword: On the one hand, it allowed for minimising interviewer bias, by putting respondents at ease and thus facilitating a freer exchange of information. On the other hand, it made it more difficult to ensure the comparability of responses. The study thus relied on a pre-set interview protocol with additional comment boxes. Doing so allowed for putting in place a control mechanism, which ensured that responses were recorded consistently across cultural settings.

To determine the sampling population of domestic Chinese pension funds and insurance companies, records were obtained from various Chinese government authorities (CIRC, 2016; NCSF, 2016; MOHRSS, 2016). The sampling population of foreign pension funds and insurance companies was based on the full directories of QFII approvals (CSRC, 2015). These data sources and classifications generated a sampling frame of 11 pension funds and 76 insurance companies (n=87). This relatively small number of firms reflects the concentrated nature of tradable Chinese insurance and pension assets among large players (CIRC, 2016).

Based on this sampling frame, 34 interviews were conducted using snowball sampling (Appendix B). Investment directors and fund trustees from national Chinese pension funds and insurance companies added up to 21 of the interviews. Foreign counterparts accounted for 13 interviews. Although the concentration of Chinese pension and insurance assets means that the sample size is by default limited, the study nonetheless captures the majority of relevant investors. The insurance companies covered equate to 62% of China's total tradable insurance assets, whilst

pension funds account for 73% of total tradable pension assets⁷. The insights gleaned from the interviews thus offer a foundation for drawing representative conclusions about shareholder practices in China's insurance and pension market.

Finally, interview data was cross-checked against annual reports, shareholder meeting announcements and participant observations from committee meetings at 16 insurance companies and 7 pension funds (Appendix B). The cross-verification with these in-depth data sources allowed for gaining additional insight into the incentives behind and practices of fund managers' interaction with investee companies.

The interview responses, company reports and notes from participant observations were analysed using a two-step approach. In the first step, investor practices were classified into active/passive categories based on the shareholder engagement literature. These categories are conceptualised in detail at the outset of chapter 6. In the second step, shareholder practices were then grouped according to national Chinese investors and foreign ethnic Chinese investors. Similarities in organisational governance features were also taken into account. The purpose behind this additional layer of data sorting was to add a robustness check, by verifying whether the observed patterns of shareholder engagement also hold if we take incentives from varying business models into account.

Descriptive statistics were used to analyse the findings. This method provides a powerful tool for comparing findings, by juxtaposing the relative frequencies of shareholder practices. Whilst these comparisons allow for cross-validation, they cannot be extended to a larger group of institutional investors⁸. However, this is not a cause for concern, as the aim of chapter 6 is not to make generalisations on China's

⁷ Calculations based on total corporate pension fund and insurance assets obtained from China's Insurance Regulatory Commission, National Council for Social Security Fund and the Ministry of Human Resources and Social Security.

⁸ Whilst this study yields insights into cultural similarities, it is not possible to extend the inferences to the foreign ethnic Chinese country contexts covered in this study (Hong Kong, Taiwan, Macao and Singapore). This is because there was only one country (Mainland China) with a readily available sampling frame. The Chinese government controls cross-border capital flows through its QFII schemes and thus lists all pension funds and insurance companies in official directories. However, such quota schemes do not exist in the examined foreign ethnic Chinese country contexts. As a result, comparable sampling frames were not readily available. Extending the inferences to these contexts would require the manual construction of sampling frames, which was beyond the resources and scope of this study.

capital markets as a whole or extend inferences to foreign ethnic Chinese country contexts. Rather, its objective is to make *contingent* generalisations on the Chinese pension and insurance market.

Summary: Benefits of a mixed-method approach

Whilst the specific methodology varies between chapters, what unites them is their grounding in the systematic triangulation of different data sources. Overall, this thesis brings together the merits of in-depth qualitative inquiry and quantitative cross-verification. The interplay between formal and informal institutional governance cannot be meaningfully understood through statistical analysis alone, as research on Chinese cross-border finance remains limited. The emphasis on in-depth qualitative inquiry therefore provides the necessary toolkit to begin investigating a number of core questions.

There are two main research areas that stand to benefit in particular from the mixed-method approach adopted in this thesis. For one, access to the full directories of QFII/RQFII investors makes it possible to address the notoriously difficult task of drawing samples in global network analyses, since there is often no ‘universe’ from which to draw. Second, the methodological emphasis on exploring incentives and behavioural practices allows for uncovering both interconnections and disparities between agents from different geographical settings. In sum, this approach makes it possible able to capture *degrees* of institutional change (chapters 4-5) and *degrees* of shareholder engagement (chapter 6). The mixed-method approach adopted in this thesis thus enables us to move beyond binary coding of economic outcomes that suggests a ‘zero-sum game’ of either convergence or divergence with Western financial models (Fung, 2009).

CHAPTER 2

Literature Review

This chapter provides an overview of the key themes that underpin the discussion and findings presented throughout this thesis. More specific literature reviews can be found in each of the substantive papers (chapters 3-6). The purpose of this chapter is not to rehash these insights. Its objective is to zoom out from the specifics of each substantive paper and highlight some of the broader themes that bind them. Drawing on different theoretical literatures, the following four themes warrant further analysis:

- 1)** Capitalism ‘with Chinese characteristics’ in the Variegated Capitalism literature (Zhang and Peck, 2016)
- 2)** The state’s provision of ‘collective competition goods’ in the business systems approach (Whitley, 2007)
- 3)** Ethnic networks in Chinese area studies (Luo et al, 2012)
- 4)** Relational proximity in economic geography research (Wolfe and Gertler, 2004)

These themes have been selected for two reasons. For one, each of them relates to either formal or informal institutional governance. The appraisal of variegated capitalism research and the business systems literature on collective competition goods frames the discussion on formal institutions. Similarly, reviewing the literatures on ethnic networks and relational proximity allows for anchoring the discussion on informal institutions. The second reason for selecting these themes is that they cover both structural features of institutional governance (e.g. state capitalism) and agency-driven aspects that focus on resources (e.g. relational proximity). The purpose of the literature review that follows is therefore not simply to frame the substantive chapters; it also fulfils a representative function of the interplay between ‘structure’ and ‘agency’ in global financial networks.

Chapter 2 unfolds as follows. Section 2.1 discusses relevant theoretical literatures on formal institutional governance. It begins with a bird’s-eye view of structural aspects, by reviewing works on Chinese state capitalism in the variegated capitalisms literature. The section then narrows to an agency focus, by reviewing business system approaches that highlight the state’s provision of ‘collective competition goods’. Section 2.2 examines theoretical concepts that relate to informal institutional governance. This part starts with structural dimensions, by reviewing

previous research on the role of ethnic networks in shaping financial outcomes. It then zooms in on the agency level, by assessing the economic geography literature that links relational proximity and economic outcomes. Finally, section 2.3 summarises the main insights from the literature review and spells out their salience for the substantive chapters that follow.

2.1 Governance through formal institutions

Capitalism with 'Chinese characteristics'

Although the precise theoretical discussions vary in each chapter, they all draw conceptual inspiration from politically sensitive readings in economic geography. This includes work that highlights the role of the Chinese government in shaping transnational 'money games' (Agnew, 2010, 2012). It also covers work on the global expansion of Chinese 'national champion' firms (Wójcik and Camilleri, 2015) and the politically driven creation of new offshore financial space for trading Chinese currency (Töpfer and Hall, 2017; Töpfer, 2017). All of these works are informed by the underlying premise that the global spread of liberal market forces has led to *variegated* forms of capitalism rather than 'ideal-types' (Zhang and Theodore, 2007; Weller and O'Neill, 2014). The research presented in this thesis echoes this notion. To contextualise the idea of *variegated* capitalism, this section reviews works on capitalism 'with Chinese characteristics' (Peck and Zhang, 2013, 2016) and examines how they fit into the broader institutional literature.

The institutional literature has mainly focused on explaining how varying socio-economic structures affect the behaviour of firms (Swenson 2001; Hall and Gingerich, 2009). The prevailing framework that has emerged from this literature is the Varieties of Capitalism (VOC) approach (Hall and Soskice, 2001). This approach describes a firm-centric political economy in which two 'ideal-types' structure economic organisation. One is the liberal market economy, modelled on the United States, and the other is the coordinated market economy, based on the German model. Although the VOC approach has exerted significant influence on the study of economic organisation, it has been criticised for overemphasising path dependency and neglecting regional

variety (Peck and Zhang, 2013). In response, others have highlighted differences between sectors and local contexts (Crouch et al, 2001; 2009), bargaining dynamics behind institutional change (Thelen, 2012) and common institutional features that link seemingly disparate modes of capitalism (Streeck, 2011).

The purpose of this section is not to delve into a discussion on each of the above conceptual advances. Detailed reviews can be found elsewhere (Deeg and Jackson, 2007; Streeck, 2011). The focus is instead directed toward two specific strands of literature. The first research strand highlights various regional sub-models outside the typical VOC focus on Western economies (Peck and Zhang, 2013, 2016). The second strand highlights the role of bargaining dynamics in bringing about institutional change (Thelen, 2012 Scott; 2014). These two bodies of literature provide a suitable foundation for analysing the dynamics of Chinese capital market development across different scales. Each is discussed in turn.

In contrast to the VOC focus on the national level, the variegated capitalism literature emphasises that firms are embedded within many different institutional scales. For example, Crouch et al (2009) emphasises communities at the local scale, sector-specific scales as well as national global scales. The authors highlight that the interconnections between a whole range of spatial scales shapes the strategies that firms adopt and the economic outcomes they generate. This perspective provides a useful conceptual starting point for this thesis. It enables us to think about Chinese cross-border finance as a multi-layered phenomenon that is characterised by the interplay of global, national and local structures.

The trouble with the work by Crouch et al is (2009) is that their focus on firms leads the authors to define 'institutional layers' in economic terms. Yet, a purely economic conception would struggle to explain outcomes in China's financial sector, since the central government controls key resources such as market access. In addition, China's provincial and municipal administrations have direct input into all major policy decisions at the central government level. They hold the biggest voting bloc of all members in the Central Committee, the governing body that runs China's top ruling body, that is, the Chinese Communist Party (Brown, 2016). What is needed is thus an approach that maps how the interaction between firms and different levels of government shapes economic outcomes.

Recent advances have highlighted that Chinese capitalism is anchored by a centralised developmental state and complemented by regional sub-systems (Conlé, 2011). These connections between the Chinese party-state and business systems have inspired a growing body of research on the rise of capitalism ‘with Chinese characteristics’ (Zhang and Peck, 2013, 2016). Rather than forcing China into existing analytical boxes of European and North American capitalism, this research adopts a sub-national perspective. For example, Zhang and Peck (2016) identify five regional ‘sub-models’ of Chinese capitalism: the Guangdong, Sunan, Wenzhou, Zhongguancun and Chongqing models. The authors argue that these sub-models are distinct from one another and largely representative of the different styles of capitalist development adopted across Chinese provinces. They are also intertwined with China’s industrial economy, which consists of several tiers (Ernst and Naughton, 2008): the first tier refers to large-scale SOEs; the second tier includes medium-sized firms such as smaller state-owned enterprises, domestic Chinese start-ups and foreign companies; the third tier describes the small-scale tier and covers privatized township, village enterprises and small family-run businesses. In sum, these works provide a much more nuanced view of the interconnections between different business systems and regional governments.

Another important aspect is the reliance on privileged personal relationships (*guanxi*) that shape China’s regional sub-models to varying degrees. Such *guanxi* shape both commercial and governmental transactions, on a scale largely absent in traditional VOC models (Redding and Witt, 2007). Their reasons behind the sustained influence of *guanxi* networks in the Chinese economy will be spelled out in the next section on informal institutional governance. The key point to note is that the Chinese model does not fit easily into any single analytical box under the VOC approach; it reflects an institutional mosaic of regional adaptations that combine elements of ‘liberal market’ models, ‘coordinated market’ models and informal social institutions.

Despite this differentiated appreciation of China’s economic organisation, the variegated capitalism approach does not go far enough in mapping the different segments of the Chinese economy. In empirical terms, China’s financial markets have received little attention to date. This partly reflects the prevailing conception of Chinese ‘business systems’ in the literature, which is largely synonymous with the

industrial economy. As a result, reference to the financial sector is only made in the context of varying sources of corporate financing between regions. For example, Zhang and Peck (2016) highlight that regions with a historical dominance of SOEs such as Chongqing tend to rely heavily on credit supply from state-owned banks. By contrast, in places such as Guangdong, which is home to the Shenzhen stock market and located in close proximity to Hong Kong, the role of equity financing is much more common. The financial sector is therefore understood as one of several aspects that shapes regionally differentiated industrial organisation rather than as a sphere of economic organisation that requires explanation in its own right.

Few notable exceptions have extended the variegated capitalism approach to examine the financial geographies of firms (Dixon, 2011; Clark and Wójcik, 2007). Yet, they focus on companies located in Western liberal market economies, which operate largely free from state intervention. As such, their insights are not easily applied to the Chinese context. Recent advances have extended the analysis to explain how the interrelationship between foreign firms, financial intermediaries and offshore jurisdictions helped domestic Chinese ‘national champions’ to become players in global finance (Wójcik and Camilleri, 2015). Despite their important insights, the focus remains on economic relations across locations. The specific channels through which political bargaining *inside* the Chinese party-state shape global financial outcomes remain little understood. Whilst the state’s role in the literature is acknowledged, it is mainly viewed as the agent that represents ‘sub-national models’, ‘regions’ and ‘jurisdictions’ (Zhang and Peck, 2013; 2016; Wójcik and Camilleri, 2015 Conlé, 2011). As a result, the theorisation of the *political* underpinnings of China’s global financial networks (GFN), and how they feed into business systems, remains in its infancy.

Theories of institutional change provide useful insights that allow for connecting economic layers of China’s GFN with various political layers (see Thelen, 2012; Hall and Thelen, 2009). Their emphasis on bargaining dynamics makes it possible to unravel how changes in China’s RQFII/QFII programmes reflect the relations between Chinese political elites, foreign investors and domestic corporate interests. Understanding how these different agents interact is vital if we are to explain why Chinese cross-border programmes yield asymmetrical outcomes for different types of firms. The next section reviews the institutional change literature in greater detail. It

shifts the attention from structures of economic organisation to the resource interdependencies between agents that inhibit these structures.

State-firm relations and 'collective competition goods'

The institutional change literature specifies two main channels through which agents can affect change. One emphasises 'critical junctures' such as financial crises, conflicts or international agreements (Cortell and Peterson, 1999). According to this view, such events disrupt institutional stability and replace established arrangements with a new set of institutions. Yet, this only provides a partial explanation since individuals decide when and how to respond to 'critical junctures'.

A more recent approach to institutional change has highlighted the role that bargaining between political, social and corporate elites plays in bringing about institutional change (Thelen, 2012; Scott, 2014; Hall and Thelen, 2009). This thesis draws on this agency-driven school of thought as the conceptual foundation for investigating institutional change, as it reflects the empirical reality in China. Formal institutional governance in the country combines both proactive and reactive policy experimentation, which facilitates constant *ad hoc* adjustment to endogenous and exogenous challenges (Heilmann, and Perry, 2011). Such policy experimentation involves the decentralised accumulation of knowledge across and bargaining between different government bodies and market agents (Bell and Feng, 2013). Drawing on these insights, this thesis adopts an agency-driven perspective that views institutional change as the outcome of agents' choices and actions in response to external circumstances.

If we accept the above premise, the question then arises what shapes the choices of and relations between agents. Answering this question requires mapping the interplay between different strategic interests. The 'business systems' approach (Whitley, 1999; 2007) provides a useful theoretical starting point, by arguing that economic organisation reflects the interaction between state elites and different types of firms. In this interaction, the state provides 'collective competition goods' such as a country's public science system or local labour market institutions (Whitley, 2007). Such 'goods' tie domestic firms to the respective institutional context, by creating

distinctive organisational capabilities (Crouch et al, 2001, 2009). This logic clarifies that economic organisation is not the result of 'private' markets; it reflects major interdependencies between the state and firms.

The trouble with this approach is that it focuses on 'collective competition goods' of *domestic* firms. To address such methodological nationalism, others have emphasised that multinational corporations and international organisations also shape 'collective competition goods', by means of cross-border knowledge transfers (Dolowitz and Marsh, 2000; Stone, 2004). This provides a more nuanced perspective, by considering how global agents and processes feed into domestic economic organisation. It clarifies that the state may control 'collective competition goods' such as market access but it equally depends on the resources generated by domestic and foreign capital accumulation. Consequently, these works add a global layer to the early work of Polanyi (1957) and Block (1987), which highlighted that neither capital nor the state is capable of achieving its goals independently.

The key feature that unites internationally sensitive works with early business systems approaches is the recognition that *interdependency* between state agents and firms is central for understanding economic outcomes. This notion has regained particular prominence in the wake of the 2008 global financial crisis. Recent works highlight that the global spread of neoliberal economic ideas such as deregulation has led to a diversification rather than to a withdrawal of the state in financial markets (Kirshner, 2014; O'Neill and Weller, 2016). The state not only acts as a regulator of market behaviour; it designs and re-designs entirely new markets and economic systems (Weller and O'Neill, 2014; Painter, 2003).

The notion of firm-state interdependencies provides a useful conceptual foundation for this thesis. It echoes the 'hybrid' nature of economic development in China, which embraces experimentation with neoliberal market forces under the hierarchy of China's party-state (Yeung, 2014; Heilmann and Perry, 2011). The thesis applies this logic to the analysis of Chinese cross-border finance. It examines how the experimentation with liberalising measures such as the QFII/RQFII schemes generates increasing resource interdependencies between the Chinese party-state and the supply of capital by foreign and domestic firms. This allows for shedding light on how strategic bargaining occurs not only between multiple economic layers of China's GFN

but also between multiple political layers. The thesis thus seeks to extend the literature on business systems, institutional change and variegated capitalism, by examining how internal differences within seemingly homogenous actors such as ‘the state’ shape outcomes in Chinese cross-border finance.

Unravelling the multi-layered and often conflicting nature of strategic state interests is crucial to understand how China’s financial liberalisation shapes competitive hierarchies. China’s QFII programmes illustrate this well. To reduce transaction costs and ‘agency shirking’⁹, China’s State Council¹⁰ has delegated specialist competencies such as cross-border financial regulation to various administrative bodies. These include the Chinese Securities Regulatory Commission (CSRC), the State Administration for Foreign Exchange (SAFE) and the People’s Bank of China (PBOC), China’s central bank. Since their inception in the early 1990s, these bodies have carved out their own realm of power and frequently compete for political influence over the nature and scope of financial reform (Heberer and Schubert, 2010). The internal turf wars emanating from such competition are reflected in the piecemeal approach to Chinese financial reform and the asymmetrical nature of QFII market access (Töpfer, 2017). Disentangling political bargaining dynamics inside the Chinese party-state is thus crucial to fully understand the nature of competitive hierarchies in Chinese cross-border finance.

Based on the above rationale, this thesis complements the three bodies of literature reviewed in this section - variegated capitalism, business systems and institutional change - with theories of Chinese elite politics (see Shih, 2008; Bell and Feng, 2013). This will serve to highlight the fragmented nature of the Chinese party-state and thus shed light on how multi-level political bargaining links to the strategic interests of domestic and foreign firms.

⁹ ‘Agency shirking’ refers to the pursuit of policies by public agents that promote their own interests rather than the interests of those they represent.

¹⁰ The State Council of the Chinese Communist oversees policy implementation from the national to the local level.

2.2 Governance through informal institutions

Ethnic Networks

The above discussion clarifies that formal state institutions play a key role in shaping the behaviour of and competitive hierarchies between firms. However, at any given time, firms are subject to many different driving forces that shape their behaviour. This includes informal institutions such as common cultural values and personal relationships. These provide a foundation for mutual trust and collaboration in Chinese financial transactions (Mitchell, 2003; Robertson, 2015). Cross-cultural perspectives in behavioural finance have linked a common cultural background between investors' home and target markets to better investment performance (Choi et al, 2017), successful cross-border mergers (Ahern et al, 2015) and higher trading volumes (Berecha et al, 2014). Cultural values also affect behaviour at the cognitive level, by shaping the interpretations of investors' 'fiduciary duty' and 'ownership ethos' towards investee companies (Hernandez, 2012; Tilba and McNulty, 2013). These works clarify that explaining behaviour and outcomes in financial markets is not simply a matter of formal institutional governance; informal social dimensions such as a common cultural identity play an equally important role.

Where it gets complicated is when trying to determine how to measure 'culture'. To compare whether investors are 'culturally close', the above works rely on national averages of what a 'typical' person values in their respective country of origin. The trouble with this approach is that shared value systems not only exist *between* countries; they also exist among entire country *clusters*. The Greater China region, which includes Mainland China, Hong Kong, Macao and Taiwan, is a case in point. What unites these places is that they all have ethnic Chinese majorities. Through their co-ethnicity, they share a common heritage, language and social values. As such, they form ethnic networks. What makes a network 'ethnic' is that the group identifies with a common heritage and sense of belonging. By definition, ethnic networks are thus not tied to a specific geographical context; they have become internationally widespread through global migration flows (Mitchell, 2003).

Cross-cultural perspectives in the economic geography literature echo this conception. They highlight that groups base their sense of collective identity and cohesion on one or more of the aforementioned shared traits (Mullings, 2012). Ethnic networks are seen as an important channel that facilitates the spatial extension of the group's identity (Murphy, 2006; Amin and Thrift, 2004). Several studies show that ethnic ties have played a key role in facilitating cross-border foreign investment into Mainland China from firms located in Hong Kong, Taiwan and Singapore (Hsing, 1998; Yeung 2004; Yeung, 2014). Recent work on global value chains has formalised these findings, by conceptualising 'relational value chains' (Ponte and Sturgeon, 2014). This notion emphasises the role of personal relations and ethnic ties in managing trust between global buyers and sellers. In sum, cultural perspectives in the economic geography literature provide useful insights for the analysis of Chinese cross-border finance. They clarify that explaining global economic outcomes requires broadening the focus on economic relations and map how they interact with cultural relations.

Chinese area studies provide further insights into the interconnections between economic relations and ethnic networks. A key insight in this respect is that ethnic networks facilitate 'family-type' relationships known as *guanxi* (关系). Such privileged personal relations form an important basis of trust between entrepreneurs and colleagues in the workplace (McNally, 2011). This is because Chinese society is a highly collectivist culture⁷, where people define their self-image in terms of 'in-groups' that support each other in exchange for loyalty (Huang, 2009). At the same time, personal relations of trust continue to matter in economic transactions because they complement weak support from formal legal institutions in China (Chen et al, 2013). For this reason, personal relationships in cross-border business transaction are cooperative with trusted 'in-groups' but can be distant or even hostile toward 'out-groups' (Luo et al, 2012).

Empirically, the literature on ethnic Chinese networks has focused mainly on trade linkages (Feenstra, 2015; Rauch and Trindade, 2002), innovation capacities (Wei, 2015) and foreign investment, notably in China's automotive industry (Chin, 2010; Oh, 2013) and high-tech sectors (Sabel and Saxenian, 2008). This has been accompanied by studies on the regional variety of ethnic Chinese business communities. Notable works include studies on China's coastal provinces (Zhu and He, 2013; Jean et al, 2011) and

'ethnic enclaves' in the US (Breschi et al, 2017; Chand and Ghorbani 2011; Saxenian, 2002). However, the role that ethnic Chinese networks play in *indirect* capital investments¹¹ such as in the financial sector has been less frequently explored. Notable exceptions highlight the role of ethnic networks in providing informal access to credit (Mitchell, 2003) and mobilising resources through Chinese 'ethno-banks' (Li et al, 2001). Whilst these studies provide valuable insights into ethnic-finance linkages, they examine ethnic networks based on Chinese immigration to the US. Yet, as China has increasingly opened up its own financial markets, the interesting question becomes how ethnic ties shape financial transactions in *Mainland* China. However, this issue area is not well documented in the literature. This thesis seeks to address this research gap, by utilising the insights from the above cross-cultural research to examine the development of Chinese cross-border finance.

Relational proximity vs. Geographical proximity

An on-going debate among economic geographers has been how to think about the links between relational proximity and geographical proximity. This debate is also of fundamental importance to this thesis. Relational proximity plays a key part in conceptualising the relations between Chinese government and firms in the state-led GFN approach (chapter 3). The debate is also at the heart of investigating the role of state-firm relations in shaping the development of domestic Chinese capital markets (chapter 4) and London's offshore RMB hub at the global level (chapter 5). Similarly, it provides the theoretical backbone for investigating the links between ethnic Chinese networks and investor behaviour in Chinese equity markets (chapter 6).

Growing concerns over treating networks as containers of knowledge have given rise to claims that relational proximity rather than geographical proximity provides the 'soft' framework for learning and trust (Wolfe and Gertler, 2004). In her study of Taiwanese and Chinese high-tech firms in Silicon Valley, Saxenian (2002)

¹¹ Foreign indirect investments differ from foreign direct investments. Investments typically count as FDI if an investor controls at least 10 per cent of a firm's voting stock and owns the assets himself (OECD, 2008). In contrast, foreign indirect investments refer to foreign entities that pool investor money to buy or sell financial assets in another country.

showed that relational proximity based on ethnic ties played a vital role in internationalising high-technology industries. Saxenian found that in response to their exclusion from established business structures in Silicon Valley, immigrant professionals forged strong relations between them and others in their home countries. In turn, this provided an effective channel to mobilise capital and transfer specialist knowledge and skills (Saxenian 2008; Saxenian and Sabel, 2008). Others have extended these insights to include the role of high-skilled returnees with overseas experience (Tacconelli and Wrigley, 2009). In sum, these works argue that ethnic ties rather than geographical proximity provide the 'glue' for mutual trust and cooperation between agents.

Despite the important insights provided by Saxenian's work, there are a number of shortcomings that are worth pointing out. One relates to the assumption that ethnic identity automatically produces relations of solidarity. As Alcoff (1999) noted, feeling a sense of connection with visibly similar others does not inevitably translate into empathetic identification. Lasting tensions such as those brought about by civil conflict, as is the case between Mainland China and Taiwan, may diminish levels of trust and cooperation even if individuals share the same cultural background. Recent studies showed that such frictions informed the exclusion of Taipei's financial centre under China's RQFII programme, even though the city would have been an ideal choice given Taiwan's sizable RMB deposits (Töpfer and Hall, 2017). Consequently, this clarifies that ethnic networks are a conditional resource. We cannot, by default, treat them as channels of relational proximity without considering how the broader spatial context conditions the ties between agents.

Another related concern with Saxenian's claims is that they compartmentalise social and spatial relations into mutually exclusive phenomena. Yet, such relations can form mutually constitutive spheres (Mitchell, 2003). Understanding such overlaps is vital if we are to make sense of how ethnic ties in global economic networks are formed, maintained or cease to exist over time. Others have therefore further decomposed the interrelationship between relational proximity and geographical proximity. In their study on patent developments in high-tech production sectors, Agrawal et al (2008) found that the benefit of shared ethnicity is greater for firms that are located in close proximity to other high-tech firms, and vice versa. The

authors conclude that geographical and relational proximity are substitutes with respect to their influence on knowledge transfers and learning.

Similar to the work by Saxenian, the trouble with these inferences is that they are sector-specific to innovation clusters and knowledge-intensive production sectors. Whether they hold in other sectors such as financial services is less well understood. Some works have examined the idea that geography is becoming less and less important in finance due to global liberal market forces such as information and communications technology and deregulation (O'Brien and Keith, 2009; O'Brien, 1992). However, such 'end of geography' (O'Brien, 1992) claims reflect the characteristics of liberal market economies. They are thus unlikely to hold in one-party regimes such as China, where the state controls financial markets to promote political ends. This thesis thus seeks to advance the literature, by examining the links between relational proximity and geographical proximity in Chinese cross-border finance.

2.3 Summary

This chapter discussed some of the broader themes that bind the different chapters of this thesis in a common pursuit: to advance our understanding of the formal and informal institutions that shape the development of Chinese cross-border finance. To this end, the chapter critically reviewed different bodies of conceptual literature in political economy, economic geography and behavioural finance. This included research on variegated capitalism and business systems in the political economy literature. It also covered cultural perspectives in economic geography and behavioural finance on how ethnic networks and social-spatial relations shape economic outcomes. This section summarises the key insights from the literature review and spells out their salience for the substantive chapters that follow.

Understanding the institutional governance of the Chinese economy requires thinking more carefully about the interrelationship between formal state control and informal social networks. The above review of the variegated capitalism literature clarified that we can no longer dismiss the Chinese model as an 'odd case' that challenges traditional types of capitalist development in the VOC literature. Rather, the

Chinese case forms a ‘triangular relationship’ that integrates elements from liberal market and coordinated market economies as well as informal *guanxi* networks (Zhang and Peck, 2016). This is because the many economic and political layers of Chinese capitalism cannot be easily forced into existing analytical boxes from the VOC literature; they deserve their own conceptual recognition.

This emphasis on various layers provides the conceptual starting point for this thesis, by thinking about Chinese cross-border finance as a *multi-scalar* phenomenon. The chapters that follow examine regional and national scales of capital market development (chapters 3-4); the creation of entirely new offshore RMB hubs at the global scale (chapter 5); and the ‘intermediate scale’ between the local and the global, by examining how ethnic ties shape investor behaviour at the group level (chapter 6).

Nonetheless, the literature review also clarified that multi-scalar approaches to Chinese state capitalism do not go far enough, as they tend to focus on mapping different within-country regions (Conlé, 2011 Zhang and Peck, 2016). This leads them to prioritise the national-regional nexus at the expense of the global. As a result, they sideline the role of foreign firms and state elites in shaping domestic economic outcomes in China. Foreign firms are grouped into the ‘second tier’ of what is conceptualised as three-tier industrial economy (Ernst and Naughton, 2008). Yet, lumping together domestic and foreign firms into general ‘tiers’ masks how their frequently conflicting interests shape economic outcomes. Similarly, the role that foreign state elites play in shaping domestic economic outcomes does not feature in the analysis. The material that follows addresses these concerns. To explain competitive outcomes in China’s capital markets, it links domestic firm-state interests with the strategic interests and practices of foreign firms and state elites.

To this end, this thesis borrows from internationally sensitive readings of the business systems approach and theories of institutional change discussed earlier. Both literatures highlight major resource interdependencies between firms and state elites, and the bargaining dynamics that underpin these relations. The premise of interdependency guides the analysis of Chinese cross-border finance throughout this thesis. It serves to highlight that the development of QFII/RQFII programmes is best understood as the result of intertwined strategic interests between the Chinese and foreign policy elites, foreign investors and domestic corporate players.

Following the multi-scale approach proposed by the variegated capitalism literature, this thesis highlights two main insights: For one, unravelling bargaining dynamics across different levels of China's government is central for understanding competitive hierarchies in Chinese cross-border finance. Second, the chapters that follow extend the focus on *national* firms in Whitley's (2007) business systems approach and reconsider the direction in which state-led 'collective competition goods' are supplied. As chapters 3-5 will demonstrate, foreign firms provide a major source of financial expertise and globally visible brands, which the Chinese government seeks to attract. Whilst foreign firms may ultimately depend on government approval to secure market access, they equally provide 'competition goods' to the Chinese state. These insights thus extend Whitley's one-way logic that the state provides 'collective competition goods'.

The review also highlighted that the formal institutional governance of Chinese cross-border finance needs to be understood in tandem with informal institutions. Examining the literature on ethnic Chinese networks clarified that a common cultural identity facilitates competitive advantages in cross-border economic transactions. The discussion revealed that these links are well documented in FDI and global trade but less so with respect to cross-border capital flows. The material that follows addresses these gaps. It highlights that investors classified as 'foreign' by the Chinese government, but which share a common cultural background with Mainland China, benefit from preferential market access under China's RQFII programme (chapter 4). At the world city level, entire money centres enjoy similar cultural proximity effects. Chapter 5 highlights that IFCs located in countries with ethnic Chinese majorities are able to secure a head start in RMB markets.

The literature review also revealed that there is currently little understanding of how ethnic networks shape economic outcomes in the Mainland Chinese context. Chapter 6 addresses this research gap, by investigating the links between ethnic ties and investor behaviour in Chinese equity markets (chapter 6).

In close connection to the literature on ethnic networks, the debate on the links between social relations and geographical location was also reviewed. Rather than treating social-spatial relations as separate features (Saxenian and Sabel, 2008), this thesis disentangles their interrelationship. Through the analysis of Chinese cross-

border finance, it distinguishes between two types of relational assets, that is, *acquired* relational proximity and *bequeathed* relational proximity. The first type can be obtained by means of geographical relocation, as it cultivates familiarity with and social contacts in the local market. Drawing on this logic, chapters 4 and 5 examine how market access under the RQFII scheme was initially limited to Mainland Chinese subsidiaries in Hong Kong. Yet, Chinese policymakers extended this privilege to foreign investors willing to relocate their business to Hong Kong. By tracing the drivers behind this decision-making process, the chapters seek to uncover the conditions under which acquired relational proximity and geographical proximity can be complementary forces.

In contrast, *bequeathed* relational proximity is based on common ethnic origins. It is thus a fixed relational asset rather than one that can be acquired. The literature review clarified that ethnic ties facilitate mutual trust and access to similar information through a common cultural understanding. Chapter 6 investigates whether these premises hold in the context of Chinese equity markets. It compares the shareholder behaviour of national Chinese investors and foreign ethnic Chinese investors. If the claims on ethnic ties and local information advantages hold, then the behavioural patterns of both investor groups will be similar. This investigation thus allows for extending the debate on social-spatial relations, by exploring a new issue area.

In sum, the four themes assessed in this literature review appear to have little in common at first sight. But if taken together, they start to give a cohesive sense of the formal and informal institutions that shape Chinese cross-border finance. Rehearsing some of their key insights provides the necessary contextualisation for the substantive chapters that follow.

CHAPTER 3

China's Integration into the Global Financial System: Towards a State-led Conception of Global Financial Networks

3.1 Abstract

This paper critically reviews theories of global economic networks and refines their application to China's state-controlled financial sector. Current approaches view global production networks (GPN) and global financial networks (GFN) through an agency focus on inter-firm relations and a structural emphasis on neoliberal forces. This market-driven perspective exposes several shortcomings when it comes to understanding the governance of global financial networks in China. In the Chinese context, these networks are characterised by complex bargaining that bridges different levels of the Chinese party-state and corporate interests. This paper exploits the theoretical synergies between economic geography and theories of Chinese elite politics and institutional change to develop a politically sensitive reading of GFN. It identifies channels through which multi-level bargaining in the Chinese party-state shapes the competitive positions of firms. By integrating recent findings on Chinese cross-border finance, the paper develops an empirically grounded theoretical approach of GFN 'with Chinese characteristics'. This opens up a promising research agenda in the GFN literature on the role of the state as an architect and entrepreneur behind global financial networks and the outcomes they produce.

3.2 Introduction

Global economic networks have become an influential framework to analyse how interconnected economic and non-economic agents from different locations produce goods and services for international markets. Broadly speaking, the notion of global economic networks encompasses two main sub-types that the literature has focused on: Global Production Networks (GPN) and Global Financial Networks (GFN). The GPN approach has traditionally focused on the power of global 'lead firms' in shaping regional production processes, innovation clusters and trade linkages (Gereffi et al, 2005). The trouble is that GPN are not solely the result of relations between firms. Nor do they occur in isolation of the financial sector, as services such as equity and loans are necessary to finance production activities (Pike and Pollard, 2010). A more recent approach has therefore sought to integrate finance into GPN, by developing the

framework of global financial networks (GFN). This approach highlights the role of advanced business services, international financial centres and offshore jurisdictions (see Coe et al, 2014). Each of them forms a key 'building block' of a global network that connects financial sector agents with global production systems, by facilitating the transfer of funds between buyers and suppliers (Wójcik and Camilleri, 2015; Pryke, 2011). Acknowledging this intersection between finance and industrial production, recent work has developed an updated 'GPN 2.0' framework, which integrates the role of financial intermediaries and 'extra-firm actors' into the analysis (Coe and Yeung, 2015).

One of these 'extra-firm actors' is the state. Previous GPN works have acknowledged the state's role in relation to policies that promote local competitive advantages, commonly known as 'strategic coupling' between global firms and specific regions (MacKinnon, 2012). (MacKinnon, 2012). Others view the state's agency through the lens of regional 'sub-models' of capitalism (Zhang and Peck, 2016). In GFN research, the state's role is understood as a part of 'offshore jurisdictions' and 'financial centres' (Wójcik and Camilleri, 2015). The state may therefore not be absent in current approaches to global economic networks but its significance is reduced to a representative function of territory and regions.

The trouble with a-political interpretations of the state is that they neglect how bargaining across different levels of government shape processes of capital accumulation. Conceptualising the state as an 'extra-firm actor' or 'jurisdiction' reflects the characteristics of liberal market economies, where economic networks operate with relative freedom from state intervention. Only few notable exceptions in the empirical literature have investigated financial sector networks in countries with alternative economic models (Wójcik and Camilleri, 2015; Bassens et al, 2013; Pan et al. 2016). However, even here the focus continues to be on firms and economic relations. Recent work has therefore called for a more thorough theorisation of the state's role, which goes beyond the mediation of corporate behaviour and regions (Stephenson and Agnew, 2016; Smith 2015). This is especially important for understanding the development of GFN in major non-Western economies such as China, where the state plays a dominant role in the financial sector.

Mainland China has become increasingly integrated into global capital markets and now holds one of the world's largest pools of financial assets¹², second only to the US (Allianz, 2015). To achieve such global financial integration, the Chinese government has increasingly opened up its capital markets to foreign investors and allowed them to buy Chinese securities. However, in China's one-party regime¹³ market access depends on gaining permission from the Chinese government based on two main channels for capital inflows¹⁴. One is the 2002 Qualified Foreign Institutional Investor (QFII) scheme for investment denominated in foreign currency. The more recent Renminbi (RMB) equivalent of the QFII programme, the R-QFII scheme established in 2011, allows foreign players to raise funds offshore in Chinese currency and invest them in domestic securities. The QFII/RQFII approval system provides the Chinese government with an important tool to control the speed and scale of financial integration with global markets. This illustrates where power¹⁵ is located in Chinese cross-border finance, and where it is not: Rather than lead firms, it is the Chinese government that is the main architect of market structures and decides which players gain access in the first place.

The case of Chinese cross-border finance contrasts with the focus on corporate power in the literature on global economic networks and the view of the state as a 'jurisdiction' (Coe et al, 2014) or an 'extra-firm' mediator (Coe and Yeung, 2015). As the QFII/RQFII schemes highlight, the Chinese state is not limited to regulatory functions of mediating capital flows between foreign investors and Chinese firms; it creates and controls these flows. Unravelling the channels of Chinese state power is thus critical if we are to understand the rise of GFN in which political bargaining rather than economic relations are the main driver behind the competitive positions of and thus power balance between firms.

¹² These include asset classes such as equities, loans and bonds.

¹³ 'One-party regime' refers to single-party systems such as China, which prohibit opposition parties from entering political decision-making. For alternative conceptions that include dominant-party regimes see Magaloni and Kricheli (2010).

¹⁴ The 2014 Shanghai-Hong Kong Stock Connect Scheme and the 2016 Shenzhen-Hong Kong Stock Connect scheme provide two recent additions in Chinese cross-border finance, which allow foreign investors to trade domestic Chinese stocks.

¹⁵ In this review, 'power' is understood as an agent's ability to control material and non-material resources in bargaining processes with other agents (Brown, 2016).

The interesting question then becomes what sort of cross-border finance space the Chinese government seeks to create and the implications this has for our very conception of 'GFN'. Any such discussion needs to begin with an understanding of how financial networks are governed in the Chinese context. This requires mapping how control is exercised across different administrative authorities and leaders of the Chinese Communist Party (CCP), the country's main source of political authority. However, the GFN and GPN literatures currently lack a theoretical foundation to analyse cross-border financial networks in this type of state-controlled setting. By drawing on GFN approaches as a reference point, the goal of this paper is therefore to add a politically sensitive conception of *state-led* financial networks to the literature. Given the aforementioned intersection between global finance and global industrial production, the discussion on how to rethink the state's role in GFN also provides pertinent insights for other variants of global economic networks such as GPN. Despite its focus on GFN, the paper therefore adds to the study of global economic networks more broadly.

To this end, the paper critically reviews the current state of global economic network approaches and connects them with theories of Chinese elite politics and institutional change in Chinese financial markets (see Bell and Feng, 2013; Shih, 2008). Teasing out the theoretical synergies between these different literatures allows us to develop a fuller appreciation of how market-driven GFN dynamics are shaped by political bargaining and thus extend the explanatory power of GFN to authoritarian capitalist¹⁶ economies such as China. In turn, this makes it possible to reinterpret the position of 'lead firms' as an outcome that is *conditional* on the alignment with strategic interests of the Chinese party-state. As such, the framework developed in this paper responds to calls for more sustained theory-building on *why* certain power constellations emerge in global economic networks (Neilson et al, 2014; Ponte and Sturgeon, 2014).

Politically sensitive readings of GFN provide the conceptual point of departure for this review. By broadening the conception of the state from market mediator to

¹⁶ 'Authoritarian capitalism' is understood as the integration of a free market system into countries ruled by a non-elected and often autocratic government.

market maker, it builds on China-focused works that highlights the decisive role of the Chinese government in transnational 'money games' (Agnew, 2010), the global expansion of domestic 'lead firms' (Wójcik and Cammilleri, 2015) and the creation of new offshore financial space (Töpfer and Hall, 2017). The key premise guiding the discussion is thus that the global spread of neoliberal market ideas has not led to the demise of the state; rather it has given rise to more complex interdependent forms of governance, whereby the state shares authority with non-state actors (Weller and O'Neill, 2014; Büthe and Mattli, 2011).

The paper unfolds in three sections. The first critically assesses the literature on global economic networks. It highlights areas of conceptual refinement, by integrating theoretical insights from Chinese elite politics and institutional change. Based on this assessment, section two conceptualises the relationship between foreign investors, domestic corporate players and different levels of the Chinese party-state. This theory-building effort integrates recent empirical findings on Chinese financial reforms to develop an empirically grounded conceptual approach to state-led GFN. The third section concludes, by outlining theoretical implications and an agenda for future research on global economic networks.

3.3 Global economic networks: A critical review

Global economic networks such as GPN and GFN have provided influential frameworks for mapping the interconnected organisation of economic activities and agents. At the same time, they have suffered from three main shortcomings. First, the role of political bargaining dynamics and the channels through which non-firm agents shape the governance of economic networks have been largely neglected. This has given rise to concerns over the *comprehensiveness* of current approaches to global economic networks. Second, and as a direct consequence of the first point, there is little conceptual *clarity* on the political underpinnings of key concepts such as 'lead firms', which are central to both the GPN and GFN literature. Thirdly, there has been a tendency to favour broad descriptions of global network features. Specific conceptions of how corporate behaviour links to strategic state interests have thus been sidelined,

which has affected the *consistency* of empirical findings.

The above three-dimensional benchmark originates from public policy analysis to evaluate the effectiveness of policy frameworks (Anastasakis, 2008). The following review borrows from this analytical toolkit to critically assess global economic network approaches in relation to China's state-controlled finance sector. It is argued that giving equal consideration to all three dimensions - clarity and credibility and comprehensiveness - is necessary to ensure the explanatory power of global economic networks both inside and outside liberal market contexts. This provides the foundation for subsequently connecting these approaches with theories of Chinese elite politics and institutional change.

The clarity problem

The definition of power determines whether scholars end up focusing on agents' capabilities and resources or on their influence over outcomes and other agents. The GPN literature has tended to focus on the former, by identifying characteristics of firms such as 'buyer power' (Lee and Gereffi, 2015). This interpretation of power describes a supply chain situation, whereby large corporations such as retail chains are final buyers and thus impact suppliers' ability to achieve profitability. The trouble with this notion is that it offers a rather static 'buyer-seller' view on how power is obtained.

To develop a more dynamic approach, recent theory work has identified various firm-level strategies. For example, 'lead firms' can consolidate their position by intensifying inter-firm coordination or establishing strategic partnerships with suppliers (Coe and Yeung, 2015). Firms adopt such strategies because in order to respond to competitive pressures such as the 'cost-capability ratio'. The trouble is that the significance of the 'cost-capability' ratio cannot be fully captured through absolute costs alone. This is because costs are *relative* to the specific capabilities within a network and how these capabilities feed into the network's performance. In authoritarian one-party regimes such as China, such performance-optimising capabilities are intimately connected to the state's control over means of production and financing. Such state control allows for 'cherry-picking' which firms receive access to competitive resources (Nan and Meng 2009). This clarifies that the state has direct

influence over 'cost-capability' ratios and thus over which players ultimately emerge as 'lead firms'. These dynamics contrast with the economic conception of 'cost-capability' ratio that currently dominates the GPN literature. Such a conception assumes that firms can decide freely how to allocate spending and capabilities, which does not hold in the Chinese context.

Current approaches in the GPN and GFN literatures also posit that the strategies that firms choose to remain competitive eventually impact regional development (Coe et al, 2014; Coe and Yeung, 2015). If we follow this logic, then the ultimate dependent variable should be regional development rather than different types of firm strategies. As the outcome to be explained remains ambiguous, some works have focused on regional development (Horner, 2014), whereas others sought to explain the organisation and behaviour of firms (Zhu and He, 2013; Coe and Yong-Sook, 2013). This suggests that there are 'two analytical approaches in one': one framework that focuses on explaining firm-level outcomes at the industry, intra-industry and inter-industry level; and another one that maps how firm behaviour shapes regional development.

Yet, the theorisation of the channels through which *political* interests feed into firm-level organisation remains in its infancy (Smith, 2015). This is especially problematic when it comes to examining state-controlled contexts such as China, where Communist party leaders and regulatory authorities retain a firm grip on market resources such as cheap access to credit (Chen et al, 2013). Economic features such as 'cost-capability ratio' and 'market access' are thus not the explanatory variables of corporate behaviour; they are outcomes to be explained. The key question to be investigated is then not one of inter-firm relations; it is how the strategic interests of China's party-state influence firms' competitive positions and the strategies they end up choosing. For theories of global economic networks to hold in such state-controlled contexts, it is thus necessary to develop a clearer understanding of how internal differences within the state shape economic outcomes.

The consistency problem

Recent work has started to recognise the importance of broader institutional and

societal processes in shaping relations between firms. Theory-building efforts on 'relational value chains' highlight personal ties between businessmen and family members in managing trust between buyers and sellers (Ponte and Sturgeon, 2014). This approach echoes the premises of Chinese business studies, which emphasise privileged relationships as a basis for trust and collaboration in Chinese business transactions (McNally, 2011; Luo et al, 2012). Such overlaps afford an opportunity to move the literature on global economic networks beyond the dominant focus on liberal market economies.

However, the opportunity of exploiting conceptual synergies is constrained by the focus on stylised linkages in the 'relational value chains' approach. The trouble with focusing on 'stylised' linkages is that relations between agents are not 'fixed'; they are subject to shifts in social norms and practices. Previous work on China's reform era has shown that local entrepreneurs developed informal 'coping strategies' in response to formal regulation that they found too constraining (Tsai, 2006). Such creative responses disrupted the stability of established social relations, which motivated political elites to introduce formal economic reforms. Any theorisation of 'relational' networks thus needs to be able to explain both continuity and change in social relations. This is essential to ensure that empirical accounts are consistent in their explanations of why network linkages are maintained, altered or cease to exist altogether. Rather than focusing on stylised features, what is needed is a time-sensitive conception that traces how strategic interests and choices of agents co-evolve.

Recent work has started integrating deliberate tactics and practices into the analysis. The 'GPN 2.0' framework highlights that firms choose to interact with 'extra-firm actors' such as the state, consumers and civil society groups in order to remain competitive (Coe and Yeung, 2015). Similarly, the GFN literature highlights that financial and business service firms (FABS) such as accountancies and law firms pursue intermediation strategies to create new business opportunities (Coe et al, 2014). Studies on China have shown that FABS helped the Chinese government 'plug' domestic Chinese firms into GFN, by creating offshore entities and cross-listing on overseas stock markets (Wójcik and Camilleri, 2015). These works are instructive, as they identify the strategic interests and social practices that underpin global network

linkages.

Nonetheless, firms continue to be the most important unit of analysis. As the aforementioned studies illustrate, they are viewed as the agents that enable governments to connect with global economic networks rather than vice versa. The trouble is that this perspective closes off the alternative logic in which the state enables firms to be 'plugged' into GFN. Recent empirical work on Chinese cross-border finance lends support to this logic. It is the Chinese party-state that shapes which investors and money centres gain first-mover advantages in the offshore RMB market (Töpfer and Hall, 2017). This exposes a major gap in the current state of GFN research. The conceptual ambiguity surrounding the channels of state power increases the interpretational freedom that researchers have for analysing state-firm relations. In turn, this jeopardises the consistency of empirical explanations on how such relations shape financial market outcomes. Further theory-building on the *politics* of economic strategies and competitive positions is thus required to explain how GFN are governed outside liberal market contexts.

The frequent neglect of political drivers partly reflects the conceptual ambitions in the GPN and GFN literatures to characterise an entire global network or industry. Recent approaches have therefore started to zoom in on micro-level features such as 'practices'. Research has covered multiple areas including global value chains, production networks (Murphy and Schindler, 2011; Wood and Reynolds, 2012) and finance (Haberly and Wójcik, 2013). Others have explored the role that corporate practices play in cultivating close relationships in specific industries including venture capital (Jones and Search, 2009), high-tech (Wang et al, 2010) and the entertainment sector (Watson and Ward, 2013). This focus on 'practices' is instructive, as it offers a way of turning broad global network linkages into concrete manifestations of 'agency'. Nonetheless, the emphasis is again on inter-firm relations. The question of how the practices and strategic interests of state agents link to the practices of corporate agents thus remains unexplored.

The comprehensiveness problem

The continued theoretical emphasis on market-driven dynamics has led empirical

network analyses to downplay the role of non-economic forces even in authoritarian regimes such as China. For example, Yeung (2009) and Tacconelli and Wrigley (2009) find that personal relationships are less important in China's knowledge-intensive sectors such as advanced technology. This is because the authors argue that technological innovation depends on cross-border transfers of specialist expertise and high-skilled labour between firms. Such knowledge transfers are considered to exceed close personal ties (Saxenian and Sabel, 2008). Although these works shed light on sector-specific conditions, their conception of personal ties follows the emphasis on inter-firm relations in global economic networks. Consequently, this leads them to downplay how other powerful agents such as the state shape outcomes in knowledge-intensive sectors.

In the Chinese context, the focus on free flows of knowledge between firms does not hold. To explain technological innovation, it is necessary to shift the attention to the state's role in facilitating innovation through policies such as land and tax subsidies, preferential market access and cheaper borrowing costs (Haley and Haley, 2013). A similar logic applies to other knowledge-intensive industries such as financial services. The Chinese government grants privileged capital market access to foreign investment organisations with a long track record to leverage their financial expertise for 'testing' reforms in a controlled setting (Töpfer and Hall, 2017; Töpfer, 2107). Similarly, studies published in Chinese language highlight that firms, which supply policy-relevant market expertise, tend to get preferential access to loans and investment deals (Chen et al, 2015; Yin et al, 2008). This suggests that knowledge transfers and market experimentation are not exclusive to firms. Financial sector innovation in China reflects the state's willingness to accumulate expertise from different market agents. For GFN approaches to hold outside liberal market economies, it is thus necessary to rethink the state as a primary, not a secondary, force in cross-border knowledge transfers.

Politically sensitive readings of state-finance relations provide a useful step toward developing a more complex appreciation of the state's diverse roles. According to Agnew (2010, 2012), the transition of financial activities from a nationally confined toward a global scale is shaped by the political agendas of governments. Seen from this perspective, the links between state power and corporate power are central for

grasping the financial market outcomes. Echoing these premises, recent GFN work on China has recognised that the interests of central and regional governments are essential to explain the creation of network linkages between 'national champions' and foreign FABS (Wójcik and Camilleri, 2015). This approach starts to recognise how political bargaining across different levels of government might inform the governance of GFN but this remains suggestive. Economic forces continue to be the defining dynamic in GFN, with a focus on linking FABS, investment organisations, financial centres and offshore jurisdictions. As a result, the channels through which multi-level politics feed into GFN governance remains unclear.

Other politically sensitive GFN approaches have examined how seemingly 'universal' financial practices require context-specific adaptation to local institutional settings (Bassens et al, 2013; Robertson, 2015). These works show how foreign companies emulate organisational 'best practice' of a local 'lead firm' and adapt to the given policy environment, with the ultimate goal of seizing the 'lead' position. This approach clarifies that political elites, domestic firms and foreign companies are interconnected rather than separate. Nonetheless, the notion of emulating local 'best practice' and adapting to the local policy environment assumes that there is a recognised 'leader' and established institutional structures to start out with. However, the Chinese government has created new offshore RMB trading centres across the global market to experiment with the integration of RMB finance into Western institutional contexts (Töpfer and Hall, 2017). As such, there is neither a proven method to follow nor given institutional structures to get acquainted with. To explain the development of this new type of offshore financial space, GFN approaches thus need a more comprehensive theorisation of how the state's strategic interests shape global finance.

Any such theoretical approach requires a nuanced appreciation of the complex multi-level bargaining dynamics that underpin the governance of China's state-led GFN. The remainder of this paper seeks to address this gap, by exploiting conceptual overlaps between global economic networks, theories of Chinese elite politics and the institutional change literature. By drawing on Chinese cross-border finance as a reference case, this combination of theoretical insights makes it possible to rethink GFN, by extending its explanatory power to state-controlled economies.

3.4 Toward a conception of state-led global financial networks

Recent theory advances in global economic network literatures emphasise the multi-layered nature of global economic networks. Coe and Yeung (2015) and Coe et al (2014) point to three organisational variants: multiple networks forming an industry; mutual strategic partners and suppliers creating intra-industry connections between networks; and firms undertaking activities across different sectors, thus giving rise to inter-industry overlaps of networks (Coe and Yeung, 2015:61-62). This emphasis on multiple network 'layers' provides a useful starting point for thinking of Chinese cross-border investment channels in terms of 'QFII GFN' and 'RQFII GFN'. Seen from this perspective, each market access scheme creates its own global financial network but still intersects with networks from other market entry points. This type of GFN is, by definition, cross-border in nature, which includes places such as Hong Kong, Macao and Taiwan. Although they are linked to the People's Republic of China, Chinese legislation classifies entities from these territories as foreign rather than domestic investors (CSRC, 2015). This point is important for developing a theoretical framework on Chinese GFN: The aforementioned regional investors require government approval before they can access Mainland Chinese capital markets, thus making their connection with China's GFN dependent on 'strategic coupling' with the Chinese party-state.

The state-controlled nature of China's GFN makes it necessary to develop a politically sensitive perspective that links economic network layers with political layers. Recent theory-building efforts specify how state-firm relations and state-state relations, both at national or supranational scales, create fundamental enabling conditions for the expansion of economic activities to new places (Töpfer and Hall, 2017; Smith, 2015; Glassman, 2011). Despite their emphasis on multiple spatial levels and different interests across states, geopolitical interests are nonetheless analysed at the national level. This neglects country-internal diversity of political interests and thus masks bargaining dynamics between firms and different levels of bureaucracy *within* states. The trouble with treating the state as one unit of analysis is that 'strategic coupling' between firms and the Chinese state reflects competing agendas between

Chinese Communist Party (CCP) leaders, administrative agencies and corporate interests (Bell and Feng, 2013; Shih, 2008). To conceptualise how multi-level politics feeds into GFN governance, the remainder of this paper distils insights from theories of Chinese elite politics and institutional change and connects them with the literature on global economic networks.

Institutional foundations and multi-level bargaining

In contrast to the emphasis on path-dependency in early institutional theory (Hall and Soskice 2001), recent works highlight the role that various actors, including political elites, play in shaping economic outcomes (Scott, 2014). These approaches not only emphasise agents' deliberate choices in responding to 'critical junctures' such as economic crises; they also highlight the role of inter-agent bargaining in bringing about incremental adjustments that add up to substantial institutional change over time (Thelen, 2012). This emphasis on bargaining dynamics provides a suitable theoretical foundation for analysing the governance of GFN in the Chinese context. Institutional structures¹⁷ in China display a substantial degree of internal variety, which reflects the combination of proactive and reactive policy experimentation among political elites (Zhang and Peck, 2016). The precondition for such experimentation in any political economy is the openness to random discoveries of new ideas and solutions through institutions, policy processes and actors. Policy experimentation can take place in authoritarian one-party regimes such as China as long as the incumbent government is willing to encourage the decentralised accumulation of new knowledge across government bodies and market agents (Heilmann and Perry, 2011). Conceptualising the creation of new institutions such as financial networks thus requires unravelling how institutional change is embedded in bargaining dynamics between Chinese political elites, domestic and foreign corporate interests.

The literature on Chinese elite politics provides useful insights, by highlighting factional conflicts both within the CCP leadership (Shih, 2008) and between CCP

¹⁷ This paper defines 'institutions' as formal or informal norms, rules and enforcement mechanisms that are grounded in the common expectations between social agents and therefore guide their behaviour.

leaders and vested interests such as military members (Yang, 2004). Others emphasise the role of policy entrepreneurs (Bell and Feng, 2013) and party leaders' intervention into day-to-day policymaking of bureaucratic institutions (Bell and Feng, 2009). Combined, these insights clarify that any conception of the Chinese state requires mapping how power is exercised across multiple levels of government. This emphasis on multi-level *political* governance thus provides an opportunity to exploit conceptual synergies with multi-level *economic* governance in GPN and GFN frameworks.

A major conceptual challenge in connecting both political and economic network layers is how to define different levels of governance in the Chinese context. Much work uses 'Leninist state', 'central government' and 'party leadership' interchangeably (Green, 2004; Collins and Gottwald, 2014), thus assuming a rather homogenous view of the state. To make headway, Bell and Feng (2013:48) differentiate between 'bureaucrats' and 'Communist Party leaders'. The authors highlight the latter's authority to intervene 'from the outside' into everyday policymaking of bureaucrats. This authority to maintain the final say over policy decisions is what distinguishes CCP leaders from bureaucrats in their capacity to affect institutional change. Bell and Feng (2009) thus equate 'elite' exclusively to 'CCP leaders', which reduces the locus of state power to a dominant 'top-down' layer rather than multiple competing ones.

The trouble with the above conception is that senior bureaucrats can also be members of the Politburo Standing Committee, China's top decision-making body. For example, the former head of the State Planning Commission, Yao Yilin, also held the position of Politburo member. Rather than concentrated within a single top-down layer, these overlaps between 'bureaucrats' and 'party leaders' clarify that state power is diffused through multiple layers. To fully capture how multi-level politics shapes China's economic networks, a more inclusive conception of 'elite' is thus needed that considers the bottom-up power of bureaucrats.

Counting 'bureaucrats' towards China's 'political elite' is especially important to capture the role of 'policy entrepreneurs'. Originating from the institutional change literature, 'policy entrepreneurs' are advocates who invest their resources to achieve favourable policy outcomes or the advancement of an idea that they support (Kingdon, 1995). The literature has identified various types of 'policy entrepreneurs'. In his

original formulation developed to analyse US public policy, Kingdon (1995) referred to 'policy entrepreneurs' as particularly skilled *individuals* including elected politicians, interest group leaders or spokespersons for certain causes. Others have viewed them as *organisations* such as multinational companies, NGOs or think-tanks which actively promote compromise solutions (Meckling, 2011) or international best practice (Dolowitz and Marsh, 2000). Again others highlight that national and supranational *institutions* can act as influential policy entrepreneurs. Previous studies show how reform-orientated bureaucratic institutions such as the European Commission created a sense of 'climate urgency' to advance EU climate policy (Braun, 2009). In sum, these works highlight that 'policy entrepreneurship' is not limited to political leaders but also encompasses bureaucrats that can exert pressure on top decision-makers. Similarly, the evidence on non-state agents also clarifies that policy entrepreneurs do not necessarily have to be in a position of political authority. As Christopolous (2006) notes, what matters is that agents occupy a strategic position in political networks that provide the access to key decision-makers required to advance their ideas.

The empirical focus on Western contexts may nonetheless create the impression that 'policy entrepreneurship' is tied to pluralist democratic systems. This would be too narrow and constraining. Policy entrepreneurship can also take place in authoritarian one-party regimes such as China. This is because China's 'trial-and-error' approach to policy-making draws on the decentralised accumulation of new knowledge across multiple levels of government and market agents (Heilmann, 2008). This fragmented structure enables agents to establish alliances and exploit internal power rivalries within China's party-state that enable policy entrepreneurs to tip the balance of power toward institutional reform (Mertha, 2009).

Similar to the aforementioned Western variants, policy entrepreneurs in the Chinese context come in various shapes and forms. Current empirical work highlights the role of international policy entrepreneurs such as the World Trade Organisation in exerting 'outside' reform pressure on China's party leadership (Bowles and Wang, 2013). Similarly, 'national champions' among Chinese state-owned enterprises (SOEs) and foreign multinational companies can also exert 'outside' influence on China's political leaders (Naughton and Tsai, 2015; Schlichting, 2008). The trouble with these works is that they focus on agents that operate either outside China's policy-making

process or are indirectly connected such as SOEs. What is equally important, if not more so under China's authoritarian regime, is the role that policy entrepreneurs *inside* government play in shaping the decision-making process.

However, empirical studies on 'inside' policy entrepreneurs remain limited. Notable exceptions focus on CCP leaders such as reform-orientated members of the Politburo but also party leaders at local government levels (Heilmann, 2008; Zhu, 2013). Considering this regional layer in the study of 'inside' policy entrepreneurs is important, as local governments hold the biggest voting bloc of all members in the Central Committee of the CCP, the governing body that runs the party and constitutes both the Politburo and influential advisory bodies such as leading groups (Brown, 2016). Consequently, this equips provincial leaders with direct input into shaping all major policy decisions at central government level including financial reforms.

The empirical literature supports this importance of regional governance layers. Previous works demonstrate that the bottom-up diffusion of successful government practices from local to central government is a pervasive feature of Chinese policy-making (Hammond, 2013; Zhu 2012, 2013). These studies focus on issue areas such as urban income policy (Hammond, 2013), local housing (Zhu, 2012) and municipal health insurance systems (Zhu and Xiao, 2015). As these policy areas are inherently regional in nature, policy entrepreneurship from local governments is thus little surprising. The trouble is that focusing solely on such typical cases limits the generalisability of findings required for building 'good' social scientific theory on policy entrepreneurship. What is needed are empirical insights from 'critical cases' that provide least favourable conditions for the occurrence of a certain phenomenon. From a theory-building perspective, this is important to allow for making generalisations of the type 'if it is valid for this case, then it applies to many cases' (Flyvbjerg 2006:423).

When investigating local policy entrepreneurship within China's party-state, a 'critical case' would require focusing on policy areas that are managed at central government level. This is because the likelihood that local governments can attain their policy preferences decreases if authority over policy-making is concentrated in the hands of central government bodies. Chinese financial regulation is a case in point. As it is a centrally administered policy area, one might assume that multi-level governance plays a limited role in shaping outcomes in Chinese capital markets. Such

centralised control over financial reform decisions therefore provides least favourable conditions for bottom-up policy entrepreneurship at local government level.

Recent empirical developments shed light on how policy entrepreneurship unfolds in such 'critical' cases. For example, the launch of the 2014 'Stock Connect'¹⁸ scheme with Hong Kong illustrates the role of local party leaders in shaping competitive advantages in GFN. Shanghai secured a first-mover advantage in 'coupling' with Hong Kong. This enabled the city to boost the flow of foreign capital investments passing through its stock exchange and thus secure a regional head start over Shenzhen, where Mainland China's other stock exchange is located (Töpfer, 2016). This outcome reflected the Shanghai leadership's superior lobbying position thanks to privileged relations across the spectrum of vested domestic interests: close ties with top Politburo leaders thanks to the city's special status as a central government-administered municipality and Chinese President Xi Jinping's previous position as party leader of Shanghai; direct links with central-level financial authorities, as some city administrators also held senior positions at the China Securities Regulatory Commission (CSRC); and support from large SOEs given their heavy weighting in Shanghai's stock market listings (Töpfer, 2016). These empirical insights clarify that bringing about financial policy innovation in GFN is not exclusive to top CCP leaders; local government leaders are equally important in shaping regional competitive advantages in GFN, by exploiting privileged relations to mobilise support. These empirical insights highlight the need to further disintegrate the internal differences within China's local governmental system to explain outcomes in 'critical' cases of policy entrepreneurship such as financial reform.

Nonetheless, the focus on local party leaders ignores the role of bureaucrats in such 'critical' cases. 'Bureaucratic entrepreneurs' refer to reform-oriented officials within China's central and local administrative bodies (Bell and Feng, 2013). These bodies are tasked with implementing the strategic policy directions set by the CCP leadership. Previous works have shown that high-autonomy bureaucratic bodies as

¹⁸ The Shanghai-Hong Kong Stock Connect scheme allows Hong Kong brokers to trade stocks listed on the Shanghai exchange, and Chinese brokers to trade some stocks on the Hong Kong exchange. It marks a significant departure from previous cross-border schemes that require foreign investors to obtain an investment license and quota to buy shares traded in Mainland China.

powerful enough to outmanoeuvre CCP leaders (Moore, 2002). Administrative agencies with a significant degree of policy autonomy can thus mobilise bottom-up resources to shape strategic policy decisions. Whilst their primary main function may thus be to implement policies, this does not mean that their role is confined to acting as administrative ‘outsiders’.

However, some works highlight that CCP leaders are able to overrule bureaucratic resistance even in the case of high-autonomy administrative bodies (Bell and Feng, 2009). Such inconclusiveness partly reflects that the *conditions* underpinning the autonomy of bureaucratic entrepreneurs remain underspecified if not missing. In response, recent works have identified informal institutions such as long-term personal relationships and the fragmented structure of China’s formal institutions as notable intervening variables. For example, the close ties between central bank governor, Zhou Xiaochuan, and Politburo members, have bestowed China’s central bank with substantial informal authority over financial reforms (Bell and Feng, 2013). In addition, China’s top party leadership has extensive political agendas but limited human resources. They thus lack the expertise to evaluate regulatory measures across a wide range of policy areas, thus delegating substantial autonomy to administrative bodies, which specialise in particular issue areas (Shih, 2008). These insights provide a foundation for mapping institutional conditions under which bureaucratic entrepreneurs are able to maximise autonomy and thus shape China’s GFN.

The emphasis on formal and informal institutions nonetheless downplays the role of agents’ strategic choices. Framing, that is, the strategic use of rhetoric, provides bureaucratic entrepreneurs with a major tool to reduce the risk of ‘intervention from above’. To maximise autonomy, administrative bodies thus have an incentive to frame reform proposals in line with the interests of CCP leaders (Collins and Gottwald, 2014). The case of the People’s Bank of China (PBOC), China’s central bank, illustrates this well. Bell and Feng (2013) show that the PBOC’s strategic linking of monetary policy and the CCP agenda of liberal economic policy allowed the central bank to take charge of battling inflation in the 1990s. Such framing practices allowed for overcoming strong opposition from the Ministry of Finance, state-owned enterprises (SOEs) and banks, which all favoured continuous monetary creation. Similarly, others show that the PBOC’s framing of QFII/RQFII reforms as ‘alternative sources of bank financing’ not

only promised to turn domestic state-owned banks, AMCs and related ministries into major beneficiaries of China's capital market opening to foreign investors; it also supported the goal of the CCP leadership to safeguard domestic financial stability, by reducing unproductive lending (Töpfer, 2017).

A number of insights can be gleaned from these empirical works for the study of GFN. One important observation is that bureaucratic entrepreneurs in China rely on a combination of skilful framing and the strategic use of multi-level governance structures to advance their policy goals. Although they operate within an authoritarian context, they thus bear similarities with aforementioned variants of policy entrepreneurship in Western political economies. They, too, emphasise rhetorical skills and strategic network positions among reform-orientated bureaucratic institutions (Braun, 2009; Christopolous 2006). This clarifies that the notion of bureaucratic entrepreneurship is not regime-specific. There may be different variants but these are anchored by the convergence of common behavioural conditions (framing practices) and structural conditions (multi-level governance) that apply irrespective of their economic system. The observations from bureaucratic entrepreneurs in China therefore add to wider theory-building efforts on how policy entrepreneurship feeds into state-led GFN governance.

The empirical literature on China also clarifies that 'strategic network positions' do not require having the same level of authority as top CCP leaders; what matters is how bureaucrats use their skills and relational capital to align interests across China's party leadership, administrative bodies and corporate interests. In contrast to capabilities-oriented works (Braun, 2009; Christopolous, 2009), this suggests that bureaucratic entrepreneurship is not about the resources of individual officials or institutions; it is a dynamic collective process, which involves the pooling of resources by means of interacting with other agents. Understanding the role of bureaucratic entrepreneurs thus requires mapping the *practices* through which individual resources translate into outcomes in GFN.

The empirical insights into framing practices illustrate this well. Bureaucratic entrepreneurs in China 'advertised' financial reforms, by highlighting their mutually beneficial nature for different government bodies and corporate interests. Such framing practices facilitate preference cohesion both within and across multiple

political and economic layers of China's state-led GFN. In turn, preference cohesion empowered reform-orientated bureaucrats to tip the balance of competitive advantage from protected domestic interests toward greater foreign participation in Chinese capital markets. This clarifies that state-firm 'strategic coupling' does not automatically lead to positive outcomes. As new agents enter the GFN playing field, old network linkages can be 'layered' with new linkages, which then shift the existing balance of inter-firm competition. These insights have important theoretical implications, which suggest that changes in GFN governance do not require an abrupt displacement of existing rules; they can take on 'quieter' more incremental forms facilitated by political entrepreneurship. To fully explain how new agents and linkages emerge in state-led GFN, it is thus necessary to 'politicise' our understanding of strategic coupling. This requires paying greater attention to the social practices of bureaucratic entrepreneurs in 'managing' bargaining conflicts and facilitating 'strategic re-coupling' between firms and the state. This will allow for broadening current conceptions of the state beyond a mere representative function of territory and specific regions (Mackinnon, 2012; Zhang and Peck, 2016).

The empirical literature also suggests that China's fragmented financial governance provides a decisive structural condition for the effective use of framing practices. As many different administrative agencies and government-linked corporate entities are involved in China's financial reform processes, this increases competition for political influence over the nature and scope of reform. The internal turf wars emanating from such competition provided bureaucratic entrepreneurs such as the PBOC with multiple 'access points' to deploy framing strategies, build pro-reform alliances and thus strengthen its own policy autonomy over QFII/RQFII reforms (Töpfer, 2017). These insights allow for extending the emphasis on multi-scale economic governance in GFN frameworks, by specifying how agents can exploit multi-level *political* governance to alter established GFN structures. The central role of agency in such multi-level governance games has important spatial implications for the study of GFN. It highlights that space can function as a major power resource in its own right and thereby adds to explanations of a recurring puzzle in economic geography: how to make a systematic assessment of the links between space and the ways in which power is exercised (see Allen, 2016).

Corporate power resources in China's state-led global financial networks

Grasping the sources of corporate power in China's state-led GFN requires unravelling which resources supplied by firms best serve the strategic interests of the Chinese government. At the highest level of government, CCP leaders require support from politically relevant agents to 'manage' international pressure to liberalise Chinese capital markets, whilst safeguarding state control (Schlichting, 2008). In this context, the 'political relevance' of foreign firms depends on 'global visibility', that is, their presence in terms of global operations and well-known brand names. This is because foreign firms with a widespread international presence provide Chinese policymakers with a strategic resource to advertise reform efforts globally.

Recent work shows that in the launch phase of China's QFII investment schemes, eligibility criteria favoured 'sell-side' investors with big brand names in global finance over more passive and thus less visible 'buy-side' investors such as pension funds (Töpfer, 2017). This selective approach allowed CCP leaders to ease financial liberalisation pressure without relinquishing state control given the traceability of well-known brand names. The political favouritism of 'sell-side' investors such as investment banks and securities companies not only highlights that 'global visibility' is a major corporate resource in China's state-led GFN; it also clarifies that access to competitive resources is set in *absolute* terms according to investor types, which then compete over market access *relative* to other investor groups. Consequently, this shifts the attention from the power of a global 'lead firm' to the political weight of corporate resources as a *collective* phenomenon.

The 'political relevance' of firms also depends on their supply of policy-relevant information. The CCP leadership's limited human resources with finance-specific expertise generate uncertainty about the potential consequences of financial reforms. This risks undermining the CCP's authority within the Chinese party-state. To mitigate such uncertainty, the CCP accommodates corporate interests that hold market-specific insights and thus enjoy informational advantages over party leaders. We can distinguish between two types of information: market knowledge supplied by foreign investors and insights into domestic corporate interests. Foreign knowledge supply

matters because China has sought to emulate Western fund management practices to 'upgrade' its domestic financial sector (Robertson, 2015). Information on domestic corporate interests matters because the Chinese government continues to depend on capital accumulation by SOEs, banks and asset management companies (AMCs) to support employment needs and finance economic growth (Naughton, 2015).

The cash flow of domestic SOEs and banks has, however, been drying up, as non-performing loans and defaults on existing loans have surged in the period following the 2008 financial crisis. The failure to recover such loans spilled over into a cash crunch among Chinese AMCs, which are directly linked to banks, given their function to purchase bad debt from state-owned banks (Walter and Howie, 2014). As previous studies show, the risks of an industry-wide banking crisis generated a sense of urgency among CCP leaders to accelerate financial liberalisation in order to unlock fresh capital for domestic firms (Bell and Feng, 2013). This clarifies that foreign and domestic capital accumulation are interdependent forces in China's state-led GFN by means of the vested political interests that connect them.

The CCP's receptiveness towards the above corporate resources is mediated by informal relational assets, which matter both inside and outside China. Inside China, privileged personal relations (*guanxi*) partially matter because Chinese society is a highly collectivist culture, where people define their self-image in terms of 'in-groups' that support each other in exchange for loyalty (Huang, 2009). However there is also an institutional logic at play. Relational proximity mitigates weak formal institutional support inside China, by providing a basis of trust in social exchanges such as domestic state-firm interactions (McNally, 2011). In this respect, relational proximity provides an important resource for local 'lead firms' to achieve and maintain their competitive edge over other firms. Recent works show that Chinese investment firms led by 'princelings' (*taizi dang*), that is, children of CCP leaders, are able to secure preferential access to deals, raise capital and lobby decision-makers to accelerate deal approvals (Robertson, 2015).

Alongside CCP family ties, direct legal ownership also promotes close ties between powerful government bodies and domestic SOEs, banks and AMCs. For example, China's AMCs such as Central Huijin are state-owned by the Ministry of Finance. The same ministry can also influence financial regulation through direct

shareholdings in major banks. Similarly, other financial authorities such as the CSRC have been complicit in perpetuating the interests of state-owned banks, by giving preferential treatment to SOEs for new stock listings. A good example is the CSRC's support of former Premier Zhu Rongji's campaign to revive SOEs as the main pillar of the Chinese economy. This move reflected the CSRC's weaker bargaining position to discipline SOEs backed by the Finance Ministry and the State Asset Supervision and Administration Commission (Naughton, 2015). With joint resources, these administrative bodies were able to exert pressure on the CSRC to issue privileged stock market launches and secure higher sales prices for SOEs (Du, 2011). Relational proximity between local Chinese firms and powerful bureaucratic alliances are thus critical for understanding lasting competitive advantages in China's GFN.

Outside China, relational proximity with foreign firms and governments provides the Chinese state with a tool for institutional capacity-building including financial knowledge transfers and policy experimentation (Heilmann and Perry, 2011). For foreign firms operating in Chinese financial networks, one way to acquire relational proximity is by means of geographical location. Recent works demonstrate that market access under the RQFII scheme was initially only available to Mainland Chinese subsidiaries in Hong Kong. Yet, to promote the development of Chinese currency markets, Chinese regulators also extended this privilege to foreign investors willing to register their business in Hong Kong (Töpfer and Hall, 2017). This not only cultivated familiarity with the local target market for foreign investors; above all, it served the strategic interests of the Chinese party-state to develop a global RMB offshore market.

Another channel of relational proximity for foreign firms is the recruiting of 'princelings', which have emerged as influential new agents in Chinese finance (Robertson, 2015). Employing family members of CCP leaders constitutes a major relational asset that enables foreign firms to achieve a premier position over other foreign firms in China's state-led GFN. For example, recent empirical studies highlight that princeling ties played an important role in securing first-mover advantages for foreign investment banks under the QFII scheme (Töpfer, 2017). The vast financial resources of large banks enabled the Chinese government to attract big brand names in global finance but it was the personal relations of their Chinese employees with CCP leaders that provided the necessary basis of mutual trust. Such mutual trust, and the

knowledge of local norms and customs that comes with it, mattered for Chinese policymakers especially in the early stages of QFII reform, as uncertainty about possible policy consequences was high.

To put this into context, other foreign investors such as pension funds also had the necessary financial resources to meet the QFII criteria. However, as they are driven by longer-term and often passive asset ownership, these investor types were much slower in acquiring informal relational assets. 'Sell-side' investors such as investment banks were thus able to emerge as first-mover lead firms, by combining their financial resources with the supply of relational and knowledge-based resources (Töpfer, 2017). In turn, these provided Chinese policymakers with a reliable 'testing ground' for their financial reforms. To fully explain the premier positions of 'lead firms' in state-led GFN governance, it is thus necessary to unravel the co-constituted and negotiated nature of such positions. The Chinese party-state may have the final say over competitive hierarchies but state-firm resource interdependencies also matter for explaining who gets ahead and who lags behind in China's GFN.

In addition to leveraging CCP family relations, another important competitive resource is common cultural background based on ethnic ties. Foreign investors from places with ethnic Chinese majorities such as Singapore tend to have stronger relationships with local firms and policymakers, which affords competitive advantages (McNally, 2011). This competitive effect of cultural proximity stems from agents sharing a group identity that facilitates mutual trust based on a common language, ancestry and social values (Soontiens, 2007).

Echoing the above logic, recent empirical work reveals that culturally close investors including from Singapore and Seoul account for the largest segment of quota approvals and trading volumes under China's RQFII scheme (Töpfer and Hall, 2017). It is shown that the close bilateral ties of these places boosted regional trade finance, which has been the main driver behind the demand for RQFII investment products (Töpfer and Hall, 2017). Political favouritism of culturally close investors also provided the Chinese government with a familiar regional and thus more controllable 'testing ground' for opening domestic capital markets and promoting the internationally more widespread use of Chinese currency (Töpfer, 2017). To borrow from the terminology of GPN research, ethnic Chinese networks are thus an important relational resource to

facilitate ‘strategic coupling’ between foreign corporate agents and the strategic interests of the Chinese state.

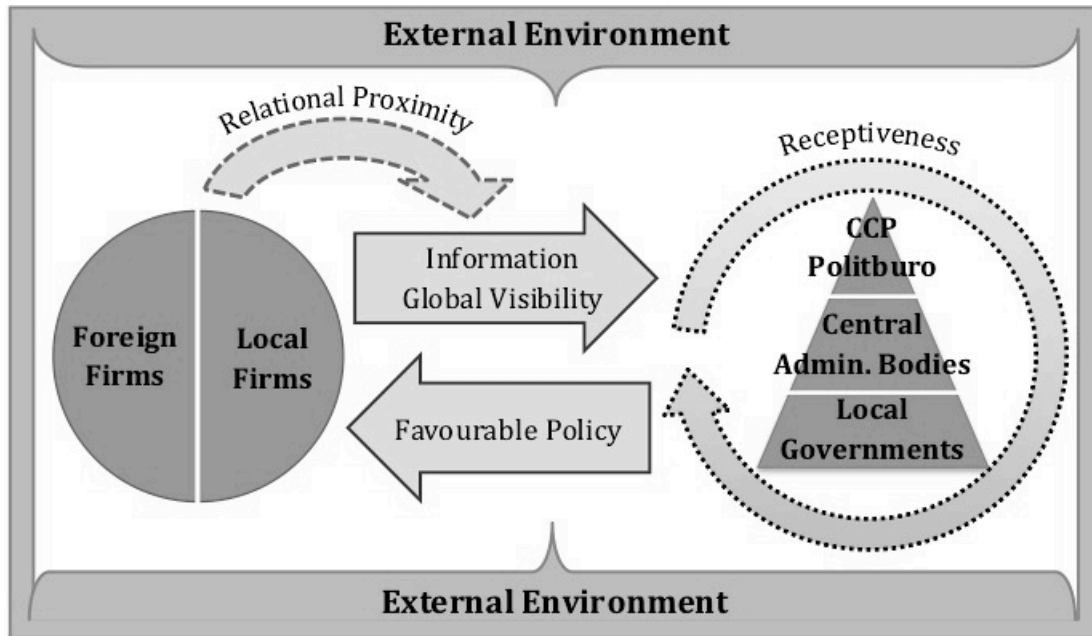
However, ethnic ties do not automatically translate into relations of solidarity. As Alcoff (1999) notes, feeling a sense of connection with visibly similar others does not inevitably translate into empathetic identification. Lasting geopolitical tensions between governments such as those brought about by civil conflict may diminish levels of trust and cooperation even if countries share the same cultural background. The on-going frictions between Mainland China and Taiwan governments surrounding the ‘One China’ policy are a case in point. For example, Töpfer and Hall (2017) show that such frictions informed the exclusion of Taipei’s financial centre under China’s RQFII programme, even though the city would have been an ideal choice given Taiwan’s sizable RMB deposits. The Chinese government tied its RQFII approval for Taipei’s financial centre to the ratification of a Cross-Strait trade deal, which was subsequently rejected by the Taiwanese government due to considerable anti-China protests. Consequently, these empirical insights clarify we cannot, by default, treat ethnic ties as given relational assets in state-led GFN without considering the geopolitical relations between states. Ethnic ties are thus a conditional resource that interacts with the broader spatial context that shapes the ties between agents.

In sum, by distilling the insights from the empirical literature, it is possible to differentiate between two types of relational assets in China’s state-led GFN, that is, *acquired* relational proximity and *bequeathed* relational proximity. Acquired relational proximity can be obtained by means of geographical relocation, whereas bequeathed relational proximity is based on ‘inherited’ traits such as family relations and ethnic ties. As the case of RQFII highlighted, the latter is given priority by the Chinese government when new policies are tested and uncertainty is high. Acquired relational proximity by means of geographical relocation also mattered albeit with a time lag in subsequent policy stages. This clarifies that the ‘home bias’ underpinning the hierarchy of relational assets is inherently time-sensitive. Timing is thus a key condition for whether geographical proximity enables relational proximity in shaping GFN outcomes.

Overall, the governance of GFN needs to be understood as a *negotiated* outcome that involves bargaining conflicts between foreign and domestic corporate interests and different levels of the Chinese party-state. Such a multi-level conception

allows for specifying key mechanisms that link bargaining dynamics across different economic and political network layers. Figure 1 graphically summarises these dynamics.

Figure 1. Multi-level Governance of China's Global Financial Networks



The network-internal bargaining dynamics in Figure 1, and the choices of firms and political elites underpinning them, are conditioned by shifts in the external environment such as economic crises. They can trigger ‘critical junctures’ (Cortell and Peterson 1999), by changing what agents perceive to be ‘appropriate’ ideas of how to achieve economic progress. External shocks such as the 2008 global financial crisis illustrate the importance of ideational shifts. Recent studies show that the crisis eroded the legitimacy of neoliberal ideas including ‘free markets’ and ‘deregulation’, which prompted Chinese political elites to search for ideational alternatives (Kirshner, 2014).

Similarly, the near-total collapse of Western banks led to a more differentiated understanding of how investors’ varying business models affect financial stability. Recent work shows that this triggered a U-turn in the composition of China’s cross-border investment programmes: Whereas in the pre-crisis period foreign banks and

other 'sell-side' investors enjoyed a first-mover advantage, post-crisis preferential treatment was given to 'buy-side' asset owners such as pension funds (Töpfer, 2017).

In sum, the empirical literature highlights that externally induced learning effects can undermine Chinese policymakers' trust in and thus their receptiveness towards the supply of foreign financial expertise. This clarifies that changes in the network-external environment can reshuffle the constellation of desired resources that are 'traded' between the state and firms. In turn, such external changes they shift the nature of firm-state 'strategic coupling' in GFN and thus give rise to varying competitive advantage among firms. This point is instructive, as it clarifies that competitive hierarchies in state-led GFN reflect that interdependencies between government elites, firms and financial centres are *time-sensitive*. To capture this importance of timing, any theorisation of state-led GFN needs to consider how multi-level bargaining and learning effects within networks interact with externally induced 'shocks'.

3.5 Conclusion

This paper sought to reconceptualise the GFN approach, by drawing on Chinese cross-border finance to add a *state-led* conception to the literature. The paper argued that conceptualising state-led GFN requires going beyond the emphasis on inter-firm relations and economic incentives that dominates the literature. It requires a systematic conception of how multi-level bargaining within the state shapes the formation, subsequent development and outcomes of financial networks. Although recent conceptual advances have acknowledged non-firm actors and institutional processes, a comprehensive theorisation of the state is still missing. This paper therefore combined politically sensitive perspectives from the GFN 'school' with theories of Chinese elite politics and institutional change. This interdisciplinary lens made it possible to conceptualise how bargaining across different levels of the Chinese party-state shapes the competitive positions of firms. Throughout, this approach was linked to the empirical literature on Chinese cross-border finance to develop an empirically grounded framework of state-led GFN.

The discussion of the Chinese case allowed for advancing theory-building efforts on global economic networks along three main dimensions, that is, conceptual clarity, consistency and comprehensiveness. Concerning the former, the empirical review showed that first-mover advantages under China's cross-border investment programmes do not solely reflect the capacity of 'lead firms' to outperform their competitors but their supply of relevant resources that best serve the strategic interests of the Chinese party-state. This challenges liberal market conceptions of 'cost-capabilities ratio', 'market access' and 'lead firms' in the literature on global economic networks. The paper also clarified the need to adopt a multi-level perspective that remains sensitive to varying incentives and practices within the state. Since financial regulation is centrally administered in China, it is tempting to assume that multi-level governance plays a limited role in shaping outcomes in Chinese capital markets. Contrary to this logic, the paper highlighted that GFN governance is not limited to top-down control by the Chinese party leadership; policy entrepreneurs at the central and local level of government are decisive for understanding changes in 'strategic coupling' between firms and the state. Such a politically sensitive interpretation adds to the conceptual *clarity* of key economic concepts in the GPN and GFN literature, by specifying their political underpinnings. In turn, this allows for enhancing the explanatory power of global economic network approaches outside liberal market contexts.

Rather than calling for a return to state-centric analyses of economic development (see Henderson et al., 2002), this paper advocated for developing a more *comprehensive* conception of the state. As the review of the empirical literature on China's QFII/RQFII schemes highlighted, the Chinese party-state does not solely regulate cross-border finance; it creates entirely new financial networks in overseas jurisdictions. This requires rethinking the state's role as a primary architect of rather than a secondary force in the creation and subsequent development of GFN. It also requires rethinking the idea that changes in established network linkages are the result of bargaining *between* different network layers such as 'the state' and 'firms'. Such changes also reflect bargaining dynamics *within* a particular network layer. China's GFN may appear 'stable' as formal linkages between network layers remain intact; but they can still undergo substantial functional adaptation that changes the logic behind

these linkages. It is therefore necessary to further disintegrate seemingly homogenous actors such as ‘firms’ and ‘the state’. The GPN and GFN literatures have provided ample insight into the former. Future research should pay equal attention to internal differences of other key agents such as the state.

The paper also advanced our understanding of how spatial constellations of GFN change over time, by integrating concepts of institutional change such as ‘critical junctures’, ‘institutional learning’ and ‘policy entrepreneurship’. Linking this time-sensitive conception to the context of China’s authoritarian one-party regime allowed for taking up recent calls to move beyond the focus on market-driven incentives (Smith, 2015). In sum, the discussion adds to the *comprehensiveness* of global economic network research, by offering an integrative approach to geographical contexts, network-internal power politics and network-external shifts over time.

Nonetheless, the approach developed in this paper adopted a deliberately partial focus on specific practices and resources such as information supply and policy framing, which link different corporate and political agents in state-led GFN. This middle-range¹⁹ approach takes up recent calls for ‘modular’ theory-building that zooms in on incentives, strategies and practices to specify the role of ‘agency’ in global networks (Ponte and Sturgeon, 2014). By limiting the conceptual scope to the exchange of resources shaping firm-state relations, the proposed theoretical foundation thus contributes to ensuring the *consistency* of empirical findings.

The adoption of a middle-range approach focused on China does, however, not preclude this paper from providing insights for the study of global economic networks more generally. As Liebman and Milhaupt (2015) note, China’s state-led approach may neither be completely distinctive nor classify as a ‘model’ but it contains a number of useful lessons. Echoing this claim, the state-led GFN approach developed in this paper should not be read as a call for ‘Chinese exceptionalism’. Rather, it lends

¹⁹ A ‘middle-range’ approach is a theory-building approach that starts with an empirical phenomenon - the governance of Chinese GFN in our case- and abstracts from it to create general statements that are close enough to actual observations to permit empirical verification (see Merton, 1968).

support to the argument that state capitalism is best understood as ‘a continuum’ (Kurlantzick, 2016:7), which can take various forms and shapes.

The diversity of state control mechanisms reflects this. They can range from direct state ownership of companies over minority shareholding to public-private partnerships (Kurlantzick, 2016; Naughton and Tsai, 2015; Liebman and Milhaupt, 2015). What unites these mechanisms is that they present direct means of exerting state control over firms. The state-led GFN approach extends this repertoire, by highlighting that state capitalist mechanisms are not limited to direct means. As the review of QFII/RQFII studies showed, the Chinese government experimented with market access privileges that provided a strategic ‘tool’ for developing China’s capital markets (Töpfer and Hall, 2017) and easing the burden of non-performing loans on domestic state-owned banks and companies (Töpfer, 2017). The state-led GFN approach thus highlights that the variety of state capitalism also includes more indirect means to achieve domestic competition goals.

These insights are not confined to non-Western contexts. The specific case of Chinese state-firm bargaining may not lend itself to direct application elsewhere but it opens up avenues for a more inclusive approach to GFN governance. What makes this approach more ‘inclusive’ is the specification of how bargaining between multiple *political* network layers intersects with multiple economic layers of GFN. In addition, the case of Chinese cross-border finance also highlights that it is a combination of external crises and internal learning effects that altered the power constellations in GFN. In turn, these shifts paved the way for new global network linkages to emerge.

This idea that GFN governance is *time-sensitive* and reflects a *negotiated* outcome between different levels of government, firms and their respective institutional contexts is not limited to China and Asian developmental states. This logic applies to GFN anywhere in the world irrespective of their economic system. A good example is the revival of state capitalist tendencies in Western economies following the 2008 global financial crisis. The bailouts and nationalisation of Western banks and the substantial re-regulation of financial activities highlight that the state is not confined to mediating GFN from the ‘outside’; it actively creates and re-creates financial networks through its interaction with firms across different territories.

Ultimately, this paper offers an alternative reading of global economic networks. The literature continues to view global 'lead firms' as the main coordinators of network relations, whilst non-firm agents such as the state mediate inter-firm relations through 'strategic coupling'. This paper advocated a reverse GFN logic: Rather than mediating firm relations, the Chinese party-state has the final say over which corporate resources matter for 'strategic coupling'. This way, the state shapes which corporate players are able to emerge as 'lead firms' in the first place. It is thus not 'lead firms' but the state's interaction with such firms that matters for the constellation of power in GFN. In this respect, the discussion thus serves to specify a fundamental but frequently neglected difference between power bestowed (firms) and power owned (Chinese party-state).

The rise of Chinese cross-border finance in global capital markets will increasingly challenge Western assumptions on how GFN operate and the outcomes they produce. As such, the above 'reverse' GFN logic reminds us that markets and models of capitalism are variegated (Zhang and Peck, 2016; O'Neill and Weller, 2014; Hall, 2012). If we accept the idea that global economic networks are a system of capitalisms, which differ in their national and regional contours but are interlinked and constantly evolving, then China's state-led GFN approach opens up a broader research agenda on how multi-level bargaining and politics feed into economic organisation.

CHAPTER 4
(Journal Offprint)

**Institutional change in Chinese cross-border finance:
foreign investors, the party-state and power resources**

Institutional change in Chinese cross-border finance: foreign investors, the party-state and power resources

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ABSTRACT

This paper is the first to investigate the changes in criteria for market access under China's Qualified Foreign Institutional Investor (QFII) Programmes. By combining insights on institutional change and Chinese elite politics, it demonstrates that the evolution of access criteria can be explained by interdependent bargaining between Chinese party leaders, administrative authorities and corporate interests. The 2008 global financial crisis triggered fundamental shifts in resource interdependencies that altered the bargaining dynamics between these agents. The changes in internal and external conditions are decisive for understanding how the QFII programmes evolved. The analysis draws on an original data-set coupling 91 multi-stakeholder interviews, database analysis and internal government records. The findings show that institutional change in China's cross-border investment programmes is a negotiated economic outcome bridging interdependent state and market agents. These results have important implications for the study of globalisation and institutional change in non-Western contexts. They challenge existing narratives of an all-pervasive Chinese party-state that is resistant to change.

KEYWORDS

capital markets; institutional change; Chinese party-state; global financial crisis; state capitalism; financial globalisation.

INTRODUCTION

The shift of global financial assets towards rapidly growing Asian economies is reshaping global capital markets. With a market value exceeding USD 4 trillion, Mainland China is now the world's second largest stock market and the total size of its capital markets is projected to reach USD 98 trillion by 2030 (CSRI, 2015). The on-going financial liberalisation that has accompanied this development has increasingly allowed foreign firms to buy Chinese assets and thus tap into one of the world's fastest-growing capital markets. However, in China's one-party regime¹, market access for foreign players depends on gaining government approval based on two main channels for capital inflows²: the 2002 Qualified Foreign Institutional Investor (QFII) scheme, for investment denominated in foreign currency, and its 2011 Renminbi (RMB) equivalent, the RQFII scheme, which allows funds raised offshore in Chinese currency to be invested in domestic securities.

To date, little research exists in the political economy literature on the development of Chinese cross-border finance, especially the QFII/RQFII programmes. Previous studies that offer relevant insights include early works by Lardy (2002) and Schlichting (2008). These studies demonstrated that the Chinese government's initial push for economic and financial reforms was decisive to connect its domestic capital markets with global financial flows. To explain the subsequent development of Chinese financial markets, some studies highlight external catalysts including China's WTO membership or the 2008 financial crisis (Bowles and Wang, 2013). Others emphasise internal bargaining between Chinese Communist Party (CCP) leaders and administrative agencies (Bell and Feng, 2009, 2013) or the influence of municipal governments (Walter and Howie, 2012) to explain stock market reforms, listing decisions or changes in monetary policy. Furthermore, studies published in Chinese language highlight political favouritism as a major determinant of capital allocation, whereby investors contributing to strategic policy goals obtain preferential access to loans (Chen et al., 2015; Nan and Meng, 2009; Yin et al., 2008). In sum, these works have advanced our understanding of major exogenous and endogenous factors shaping Chinese capital market development.

However, a key question that remains currently unexplored is why conditions of market access under China's cross-border investment programmes have changed and how such changes affect domestic capital market development. With the launch of its QFII/RQFII programmes, Chinese policy-makers sought to avoid short-term speculators, by limiting market access to what they considered to be long-term investors (Walter and Howie, 2012). Seen from this perspective, it is perplexing that eligibility criteria and investor approvals in the QFII launch phase did not reflect these policy preferences. Paradoxically, most QFII approvals went to 'sell-side' investors including investment banks and securities companies (China Securities Regulatory Commission (CSRC), 2004). These intermediaries have more momentum-driven investment horizons than long-term 'buy-side' investors such as pension funds (Koller et al., 2010). Interestingly, the QFII market composition over time reveals a fundamental change. 'Buy-side' investors now account for the vast majority of QFII approvals (CSRC, 2015).

This study seeks to explain this systematic U-turn in QFII approvals. By drawing on insights at the intersection of Chinese elite politics and institutional change (Bell and Feng, 2013; Robertson, 2015), the paper argues that the source of change in China's QFII/RQFII programmes is located in interdependent bargaining between CCP leaders, administrative bodies and corporate interests.³ The 2008 financial crisis triggered fundamental changes in resource interdependencies that altered the bargaining dynamics between these agents. It is demonstrated that these changes in internal and external conditions are a critical determinant of the content, pace and timing of QFII/RQFII reforms.

To investigate these policy changes, the paper draws on an original data-set of 91 multi-stakeholder interviews conducted in China's main financial and political centres: Shanghai, Beijing, Hong Kong and Shenzhen. These interviews are cross-checked against statistical databases, internal government records and news sources. Such triangulation allowed for tracing shifts in policy objectives across time and space. Investigating these changes is necessary to understand the political dynamics underpinning decision-making within the party-state, which is becoming increasingly important amid China's integration into global financial markets.

This study makes several important contributions to the international and comparative political economy literatures: it advances research on Chinese foreign economic policy, by analysing QFII/RQFII's evolution from the perspective of Chinese policy-makers and their interaction with corporate interests. This adds to political economy research on firm-government bargaining. Previous studies have focused on foreign direct investment (FDI) policies (Wei, 2015), notably in industrial sectors such as the Chinese automotive industry

(Chin, 2010; Oh, 2013). However, the role that firm–government relations play in indirect foreign investments⁴ such as China’s QFII/RQFII schemes has been neglected. This paper broadens the empirical scope of this literature, by examining the interaction between the Chinese party-state, foreign investors and domestic corporate interests in an unexplored issue area. Simultaneously, the paper adds to debates on corporate power, by specifying how bargaining outcomes shape the distribution of power between firms.

This paper also makes an important conceptual intervention into regulation approaches that have emphasised the state’s indispensable role in the creation, regulation and conduct of markets (O’Neill, 1997; Painter, 2003). It highlights shifts in the external environment and internal bargaining dynamics to explain changes in the Chinese government’s strategic objectives concerning its QFII/RQFII programmes. This advances existing regulation approaches, by specifying the conditions under which adaptive state behaviour occurs in authoritarian regimes such as China. The paper therefore challenges assumptions that state institutions⁵ are resistant to change and adds to neo-institutional debates on institutional learning and adaptation (Hall and Thelen, 2009; Thelen, 2012).

This paper unfolds in four parts. It first introduces the theoretical framework. The second part then outlines the data-set and methodology. The third discusses the empirical findings. The paper concludes by summarising the results and highlighting key implications for future research.

THEORISING INSTITUTIONAL CHANGE IN CHINESE CAPITAL MARKETS

The institutional change literature in political economy provides the theoretical foundation of this paper. This allows for examining how the interaction between policy-makers and corporate interests shapes institutional change⁶ in Chinese cross-border finance. In contrast to the emphasis on path-dependency in early institutional theory (Hall and Soskice, 2001), recent approaches highlight the role that various actors, including political and corporate elites, play in bringing about institutional change (Hall and Thelen, 2009; Scott, 2014). Within this literature, two main channels have been specified through which agents can affect change. One approach emphasises ‘critical junctures’ such as financial crises, war or international treaties, which disrupt institutional stability and replace existing arrangements with a new set of institutions (Cortell and Peterson, 1999). However, this only provides a partial explanation, since individuals decide when and how to respond to ‘critical junctures’. A second approach therefore highlights the importance of bargaining between agents in bringing about incremental adjustments that add up to substantial institutional change over time (Thelen, 2012).

This emphasis on bargaining dynamics provides a suitable theoretical foundation for analysing patterns of change in Chinese capital markets. Institutional structures in China reflect a combination of proactive and reactive policy experimentation that facilitates constant ad hoc adjustment to endogenous and exogenous challenges (Heilmann and Perry, 2011). The prerequisite for such experimentation in any political economy is the openness to random discoveries of new ideas and solutions through institutions, policy processes and actors (Taleb, 2008). Such policy experimentation can take place in authoritarian regimes such as China as long as the government is willing to encourage the decentralised accumulation of new knowledge across government bodies and market agents (Heilmann and Perry, 2011). It is therefore argued that understanding the changes in China’s QFII/RQFII programmes requires unravelling how such change is embedded within bargaining dynamics between Chinese political elites, domestic and foreign corporate interests.

For this purpose, the paper links the literature on institutional change to theories of Chinese elite politics. Adopting such a cross-disciplinary perspective allows for moving beyond the focus on Western liberal democracies in institutional change theory. This is important, since conclusions based on Western contexts are unlikely to hold in authoritarian one-party regimes such as China. The literature on Chinese elite politics highlights the importance of factional conflicts both within the CCP leadership (Shih, 2008) and between CCP leaders and vested interests such as military members (Yang, 2004). Others emphasise the role of policy entrepreneurs (Bell and Feng, 2013) and party leaders' intervention into day-to-day policy-making by bureaucratic institutions (Bell and Feng, 2009). Combined, these works highlight the necessity of adopting a regime-specific approach, which offers a politically sensitive reading of institutional change across different levels of government within China's one-party state.

A key challenge in this respect is the conceptual ambiguity of how to define 'political elite' in the Chinese context. Terms such as 'Leninist state', 'central government' and 'party leadership' are often used interchangeably (Collins and Gottwald, 2014; Green, 2004). Bell and Feng (2013: 48) therefore propose a distinction between 'bureaucrats' and 'Communist Party leaders', whereby the latter can resort to 'management by exception'. The notion of 'management by exception' refers to policy issues or crises that require external intervention from CCP leaders into policy-making by bureaucrats (Shirk, 1992). This authority to intervene 'from the outside' and maintain the final say over policy decisions is what distinguishes CCP leaders from bureaucrats in their capacity to affect institutional change. This leads Bell and Feng (2009) to equate 'elite' exclusively to 'CCP leaders'. The problem with this definition is that senior bureaucrats can also be member of the CCP Politburo Standing Committee, China's top ruling body. For example, the former head of the State Planning Commission, Yao Yilin, simultaneously held the position of Politburo member. The notions of 'bureaucrats' and 'party leaders' are therefore blurred which makes their conceptual dichotomy analytically problematic.

The definition of 'political elite as CCP leadership' also downplays the bottom-up power of policy entrepreneurs among Chinese bureaucratic institutions. Originating from the institutional change literature, 'policy entrepreneurs' are advocates willing to invest their resources to achieve favourable policy outcomes or the prominence of an idea that they support (Kingdon, 1995). In the Chinese politics literature, previous works have argued that bureaucratic entrepreneurs play a key role in policymaking: they articulate policy solutions, form alliances and exploit external crises or internal power rivalries to tip the balance of power toward institutional reform (Mertha, 2009). The effectiveness of policy entrepreneurs depends on their degree of autonomy, whereby policies promulgated by high-authority bodies are more effective than those implemented by low-authority bodies. Empirical findings have nonetheless remained inconclusive, either portraying CCP leaders as powerful enough to override bureaucratic resistance (Bell and Feng, 2009) or as outmanoeuvred by government bureaucracy (Moore, 2002).

The problem behind such inconclusiveness is partly that the underlying conditions shaping the autonomy of policy entrepreneurs are neglected if not missing. Recent advances identify long-term personal relationships and the fragmented structure of the Chinese party-state as key variables. Bell and Feng (2013) show that the Chinese central bank has plenty of administrative resources and informal authority over financial reforms thanks to close ties between central bank governor, Zhou Xiaochuan, and Politburo members. Furthermore, CCP leaders often grant administrators substantial policy autonomy, as they lack the expertise to evaluate the decisions from subordinate government bodies.

Extending these insights to Chinese cross-border finance, others highlight interdependencies between different levels of the Chinese government and corporate agents that best serve

strategic policy interests (Töpfer, 2015). At the highest level of government, CCP leaders require the support of politically relevant agents to ‘manage’ international pressure for liberalising Chinese capital markets, whilst safeguarding state control over the domestic financial system (Schlichting, 2008). In this context, the ‘political relevance’ of foreign investors depends on their ‘global visibility’, that is, their presence in terms of global operations and well-known brand names. Echoing the premises of transaction cost theory, this is because distance increases information asymmetries between agents across space due to differences in economic practices, institutions and cultural background (Chan and Covrig, 2012). When interacting with foreign agents, local agents therefore tend to favour those with a widespread international presence to reduce information asymmetries (Clark et al., 2015). Applying this logic to China’s capital market opening, it is posited that domestic financial regulators prefer foreign investors with considerable visibility in their global operations and well-known brand names. For one, greater familiarity with foreign investors safeguards the government’s control over domestic financial reform. Furthermore, attracting the biggest industry names also serves as a rubber stamp to advertise China’s reform efforts and thus ease international pressure for financial liberalisation (Hu, 2005). In sum, favouring the biggest and thus most visible global brand names therefore enables the Chinese party-state to ‘manage’ potential political costs, both in terms of harnessing domestic control and international recognition.

The political relevance of corporate agents is also shaped by their supply of policy-relevant information. The CCP leadership has extensive policy agendas but limited human resources with specialist financial expertise. This generates uncertainty about the potential consequences of financial reforms, which risks undermining the CCP’s authority within the Chinese party-state. To mitigate such uncertainty, the CCP accommodates corporate interests that hold market-specific insights and thus enjoy informational advantages over party leaders. We can distinguish between two types of information: insights into domestic interests such as state-owned financial institutions⁷ and market knowledge from foreign investors. The former matters because China continues to rely predominately on lending from state-owned banks to finance economic growth (Elliott and Yan, 2013). Foreign knowledge supply matters because China has sought to emulate Western financial practices to develop its financial services industry (Robertson, 2015).

The CCP’s susceptibility towards these resources is mediated by privileged personal relationships (*guanxi*) between corporate interests and party cadres, as they provide a basis for mutual trust and collaboration. Foreign entities can acquire *guanxi* through various channels. One way is the recruiting of ‘princelings’ (*taizi dang*), that is, family members of Communist Party leaders, which have become important new actors in Chinese finance (Robertson, 2015). Another channel is geographical proximity. Drawing on transaction cost theory, geographical proximity facilitates familiarity, by fostering close bilateral economic relations (Chan and Covrig, 2012). As Chinese area studies show, such familiarity is especially pronounced among regional ‘clusters’ that have the same ethnic Chinese background and a shared group identity based on a common language, ancestry and social values (Soontiens, 2007). Foreign firms from countries with ethnic Chinese majorities such as Singapore tend to have stronger local relationships than firms from other foreign countries (McNally, 2011). It is therefore posited that Chinese policy-makers are more receptive towards foreign investors from regional clusters with a common ethnic Chinese identity. Giving priority to culturally close regional clusters allows domestic policy-makers to ‘manage’ uncertainty surrounding policy experiments such as the opening of domestic capital markets and promoting the more widespread use of Chinese currency. Experimenting with these new policies in a familiar regional and thus more controllable setting affords the Chinese party-state a stronger grip over the speed and scope of financial reforms. Consequently, this turns culturally close regional clusters into an important

resource for market access, as they serve the Chinese government's strategic interests for domestic control.

At the policy implementation level, administrative bodies have an incentive to frame reform proposals in line with the party leadership's reliance on the above resources. The strategic use of rhetoric enables bureaucrats to advance their own policy agendas and maximise policy autonomy (Collins and Gottwald, 2014). Framing is thus an important resource for policy entrepreneurs to minimise the risk of 'intervention from above'. The emphasis on the enabling mechanisms of policy entrepreneurship links the bottom-up agency of administrators with CCP leaders' external agency of top-down intervention. Since both party leaders and bureaucrats shape institutional change, albeit through different channels, this paper adopts a broader conception of 'political elite' that encompasses both CCP Politburo members and administrative institutions.

In the case of the QFII programme, the main administrators are the CSRC and the State Administration for Foreign Exchange (SAFE). The CSRC has autonomy over approving QFII licenses, whereas SAFE is tasked with allocating investment quota to QFII license holders. Similarly, the RQFII scheme requires investors to obtain a license from CSRC and investment quota from SAFE. Application materials are then submitted to the People's Bank of China (PBOC), the Chinese central bank, which regulates the RMB cash accounts of RQFIIs and also oversees the policy moves of SAFE. As such, CSRC, SAFE and PBOC are bestowed with significant decision-making authority over the composition of the foreign investor pool within Chinese capital markets. It is the bargaining dynamics between these policy implementation bodies, the CCP's Politburo members and corporate interests that this paper concentrates on.

These bargaining dynamics, and the individual choices of political leaders underpinning them, are shaped by exogenous shocks such as economic crises. Such crises can trigger 'critical junctures' (Cortell and Peterson, 1999) by changing what agents perceive to be 'appropriate' ideas of how to achieve economic progress. These changes in economic thinking lead to a shift in policy incentives and thus reshuffle the constellation of desired resources. The 1990s Asian financial crisis illustrates the importance of such ideational shifts for understanding policy change in China's financial sector. The crisis eroded the legitimacy of and increased Chinese resentment towards dominant neoliberal ideas such as deregulation (Kirshner, 2014). This prompted Chinese political elites to search for ideational alternatives, by emphasising state-directed capital controls that keep out momentum-driven investors (Walter and Howie, 2012). As a result of such paradigm shifts, the receptiveness of Chinese policy-makers toward foreign investors becomes conditional on the supply of stable and thus controllable capital investments.

Combined, the above insights from the Chinese elite politics and institutional change literatures form the theoretical foundation of the following case study of QFII/RQFII reforms. The key premise is that institutional change in Chinese financial markets is driven by an interdependent exchange of resources between different levels of government within the Chinese party-state, domestic and foreign corporate interests.

DATA AND METHODOLOGY

This paper uses a two-step approach to trace the bargaining dynamics underpinning the changes of the QFII/RQFII programmes. In-depth qualitative methods allow for investigating such micro-level factors. Based on snowball sampling, personal interviews were chosen as the predominant form of inquiry. In the first step, multi-stakeholder interviews⁸ were conducted (n D 91) in English or Mandarin with officials from CSRC, SAFE and PBOC, the three QFII/RQFII administrative bodies, covering the Intermediary and Investment Fund Supervision (证券基金

机构监管部), Capital Account Administration Department (资本项目外汇管理) and Monetary Policy Department II (货币政策二司). Other key stakeholders include senior officials from the Hong Kong Securities and Futures Commission (SFC) and stock exchange committees in Shanghai (SHSZ), Shenzhen (SZSE) and Hong Kong (HKSE). As some regulators may strategically downplay or hide political interference, their responses were cross-checked against local news sources, official documents and interviews with other stakeholder groups. These included government think-tanks including the Institute for World Economic and Politics (IWEP) and senior investment executives from QFII-licensed entities and state-owned banks.

In the second step, database analysis was conducted as a robustness check to supplement the interviews. The full directory of QFII approvals and company-level data on the hypothesised power resources was obtained from WIND Financial Terminal. Where firm-level information was unavailable, data from Thomson Reuters Worldscope were used. Overall, the sampling frame consists of 277 QFII approvals. The data cover all entities approved from the launch of the QFII scheme in 2002 to the end of 2014. The inclusion of the 2008 collapse of Lehman Brothers allows splitting the data-set into ‘pre-crisis’ and ‘post-crisis’ periods. This provides the ideal setting to detect any changes in policy attitudes and consequent market access decisions in response to the global financial crisis.

Based on the above two-step data triangulation, institutional change is measured based on changes in the timing, pace and scope of RQFII reforms. QFII/RQFII eligibility criteria are determined by investor type rather than on a case-by-case basis (CSRC, 2015). It is therefore important to examine changes in RQFII criteria at the group level of analysis rather than focusing on individual investment entities.

The asset size of QFII/RQFII applicants is used to gauge the Chinese government’s desire for attracting foreign investors with ‘global visibility’. This is because large investors, typically with more than USD 5 billion in asset size, have greater in-house resources to build global brand names (Clark et al., 2015). The supply of foreign expertise is measured based on years of investment experience (CSRC, 2015), thereby highlighting the Chinese assumption that investment experience equates to investment knowledge. To measure an investor’s contribution to financial stability, incentive structures are used as a reference point. It is assumed that asset owners with long-term liabilities such as pension funds and sovereign funds tend to adopt long-term investment horizons, thereby contributing to financial stability (Clark and Monk, 2010). In contrast, sell-side investment intermediaries including banks, hedge funds or securities companies tend to operate on shorter-term horizons, thus adding to financial volatility (Koller et al., 2010).

To measure relational capital, several data sources were used to capture the multi-dimensional nature of this concept. To identify CCP family connections, the list of QFII approvals was screened for ‘princeling’ recruits based on the multi-stakeholder interviews, Chinese and English media sources. Furthermore, data were collected from Taiwan’s Overseas Community Affairs Council⁹ (OCAC) database to measure shared cultural background within regional clusters. The percentage of ethnic Chinese among the total population of an investor’s country of origin was used as a reference point. To be assigned ‘shared cultural background’, at least 50% of a country’s population had to be ethnic Chinese. The third measure indicates whether the Chinese language is spoken in an investor’s country of origin. Drawing on data from CIA World Factbook, a binary variable was used, whereby only countries with Chinese as an official language were assigned to the category of culturally close regional clusters. All others were excluded. Based on this coding method, Hong Kong, Singapore, Taiwan and Macao all possess

relational capital but are classified as ‘foreign investors’ by the Chinese government (CSRC, 2015).

Overall, the combination of in-depth qualitative data supplemented by quantitative verification allows for moving away from the binary coding of economic outcomes that suggest either convergence or divergence with Western financial governance. By integrating the perspectives of Chinese policy-makers, domestic corporate interests and foreign investors, this approach captures the interplay of market forces and state control, which suggests that a ‘zero-sum game’ is not the format of Chinese capital market development.

RESULTS AND DISCUSSION

This section evaluates the empirical evidence and unfolds in three parts. The first part contextualises the creation of the QFII scheme, by linking the Chinese government’s strategic objectives with varying market access conditions across investor groups. The second part discusses the evidence on the party-state’s demand for investors with ‘global visibility’ and policy-relevant knowledge supply to explain the QFII scheme’s favourable eligibility criteria for sell-side investors in the pre-crisis period (2003–2008). The third part explains the reasons behind the U-turn in QFII market access criteria in the post-crisis period (2008–2014), by highlighting the shift in policy priorities towards financial stability and investors from geographically close countries with strong bilateral ties with China.

The uneven nature of capital market access in China

The creation of the QFII/RQFII schemes needs to be understood in the context of external and internal challenges facing the Chinese economy. Externally, China faced mounting international pressure due to its WTO entry in 2001, which required the opening of its largely isolated financial market to foreign investors. A key element of this liberalisation process was to loosen restrictions on shareholding positions and local operations for foreign banks, securities companies, insurance companies and other financial services (Lardy, 2002). This created a sense of urgency among CCP leaders to initiate stock market reforms, since the trade benefits from WTO membership were essential for sustaining economic growth (IWEP, interview, April 2014). The QFII approval system therefore provided a convenient solution for Chinese leaders to meet WTO demands without reducing government control over the volume and composition of capital inflows.

Within the party-state, QFII implementation was considered much less controversial than reforming the domestic banking sector riddled with powerful vested interests. State-owned banks dominate China’s financial system, providing about three-fifths of total credit (Elliott and Yan, 2013). Powerful government authorities such as the Ministry of Finance, which are major shareholders of these banks, have helped entrench this dominant position, by seeking to limit financial liberalisation. This prevented the diversification of financing sources toward the stock and bond markets (SZSE, interview, May 2014). Consequently, this raised the political costs of reforming the banking sector (CSRC, interview, April 2014).

The political willingness to change the status quo was also curbed by the fact that administrative authorities have been complicit in perpetuating the interests of state-owned banks. For example, despite its mandate as a market regulator, the CSRC has frequently given preferential treatment to state-owned enterprises (SOEs) for new stock listings¹⁰ (Du, 2011). This was partly due to CSRC’s weaker bargaining position in light of insufficient resources to discipline SOEs with powerful links to the Finance Ministry (Naughton, 2015). Providing

market access to a limited number of QFIIs thus provided a politically acceptable tool for complying with the party leadership’s priorities to meet WTO requirements without stepping on the toes of powerful vested interests at home.

The CSRC’s balancing act between preserving control to appease vested domestic interests and leveraging foreign know-how for domestic reform is reflected in its piecemeal approach to QFII reforms (Figure 1). Only 26 foreign institutions were approved in the first two years of the QFII scheme (CSRC, 2015). This reluctance to open up the domestic market was reinforced by the lessons learnt from the Asian financial crisis and China’s success with restraints on ‘hot money’ (SAFE, interview, May 2014). Such ‘hot money’ inflows denote international funds that are sensitive to differences in interest rates, expectations of future economic growth and returns from holding securities. Even a small economic shock can lead to volatile movements in these investment flows, magnifying the impact of the shock and destabilising domestic capital markets and currencies. QFII administrators therefore sought to limit market access to what it considered to be long-term investors.

In sum, the creation of QFII and consequent advent of foreign participation in Chinese capital markets needs to be understood not only as a direct response to external pressures; it was also the result of political compromise to uphold the domestic balance of power, by limiting the scope of financial reform.

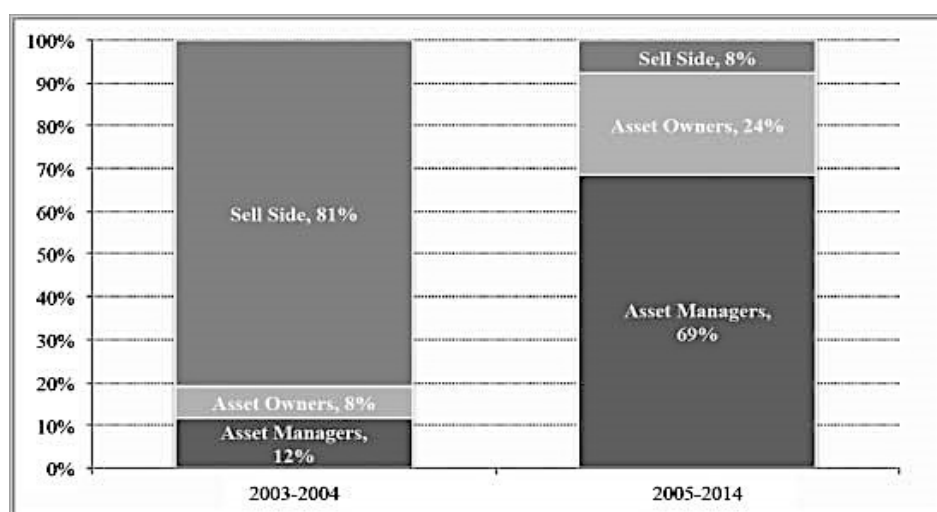


Figure 1 QFII market segmentation.

Source: Author’s own; based on data from WIND Information; rounded figures.

Given China’s policy emphasis on long-term investors, it is puzzling that access criteria and approvals throughout the launch phase of the QFII programme do not reflect these policy preferences. Asset size requirements were identical across different types of investors (Table 1). Furthermore, the vast majority of QFII approvals went to sell-side investors including commercial banks and securities companies (Figure 1). In contrast, asset owners and asset managers constituted only 8% and 12% of total QFII qualifications, respectively (Figure 1). Given their role as investment intermediaries, sell-side investors tend to adopt momentum-driven investment horizons (Koller et al., 2010). This reduces rather than enhances the regulators’ grip over ‘hot money’ inflows. The discrepancy between policy goals and policy actions highlights the lack of a coherent implementation strategy, which exposes the absence of a differentiated understanding of investment incentives. We will return to these ideas in the next

Table 1 The evolution of QFII eligibility criteria

Qualifying Component	Institutional Type	Phase I (2002-2006)	Phase II (2006-2012)	Phase III (2012-2014)
Investment License	Asset Manager	<ul style="list-style-type: none"> • ≥ 5 years • AUM ≥ USD 10bn 	<ul style="list-style-type: none"> • ≥ 5 years • AUM ≥ USD 5bn 	<ul style="list-style-type: none"> • ≥ 2 years • AUM ≥ USD 500m
	Insurance Firm	<ul style="list-style-type: none"> • ≥ 30 years • AUM ≥ USD 10bn 	<ul style="list-style-type: none"> • ≥ 5 years • AUM ≥ USD 5bn 	<ul style="list-style-type: none"> • ≥ 2 years • AUM ≥ USD 500m
	Securities Firm	<ul style="list-style-type: none"> • ≥ 30 years • AUM ≥ USD 10bn • Paid-in capital ≥ USD 1bn 	<ul style="list-style-type: none"> • ≥ 30 years • AUM ≥ USD 10bn • Paid-in capital ≥ USD 1bn 	<ul style="list-style-type: none"> • ≥ 5 years • AUM ≥ USD 5bn
Quota Cap	Commercial Bank	<ul style="list-style-type: none"> • Top 100 globally • AUM ≥ USD 10bn 	<ul style="list-style-type: none"> • Top 100 worldwide • AUM ≥ USD 10bn 	<ul style="list-style-type: none"> • ≥ 10 years • AUM ≥ USD 5bn
	Other (pension fund, SWF etc.)	<ul style="list-style-type: none"> • Not specified 	<ul style="list-style-type: none"> • Not specified 	<ul style="list-style-type: none"> • > 2 years • AUM ≥ USD 500m
		USD 800m	USD 1bn	USD 1bn*

*Quota for government-led entities including SWFs and monetary authorities could exceed USD 1bn

Source: CSRC; SAFE; compiled by author.

Note: AUM = assets under management; SWF = sovereign wealth fund.

section. For now, the key point is that this initial knowledge vacuum and the policy uncertainty this generated paved the way for the receptiveness of QFII administrators toward corporate resources.

Interestingly, the QFII market segmentation took a drastic turn over time. The majority of approvals since the QFII launch phase have been buy-side investors with long-term investment commitments including pension funds, sovereign funds and asset managers. Combined, asset owners and asset managers accounted for 93% of total QFII approvals, which suggests a fundamental evolution in policy understanding (Figure 1). The remainder of this paper sheds light on the explanatory factors underpinning this U-turn in policy direction.

Global visibility as ‘magic bullet’ for market access

Reflecting China’s cautious approach to capital market opening, initial QFII eligibility criteria imposed high requirements in terms of investment experience and asset size. Concerning the former, a successful track record enabled the CSRC to gauge the sophistication of past investment decisions (CSRC, interview, April 2014). Interacting and learning from the most experienced global investors was viewed as the ‘gold standard of investing’ (SZSE, interview, May 2014). The problem was that many of the dedicated China funds were either too small or lacked the required track record (QFII-licensed bank, interview, November 2013). By setting the regulatory bar very high, smaller fund managers with context-specific expertise were thus excluded.

At first, these decisions appear paradoxical since they undermine the CSRC’s objective to attract and learn from the most knowledgeable investors. However, equating the ‘best’ investors to the most experienced and largest firms made it possible to accommodate both domestic and foreign policy priorities. In domestic terms, cherry-picking the most knowledgeable foreign investors provided a dual resource for strategic knowledge transfers and domestic appeasement. It allowed for ‘downloading’ fund management expertise and risk-control technology from top players in global finance, thus making it available to local Chinese investment organisations and financial regulators (HKSE, interview, April 2014). As these strategic knowledge transfers also benefited local vested interests, this allowed for appeasing the reform opponents who viewed foreign competition as a threat to SOE dominance in China’s financial system.

From a foreign policy perspective, trade surpluses and FDI had led to a rapid surge in China’s foreign exchange reserves, and thereby domestic RMB liquidity. As their size continued to grow, neutralising the effects of foreign reserves became increasingly difficult for China’s central bank (PBOC, 2000). Accusations of currency manipulation therefore rose among the international community, which threatened to protect against Chinese exports (Beattie and Dyer, 2009). This urged CCP leaders to consider non-central bank channels to encourage orderly capital outflows, whilst restricting capital inflows (QFII custodian bank, interview, June 2014). In this context, the QFII scheme provided a useful channel for controlling capital inflows, whilst publicly showcasing the CCP leadership’s ‘firm commitment’ to financial liberalisation vis-à-vis the international community. The best way to achieve this was to:

attract the best-known names in global finance to advertise the new quota scheme [QFII] as an international success story. It didn’t matter so much where the money came from, as there wasn’t much clarity about what that meant. What mattered was how much money they [QFIIs] had to boost the market. Foreign banks had structural [investment] products, which they could easily adapt to the Chinese environment. (QFII-licensed bank, interview, April 2014)

The high minimum thresholds for asset size and investment experience thus deliberately favoured sell-side investors, notably large investment banks. Although asset owners also met these qualifying thresholds, they tended to be much slower than their sell-side counterparts in exploiting these new investment opportunities, as they had to match the duration of their assets with long-term liabilities (QFII-licensed pension fund, interview, June 2014). In contrast, given their international visibility and role as intermediaries, sell-side investors were flexible enough to make rapid investment decisions. This allowed Chinese policy-makers to leverage the QFII programme as a foreign policy tool to counter mounting financial liberalisation pressures, thus granting sell-side investors a first-mover advantage. The combined supply of sell-side investor resources best served these strategic interests of the Chinese government. According to one of the first QFII-licensed banks:

the big banks were much more familiar with China because many had multi-year dealings with the regulators from the investment banking side of things to do IPOs or Joint Ventures. They were able to attract the best local [Chinese] talent with overseas experience, often sons and daughters of high-ranking [CCP] officials. So the authorities already knew them and could devise eligibility criteria in co-consultation [with foreign banks]. (interview, November 2013)

The vast financial resources and visibility of foreign banks enabled Chinese policy-makers to attract the ‘big names’ in global finance. Furthermore, the close ties of their Chinese employees to the party leadership, and their associated knowledge of context-specific norms and customs, provided an important source of trust when opening up domestic markets to foreign investors. It was this simultaneous bundling of economic, relational and knowledge-based resources that provided Chinese policy-makers with an ideal policy tool to address external pressures to liberalise within a reliable setting.

To fully unravel why QFII criteria initially favoured sell-side investors, it is necessary to examine the impact of corporate resources against the backdrop of elite bargaining within the Chinese party-state. The QFII launch phase was a period of policy experimentation and learning given the absence of established financial governance tools. For example, the first chairman of the CSRC rejected the QFII application of Yale University, questioning why an education institution would invest in the stock market (QFII asset manager, interview, April 2014). This exclusion of educational foundations from the pool of investment candidates illustrates the initial knowledge vacuum on the characteristics of long-term investors. It was only after former Chinese President Hu Jintao visited the US, which included the Yale campus, that the university was granted a QFII license as the first foreign educational institution. Hu had met with endowment fund managers and Yale President Richard Levin, who had invited Hu to visit Yale during one of his six visits to China in previous years (Yale Endowment, 2007). Consequently, the authority to change the direction of administrative policy decisions clarifies that personal relationships between foreign investors and top CCP leaders are a critical resource through which change is initiated in the QFII programmes.

Sell-side investors were able to quickly exploit the initial lack of coherence between policy goals and actual approval decisions. Although these investors were recipients of QFII quota, they were often not the end users but lent their quota to third parties (SCMP, 2014b). Given that sell-side investors do not own their balance sheet, their business models and associated investment incentives differ from asset owners with long-term liabilities such as pension funds. SAFE fell short of differentiating between these incentive structures, which meant that hard rules on quota usage remained absent. Sell-side investors were thus able to lend out their quota for fee revenue, by transferring usage rights but not ownership, and without notifying the

authorities (IWEP, interview, April 2014). This provided an informal channel of market access to investor types such as foreign hedge funds, which had earned a poor reputation during the Asian financial crisis (SCMP, 2014b). The inability to track the original source of capital thus eroded regulatory control over capital inflows, which the Chinese government sought to ensure.

In sum, timing is essential in grasping how resource interdependencies shaped the first-mover advantage of sell-side investors. The Chinese government's need for foreign expertise was particularly acute throughout the QFII launch phase, as policy uncertainty was at its peak. The combination of internal knowledge vacuum and external pressure from the international community rendered the Chinese party-state receptive to the global visibility and market expertise of large sell-side investors.

Post-crisis shifts in resource interdependencies and the rise of policy entrepreneurs

The nature of the QFII programme took a drastic turn with the onset of the 2008 financial crisis. In absolute terms, fewer sell-side investors were approved between 2005 and 2014 than in the 2002–2004 QFII launch period (Figure 2). Whereas sell-side investors constituted approximately 81% of QFII approvals in the launch phase, their share dropped to 8% of total QFII approvals between 2005 and 2014. Conversely, the importance of asset owners and asset managers grew significantly from 8% and 12% in the launch phase to 24% and 69% of total approvals between 2005 and 2014. Asset managers overtook sell-side investors in 2008 and asset owners in 2012 based on total approvals.

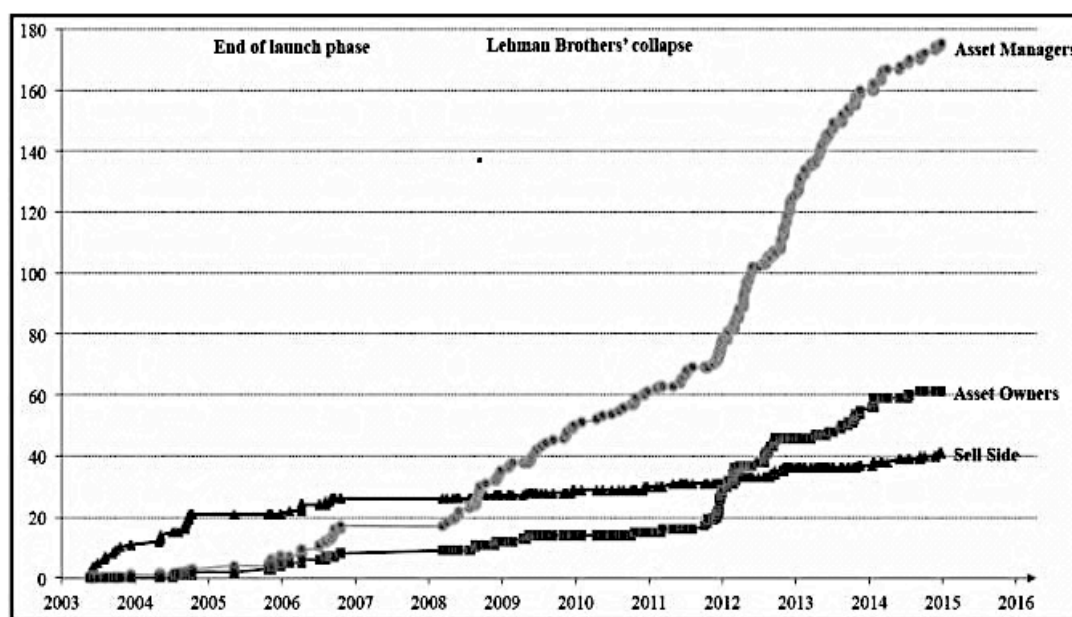


Figure 2 QFII licence approvals over time.

Source: WIND Information; author's calculations. Note: QFII approvals temporarily suspended in 2007 to ease pressure on RMB appreciation.

The U-turn in market access criteria can be explained by two developments, for which the 2008 crisis served as a catalyst: one aspect is reduced demand for QFII licenses. Tougher post-crisis capital and liquidity regulation imposed by Western governments meant that fewer foreign banks were able to submit QFII applications (QFII-licensed bank, interview, November 2013). More fundamentally, the crisis triggered a paradigm shift in attitudes within the Chinese party-

state. It eroded the legitimacy of America’s deregulation-led financial model and strengthened the view among Chinese elites that the notion of ‘free markets’ is a Western trap to undermine China’s sovereignty (Kirshner, 2014). This post-crisis erosion of trust undermined the receptiveness of Chinese policy-makers towards the supply of foreign financial expertise as a superior learning model for China. The near-total collapse of Western banks led QFII administrators to draw their own conclusions on how investment incentives affect financial stability. The end of preferential treatment for sell-side investors illustrates this well. The CSRC realised that financial intermediaries such as banks were the main source of inter-firm quota lending. Their vast financial resources were thus perceived as a greater threat to stability than smaller investment entities (SFC, interview, May 2014). Simultaneously, SAFE concluded that the investment experience of sell-side QFIIs made them more skilled at bypassing quota controls (SAFE, interview, May 2014). To address such concerns, the minimum quota application was lowered from USD 50 million to USD 20 million in 2009, which reduced the dependency of smaller asset managers on quota rents issued by large banks (SAFE, 2015). Sell-side investors now also faced the most restrictive requirements on assets size and investment experience across investor groups. In sum, these policy changes allowed for tightening the grip over capital flows, whilst enabling asset managers to take over as the dominant investor group.

QFII administrators also sought to fill past regulatory loopholes on quota lending (CSRC, interview, April 2014). Their 2011 decision to allow trading in stock index futures is a case in point. In response to a consultation paper, the CSRC specified that using futures as an instrument to sell financial access products would be deemed ‘unlawful foreign exchange behaviour’ (CSRC, 2011). In other words, foreign banks were prohibited from lending their QFII quota to third parties. This deliberate restriction of actions associated with previously established institutions is a key manifestation of the administrative learning process. The post-crisis reinterpretation of investment incentives resulted in a shift of sell-side institutions from being the most welcome to the least welcome QFII applicants.

In contrast, long-term asset owners such as pension funds enjoyed the most significant relaxation of QFII access criteria. In 2012, their requirements for investment experience were reduced from 30 to 5 years, whilst the minimum asset size was lowered from USD 10 billion to USD 500 million (CSRC, 2015). Preferential treatment was also extended to government-owned asset owners. For example, quota ceilings were eliminated for sovereign wealth funds (SWFs) and central banks but remained in place for all other investors (SAFE, 2015). This meant that asset owners formed an exclusive club of QFII favourites whose quota volumes exceeded the standard quota threshold of USD 1 billion (Table 2).

Table 2 Top QFII quota holders, USD 1 bn

Approved QFII entity	Total quota (USD m)
Hong Kong Monetary Authority	2500
Government of Singapore Investment Corporation	1500
Temasek Fullerton Alpha Investments	1500
Norges Bank	1500
ABU Dhabi Investment Authority	1500
Bank Negara Malaysia	1500
Kuwait Investment Authority	1500
Canada Pension-Plan-Investment-Board	1200
Qatar Holding LLC	1000

Source: WIND Information (2014); author’s compilation.

These privileges of asset owners must be understood from the perspective of post-crisis shifts in the party leadership's strategic priorities and the opportunities this provided for bureaucratic entrepreneurship. The party leadership under President Hu concluded that 'the American model is flawed and the West [does] not have a magic bullet for well-functioning capital markets' (HKSE, interview, June 2014). The Chinese central bank exploited these post-crisis changes, by linking the party leadership's goal of reducing dependency on Western markets with its own agenda of RMB internationalisation. PBOC governor Zhou Xiaochuan called for developing the RMB into 'an international reserve currency that is disconnected from individual nations and able to remain stable in the long-run' (cited in PBOC, 2009). However, PBOC officials worried these global ambitions were damaged by underdeveloped capital markets at home. This is because without sufficiently large and liquid capital markets, the incentives for foreign investors to hold RMB-denominated assets are significantly diminished, thus undermining the use of RMB in international transactions (PBOC, interview, November 2015). By framing capital market liberalisation as a prerequisite for RMB internationalisation and therefore long-term currency stability, the PBOC was able to strengthen the commitment of CCP leaders to financial reform. Such policy framing paved the way for widening capital inflows under the QFII scheme, by recruiting supporters for the pro-reform camp among the party's top decision-makers.

The PBOC's reform agenda clashed with the policy preferences held by CSRC. As shown earlier, CSRC sought to protect state interests in the banking sector, which vehemently opposed any changes to the status quo. However, the CSRC faced strong political headwind given the PBOC's backing by the party leadership and its administrative mandate to oversee SAFE's policy decisions. Against this backdrop, government-controlled asset owners were selected as pioneers for experimenting with the removal of QFII quota ceilings (SAFE, 2015). The CSRC was happy to support this policy move, since their government linkage gives these investors a strong disincentive to 'rock the boat politically' (CSRC, interview, April 2014), thus reducing the risk of exposing bad corporate governance in state-owned banks. Whilst these investors have plenty of capital to invest, they were also seen as a 'safe bet': their capital supply stems from public sources and thus involves a bureaucratic process driven by longer-term and mostly passive allocation strategies (CSRC, interview, April 2014). Their preferential treatment thus avoided upsetting domestic vested interests.

Simultaneously, the unique characteristics of government-controlled asset owners such as monetary authorities helped advance the PBOC's agenda of RMB internationalisation. According to the global head of central banks and SWFs at Standard Chartered:

at least 40 central banks have invested in the yuan [...] The QFII quotas granted to central banks are up to ten times larger than others in the programme and, most importantly, free of any capital controls. The yuan has effectively already become a de facto reserve currency because so many central banks have already invested in it.
(cited in SCMP, 2014a)

This mattered because the 2008 crisis forced CCP leaders to recognise that over-reliance on the US dollar resulted in excessive exposure to global liquidity shortages and thus a reduction of trade finance. This was a key concern for political elites, since trade remains critical for sustaining Chinese economic growth (IWEP, interview, April 2014). The PBOC emphasised that attracting foreign monetary authorities would reduce such spill-over effects of global liquidity crises on trade (PBOC, interview, November 2015). Building up currency reserves enabled these asset owners to promote RMB internationalisation and thus contribute to the government's objective of long-term currency stability in a way that any other investor cannot.

Consequently, this provided the PBOC with an important resource to sow the seeds for further reform by linking QFII privileges for asset owners to the CCP's economic growth agenda.

The role of such policy entrepreneurship is echoed in the timing and pace of QFII approvals. In 2012, 72 new QFIIs were approved, more than in the previous three years combined (CSRC, 2015). This reflects the accelerated reform momentum following the 2008 crisis but also internal shifts among domestic vested interests. As non-performing loans and defaults on existing loans surged in the post-crisis period, the Chinese banking sector experienced increasing liquidity problems (HKSE, interview, May 2014). This also had spill-over effects on China's asset management companies (AMCs). These are directly linked to banks, given their role of purchasing bad debt from large state-owned banks. As new non-performing loans surged, the failure to recover bad debt resulted in a cash crunch among AMCs (Walter and Howie, 2014). The risk of an industry-wide banking crisis thus rose in the post-crisis period. Since China continues to rely heavily on bank lending to finance economic growth, these risks generated a sense of urgency among CCP leaders to alleviate bad debt by raising fresh capital.

The PBOC's push for QFII reforms promised to turn Chinese banks and AMCs into major beneficiaries of accelerated capital inflows, by easing the burden of potentially unproductive bank lending. Exploiting QFII reform as an alternative source of bank financing also supported the party leadership's objective of curbing credit growth to address China's mounting debt problem (QFII-licensed bank, interview, June 2014). The financial capacities of the largest globally visible foreign investors thus provided a powerful bargaining resource for the PBOC, as both domestic market players and CCP leaders became more willing to experiment with QFII reforms.

This openness to policy experiments was further boosted by the transition of power within the party's core leadership. At the 18th Party Congress in 2012, Xi Jinping was appointed as China's new President. As part of his leadership agenda, Xi announced the focus on easing China's capital controls (Zhongguowang, 2012). In response, a new leading group on 'Comprehensively Deepening Reform' was created in 2013, which extends the reform efforts of the existing 'Economic and Financial affairs' leading group. In an unprecedented departure from CCP tradition, Xi took over as Chairman of these groups. Such presidential consolidation strengthened the authority of the Leading Groups by centralising financial decision-making that was previously delegated to administrative agencies. These reform platforms weakened the influence of conservative QFII administrators such as CSRC, whilst strengthening the bargaining position of reform-orientated bodies such as PBOC. The structural changes at the highest level of the party hierarchy were therefore a crucial enabling condition for the acceleration of QFII approvals, by tipping the balance of power toward the pro-reform camp.

In sum, the evidence suggests that the transformation of QFII criteria can be explained by the post-crisis shift in resource interdependencies between Chinese political elites, domestic financial sector interests and foreign investors. The privileges granted to large buy-side investors reflected the lowest common denominator among the pro-reform camp and reform opponents. It was only when power was handed over at the highest level of government authority that the stalemate on financial reform was broken and QFII reform accelerated.

The role of culturally close regional clusters

Once sufficient governmental support was mobilised for capital market reforms as a tool for RMB internationalisation, QFII administrators started turning to China's neighbourhood. The changing geographical imprint of China's market segmentation reflects this. Whilst entities

from the Asia-Pacific region accounted for 40% of QFII approvals before the 2008 crisis, their share had risen to 59% of total approvals by 2014 (Figure 3). What is particularly striking is that, within this regional group, QFII approvals from countries with a shared ethnic Chinese origins surged. These include entities from Hong Kong, Singapore, Taiwan and Macao. These places have a cultural background akin to China, with ethnic Chinese majority populations, but are classified as foreign investors by the Chinese government. The share of investors with a common ethnic Chinese background rose from 56% of total Asia-Pacific approvals in the pre-crisis period to almost three-quarters in the post-crisis period (Figure 3). This ‘home bias’ in QFII approvals indicates that the CSRC’s receptiveness towards foreign investors had shifted towards a growing emphasis on familiar regional settings.

Allowing investors from Asian neighbouring areas to ‘jump the queue’ in the QFII approval process provided a ‘reliable testing ground’ for leveraging domestic capital market reform as tool for RMB internationalisation (SZSE, interview, June 2014). This partly explains the surge of investors with *guanxi* in the overall QFII composition because places such as Taiwan and Singapore have large RMB deposits compared with Europe and America (QFII-licensed bank, interview, April 2014). Similarly, developing the offshore RMB market in Hong Kong served as

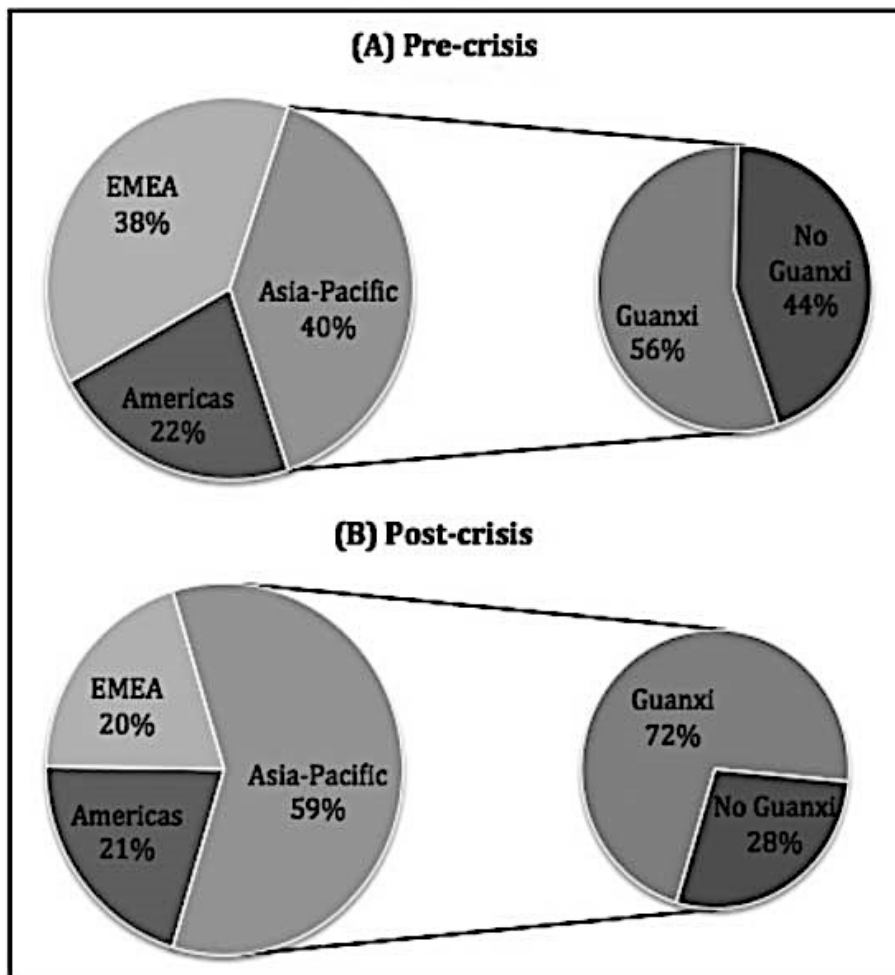


Figure 3 Breakdown of QFII approvals.

Source: WIND Information; author’s calculations. Note: Pre-crisis, 2003–2008; post-crisis, 2008–2014.

a step toward the more international use of Chinese currency (HKSE, interview, May 2014). This explains why the Hong Kong Monetary Authority holds USD 2.5 billion in QFII quota, the single largest quota volume granted to any foreign investor (SAFE, 2014). In sum, the shared cultural background within regional clusters, coupled with the large pools of offshore RMB held in their home jurisdictions, allowed QFII administrators to test the reaction of overseas financial markets to RMB internationalisation before expanding beyond Asia.

A similar logic applies to the expansion of market access channels. In 2011, the RQFII programme was launched, the RMB-denominated version of the QFII scheme. This programme was initially only open to Hong Kong subsidiaries of Mainland Chinese firms. Given its political relationship with Mainland China and *de facto* role as China's offshore financial centre, Hong Kong has by far the largest deposits of RMB outside Mainland China (HKMA, 2015). It was thus the obvious choice in geographical location to experiment with RMB internationalisation (SFC, interview, April 2014).

Since Hong Kong investors are classified as 'foreign investors' by the Chinese government, they are able to obtain investment licenses under both the QFII and RQFII schemes. Under the former, investors face restrictions on asset classes, lock-up periods of up to 12 months and require repeated approvals from the Chinese authorities before money can be repatriated (CSRC, interview, April 2014). Under the RQFII scheme, none of these restrictions apply. In 2013, the Chinese authorities extended the RQFII scheme to all foreign institutional investors providing that these are domiciled in Hong Kong (HKSE, interview, May 2014). This multi-channel market access provided investors in Hong Kong with a competitive advantage over investors limited to QFII status. In sum, investors from culturally close regional clusters enjoyed a first-mover advantage in the launch phase of the new RQFII scheme. However, the importance of geographical relocation clarifies that RQFII 'home bias' had an inclusive effect in later policy stages: once RQFII had been tested as a new market entry channel, what mattered was not solely a firm's country of origin but the chosen geographical location for its operations.

CONCLUSION

This paper sought to explain the institutional changes in China's QFII/ RQFII programmes, by examining why the Chinese government's strategic objectives shifted in terms of which type of foreign investors to grant access. As China has gradually relaxed the requirements for capital market entry, one would expect that more foreign investor groups become eligible for investment. Yet, market access remains limited to entities approved under the QFII/RQFII schemes whose eligibility criteria vary significantly across investor types. The empirical findings show that changes in QFII/RQFII approvals are a foreign policy game shaped by time-sensitive interdependencies between different levels of government within the Chinese party-state, domestic financial sector interests and foreign investors. Those foreign investors, which best served the objectives of Chinese political elites and their vested corporate interests, were most likely to benefit from preferential QFII/RQFII access. The nature of these bargaining dynamics shifted, as the 2008 crisis triggered a U-turn in Chinese policy goals, which led to substantial changes in the QFII/RQFII programmes.

Initially, the CSRC equated a large investor size and long track record with a responsible approach to investment, without differentiating between investment incentives. This knowledge vacuum, coupled with international pressure on China's financial liberalisation, enabled sell-side investors to gain a first-mover advantage and become the dominant investor group under the QFII scheme. The 2008 crisis triggered a paradigm shift in Chinese policy attitudes, which altered the government's receptiveness toward corporate resources and thereby changed QFII's

market composition. Asset owners and asset managers now enjoyed preferential treatment over sell-side investors and replaced them as the dominant market force. This reflected the more differentiated policy understanding of investment incentives and their effect on financial stability.

The launch of the R-QFII scheme also revealed that market access approvals shifted towards a growing home bias in the post-crisis period. Regional investors from countries with ethnic Chinese majorities were granted privileged access under the new RQFII scheme before those from other foreign countries. This is because China's offshore centre in Hong Kong and its Asian periphery with common ethnic origins provided a 'safe' regional laboratory for linking onshore and existing offshore RMB markets before creating new RQFII hubs elsewhere. Once the effects of these policy initiatives unfolded, Chinese regulators also integrated non-Chinese investors willing to relocate to Hong Kong. This highlights that geography shapes the choices of Chinese leaders in two fundamental ways: Bequeathed familiarity within culturally close regional clusters is given priority when new regulation is tested and uncertainty is high. Acquired familiarity by means of geographical relocation also matters albeit with a time lag in subsequent policy stages. This is because the 2008 crisis compelled Chinese policy-makers to use preferential market access as a strategic tool to develop its RMB offshore market worldwide.¹¹ Timing is therefore decisive for whether geographical proximity enables relational proximity in China's market access decisions.

The findings pose a challenge to the 'end of geography' thesis that location no longer matters in finance and financial policy-makers no longer exert full control over their regulatory territory (O'Brien and Keith, 2009). Scholars have increasingly emphasised that relational rather than geographical proximity provides the 'soft' framework for learning and trust in global networks (Wolfe and Gertler, 2004). However, as the findings revealed, foreign investors were able to increase their relational capital toward Chinese regulators, by shifting their geographical location. This clarifies that relational proximity and geographical proximity can function as complementary rather than competing forces.

The paper also showed that the institutional changes in QFII/RQFII programmes were not solely the result of the 2008 crisis. The key points were deliberate political choices to engage with the uncertain post-crisis environment and experiment with new policies to adjust to changing circumstances. These choices were the result of bargaining and compromise solutions between CCP leaders, administrative bodies and vested corporate interests. The timing, accelerated speed and widened scope of QFII/RQFII reform reflected the strategic priorities of the new party leadership under President Xi Jinping. The creation of new financial policy groups and their personal oversight by Xi shifted the locus of authority from administrative agencies toward the party leadership. This lent powerful support to the PBOC's call for domestic capital market reform as a foundation for RMB internationalisation. Despite resistance from administrative bodies and the domestic financial sector, the PBOC linked QFII/RQFII reform to the CCP's dependency on financial stability and sustained economic growth. Such framing provided an effective tool for exploiting changes in the post-crisis economic environment, generating reform commitment among party leaders and recruiting supporters from opposing administrative bodies.

The findings of this paper have important implications for the study of institutional change in China. To fully grasp the role that elite bargaining plays, it is necessary to investigate the micro-level resources that underpin effective policy entrepreneurship such as individual leadership ability and skilful rhetoric. At the structural level, it is important to examine how these resources are deployed in multi-level governance games. As we have seen, policy entrepreneurship at the highest level of the Chinese government paved the way for effective policy entrepreneurship at

subordinate levels of government, by shifting the balance of power within China's bureaucracy. These findings clarify that underneath formal institutional stability there can be substantial functional change. Whilst China's capital control system has displayed remarkable institutional resilience, the nature of QFII/RQFII criteria has undergone a functional transformation over time. In the pre-crisis period, QFII/RQFII functioned as a foreign policy tool to address financial liberalisation pressures, whereas it served as a major stability mechanism in the post-crisis period. Initial QFII/RQFII arrangements no longer 'functioned' in light of China's RMB internationalisation strategy and thus increased pressure for changing existing institutions or creating entirely new ones such as the RQFII programme. The institutions supporting Chinese cross-border finance may thus 'appear' stable as formal institutional characteristics remain intact but they still undergo functional change that alters the logic behind them.

The theoretical significance of these findings is that shifts in bargaining dynamics, often triggered by a combination of policy entrepreneurship, incremental learning and external shocks, transform the ideas of agents about political and economic outcomes. Such bargaining dynamics matter significantly in explaining the initiation and evolution of QFII/RQFII programmes. By extension, the paper challenges claims that the global spread of liberal market forces has reduced the role of the state (Büthe and Mattli, 2011). As the case of China demonstrates, the party-state plays various roles in cross-border finance: it may act as a creator, enabling force or brakeman of market access.¹² Consequently, this study lends support to more pluralist perspectives in political economy, which emphasise that growing cross-border linkages are not replacing nation-states; they are instead creating new transnational networks of power (Cerny, 2010).

The broader conclusion is thus not simply that globalisation pressures give rise to variegated roles of the state beyond a mere regulatory function of markets. It is that firm-government bargaining in situations of uncertainty is essential for understanding how the spread of liberalism unfolds across borders and why institutional change occurs.

NOTES

1. In this paper, 'one-party regime' refers to single-party systems such as China, which prohibit opposition parties from entering political decision-making. For alternative conceptions that include dominant-party regimes see Magaloni and Kricheli (2010).
2. The 2014 Shanghai-Hong Kong Stock Connect Scheme provides another channel for foreign investors to access Chinese stock markets.
3. Given the specific focus on QFII/RQFII reforms, this study concentrates mainly on the role of foreign investors. However, other corporate actors such as Chinese banks and AMCs also shape market access decisions. Examples include access to loans and non-performing assets of which a large share is owned by AMCs to support China's banking sector. These domestic players are state-owned and managed by executives with dual identities as party cadres. The way in which their interests precondition the objectives of the Chinese party-state is therefore also considered in this paper.
4. Foreign indirect investments differ from foreign direct investments (FDI). Investments typically count as FDI if an investor controls at least 10% of a firm's voting stock and owns the assets himself (OECD, 2008). In contrast, foreign indirect investments refer to foreign entities that pool investor money to buy or sell financial assets in another country.
5. This paper defines 'institutions' as formal or informal norms, rules and enforcement mechanisms that are grounded in the common expectations between social agents and therefore guide their behaviour

6. This paper focuses on institutional change, by examining the evolution of QFII/RQFII eligibility criteria. Since QFII/RQFII criteria are legally binding rather than voluntary benchmarks, any shifts in these criteria are concerned with processes of ‘change’, that is, the replacement of existing policy content. This is distinct from policy ‘revision’, which entails the less stringent idea of adjusting policy content prior to implementation such as during policy consultations.
6. These include China’s state-owned banks and AMCs, which are directly linked to powerful ministries and party bodies. For example, the Ministry of Finance has legal ownership of China’s AMCs. It can also influence financial regulation through both its direct shareholdings in the major banks and its control over the Central Huijin Company, through which it indirectly owns large stakes in banks. This paper remains receptive to these vested domestic interests insofar that they shape policy decisions on RQFII reforms.
7. The data-set of multi-stakeholder interviews covers a period of four years (2013–2015).
8. OCAC is a cabinet-level council of Taiwan that collects data relevant to cultural and economic exchanges between Taiwan and ethnic Chinese overseas communities.
9. Examples of the CSRC’s political favouritism include its support for the political campaign of former Premier Zhu Rongji to rejuvenate SOEs as the main pillar of the Chinese economy. This was reinforced by pressure from the State Asset Supervision and Administration Commission, which pushed the CSRC toward privileged IPOs and higher sales prices for SOEs (Du, 2011).
10. Since its launch in Hong Kong, the RQFII scheme has expanded to other overseas locations including the UK, Singapore, France, South Korea, Germany, Luxembourg and Canada. However, the geographical advantage of Hong Kong remains, as it holds the largest quota size compared with all other RQFII trading hubs.
11. Financial globalisation is defined as the free movement of financial flows across national boundaries without restrictions, enabled by the international diffusion of liberalising measures (Büthe and Mattli, 2011).

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CHAPTER 5
(Journal Offprint)

**London's rise as an offshore RMB financial centre:
State–finance relations and selective institutional
adaptation**

London's rise as an offshore RMB financial centre: state–finance relations and selective institutional adaptation

Laura-Marie Töpfer^a and Sarah Hall^b

ABSTRACT

London's rise as an offshore RMB financial centre: state–finance relations and selective institutional adaptation. *Regional Studies*. China's currency, the renminbi (RMB), is increasingly important in global financial markets, facilitated by the global expansion of offshore RMB centres. This paper examines London's development as the first Western offshore RMB centre established in 2013, drawing on original research conducted between 2013 and 2015 in London and China. The longitudinal analysis reveals that the development of RMB finance in London is characterized by selective adaptation in which state–private bargaining dynamics have shifted from strategic alignment to a bifurcation of interests. Understanding these state–finance relations has important implications for research and policy-making concerned with (offshore) financial centres and RMB internationalization.

KEYWORDS

Financial centres; renminbi internationalization; offshore finance; City of London

摘要

伦敦兴起成为人民币离岸金融中心：国家—金融关系与选择性制度调适。 *Regional Studies*. 中国的货币—人民币（RMB）在全球金融市场中日益重要，并由人民币离岸中心的全球扩张所促成。本文检视伦敦于 2013 年成为第一个西方人民币离岸中心的发展，运用 2013 年至 2015 年间，在伦敦与中国所进行的原初研究。纵向分析揭露出伦敦的人民币金融之发展以选择性适应为特徵，其中国家—私人的议价动态，已从策略联盟转变至利益的分化。理解这些国家—金融关系，对于有关（离岸）金融中心与人民币国际化的研究及政策制定而言具有重要意涵。

关键词 金融中心; 人民币国际化; 离岸金融; 伦敦金融城

RÉSUMÉ

Essor de Londres en tant centre offshore pour le RMB (Renminbi): relations état-finances et adaptation institutionnelle sélective. *Regional Studies*. La monnaie de Chine, le Renminbi, joue un rôle de plus en plus important sur les marchés financiers du monde entier, un essor facilité par l'expansion mondiale des centres RMB offshore. Sur la base d'une recherche originale effectuée entre 2013 et 2015 à Londres et en Chine, la présente communication se penche sur l'évolution de Londres en tant que premier centre RMB offshore du monde occidental, fondé en 2013. L'analyse longitudinale révèle que le développement des finances en RMB à Londres est caractérisé par une adaptation sélective dans laquelle la dynamique des négociations des états – privées a évolué, en passant d'un alignement stratégique à une bifurcation d'intérêts. La connaissance de ces relations états – finances a de fortes implications sur la recherche et l'élaboration de la politique concernant les centres financiers (offshore) et l'internalisation du RMB.

MOTS-CLÉS

Centres financiers; internalisation du RMB; financier offshore; City de Londres

ZUSAMMENFASSUNG

Londons Aufstieg als Offshore-RMB-Finanzzentrum: Beziehungen zwischen Staat und Finanzen und selektive institutionelle Anpassung. *Regional Studies*. Die chinesische Währung, der Renminbi (RMB), spielt auf den weltweiten Finanzmärkten eine immer wichtigere Rolle, was durch die globale Expansion von RMB-Offshorezentren begünstigt wird. In diesem Beitrag untersuchen wir die Entwicklung von London zum ersten westlichen RMB-Offshorezentrum, das 2013 gegründet wurde; hierfür nutzen wir Originalstudien, die im Zeitraum von 2013 bis 2015 in London und China durchgeführt wurden. Aus der

Längsschnittanalyse geht hervor, dass sich die Entwicklung der RMB-Finzen in London durch eine selektive Anpassung auszeichnet, bei der sich die staatlich-private Verhandlungsdynamik von einer strategischen Ausrichtung hin zu einer Interessensverzweigung verlagert hat. Ein Verständnis dieser Beziehungen zwischen Staat und Finanzen hat wichtige Auswirkungen auf die Forschung und Politik im Bereich der (Offshore-)Finanzzentren und RMB-Internationalisierung.

SCHLÜSSELWÖRTER

Finanzzentren; Renminbi-Internationalisierung; Offshore-Finzen; Londoner Bankenviertel

RESUMEN

El ascenso de Londres como centro financiero extraterritorial del RMB: relaciones entre finanzas y Estado y la adaptación selectiva institucional. *Regional Studies*. La moneda de China, el renminbi (RMB), es cada vez más importante en los mercados financieros de todo el mundo, facilitado por la expansión internacional de los centros de RMB extraterritoriales. En este artículo analizamos el desarrollo de Londres como primer centro de RMB extraterritorial en Occidente establecido en 2013; y para ello utilizamos una investigación original realizada entre 2013 y 2015 en Londres y China. El análisis longitudinal indica que el desarrollo de las finanzas de RMB en Londres se caracteriza por una adaptación selectiva en la que las dinámicas de negociación estatales y privadas han pasado de ser una alineación estratégica a una bifurcación de intereses. Entender estas relaciones entre finanzas y Estado tiene implicaciones importantes para la investigación y la elaboración de políticas que tengan que ver con los centros financieros (extraterritoriales) y la internacionalización del RMB.

PALABRAS CLAVES

centros financieros; internacionalización del renminbi; finanzas extraterritoriales; distrito financiero de Londres

JEL F, F3, F33, G, G2

HISTORY Received 2 March 2016; in revised form 8 December 2016

INTRODUCTION

Great powers have great currencies.

(Mundell, 1993, p. 10)

With China's emergence as a major economic power, the Renminbi (RMB) has become increasingly important in global financial markets. Whilst the RMB had no international influence in the early 2000s,¹ it is now the fifth most-used currency for international payments and part of the International Monetary Fund's (IMF) basket of global reserve currencies (IMF, 2015). The main policy channel facilitating this growing use of the RMB is the Renminbi Qualified Foreign Institutional Investor (RQFII) scheme established in 2011. This approval system permits foreign investors to invest offshore RMB raised in designated international financial centres (IFCs) into Chinese securities for the first time. The geographical expansion of the RQFII scheme is increasingly giving global investors alternatives to the US dollar as the dominant currency. The internationalization of the RMB, and the rise of state capitalism underpinning this development, therefore, fundamentally challenges

how we think about the distribution of power in the international financial system.

These shifts in financial power are beginning to reshape established IFC hierarchies. Securing early approval from the Chinese government under the RQFII scheme equips IFCs with a competitive advantage over their rivals. It provides the exclusive right to use RMB offshore for trade, settlement and RMB-denominated assets, and thus increases the attractiveness of an IFC for global investors. Furthermore, once Chinese capital markets are fully liberalized, the total number of RQFII hubs will surge. Early approval allows more time to develop expertise in RMB products and integrate them into existing financial structures. IFCs with an established track record in RMB finance are then more likely to retain the confidence of global investors. This suggests that the Chinese government directly affects the distribution of power between IFCs by granting early RQFII approval to some centres but excluding others. Understanding the dynamics behind the development of offshore RMB centres is therefore critical to explain IFC competition in the decade ahead. Yet, empirical research on this topic remains scarce.

We address this empirical gap in the literature by investigating how the interplay between state and private interests has shaped London's development as an offshore RMB centre. London

was the first foreign RQFII hub to be approved by the Chinese government in 2013.² The subsequent development of London's infrastructure to access and process RMB payment flows has, however, lagged behind other RQFII hubs. Money centres such as Singapore have now overtaken London in terms of allocated RQFII quota and RMB trading volumes (Society for Worldwide Interbank Financial Telecommunication (SWIFT), 2014). This study seeks to analyse the drivers behind this shift and explain the uneven development of London's offshore RMB hub. Understanding this U-turn in London's RQFII experience from first-mover to relative laggard provides important insights into why some RMB trading centres succeed, whereas others fall behind their competition. The UK's recent 'Brexit' vote makes these insights particularly timely by providing a foundation for understanding how London's appeal as the leading RMB gateway to European markets evolves in future.

To investigate this puzzle, we draw on an original dataset of 121 multi-stakeholder interviews conducted in London and China's main financial and political centres: Shanghai, Beijing, Hong Kong and Shenzhen. This dataset covers the year in which London's RMB centre was created and its subsequent development. This enabled us to adopt a longitudinal approach by tracing the co-evolution of state and private sector interests across time and space. Interviews were then verified against Chinese and UK government documents and financial news sources. Such data triangulation allowed for the construction of a nuanced account of how state-private tensions shape the selective absorption of RMB finance into London's financial architecture.

This empirical analysis makes an important conceptual intervention by extending politically sensitive readings of the international financial system (Agnew, 2009, 2012; Cohen, 2015; Eichengreen, 2012). London's development as an offshore RMB centre demonstrates the need to examine what Agnew (2009) terms transnational 'money games': it is the relationship between finance and state power, both within and outside state jurisdictions, that is central to understanding global finance. We take this work as our conceptual starting point to examine the development of RMB finance in London. Our analysis borrows from organizational sociology on 'mimetic isomorphism' (Di Maggio & Powell, 1983) and its applications to global finance (Bassens, Engelen, Derudder, & Witlox, 2013; Djelic & Quack, 2007). These works examine how seemingly 'universal' economic practices require context-specific adaptation when entering new institutional landscapes. They emphasize how companies tend to replicate

organizational 'best practice' of a recognized lead firm, with the aim ultimately of supplanting the leader. Whilst these insights are instructive for our discussion on institutional adaptation, the notion of mimicking an acknowledged leader does not apply in this case. As the first foreign RMB centre established outside China,³ London constitutes new testing ground for how RMB finance adapts to Western institutional contexts. Consequently, there is no proven 'best practice' to follow. It is in this context of uncertainty that our analysis of London's RMB centre becomes important for advancing existing explanations of institutional adaptation.

This paper makes several important contributions to literatures on IFCs and state-finance relations. It challenges the notion that financial globalization has reduced the role of the state, by adding to works that highlight more complex forms of governance in which authority is shared between state and non-state actors (Büthe & Mattli, 2011).⁴ Following the work of Agnew (2009, 2012), we propose a reading of the state that emphasizes its active role as a financial market architect. By investigating the case of London, it is demonstrated that the development of offshore RMB centres is best understood as selective adaptation. What makes London's adaptation to RMB finance 'selective' is the shift in state-private bargaining dynamics from strategic alignment toward an increasing bifurcation of interests. This study therefore adds to our understanding of which features reflect mimicry of 'universal' practices and which are 'context-specific' in the development of new financial product markets (Bassens et al., 2013).

There has also been renewed interest among social scientists in offshore financial space following the 2008 global financial crisis. Recent works have emphasized legal features such as entire offshore jurisdictions in attracting offshore financial activity (Clark, Lai, & Wójcik, 2015; Wainwright, 2011). This study extends these insights by highlighting the need to politicize the analysis of offshore finance. It seeks to broaden our understanding of the role played by the state beyond conventional regulatory functions: governments not only act as regulators or stabilizers of offshore financial space but also they actively create it.

The paper is structured as follows. The next section outlines the paper's conceptual premises grounded in economic geographic theory. The third section presents the dataset and methodology. The fourth section discusses the empirical findings. It first contextualizes the geographical distribution of offshore RMB centres by teasing out the political drivers behind the creation of the first foreign RMB

centre in London. Subsequently, changes in state–private interests are analysed and how these affect the integration of RMB finance into London’s IFC architecture. The paper concludes by summarizing the results and outlining implications for policy and future research.

CONCEPTUALIZING INSTITUTIONAL ADAPTATION IN OFFSHORE RMB CENTRES

The development of and relations between financial centres have commonly been explored through the conceptual lens of location-specific complementarities (Clark, 2002; Faulconbridge, 2004) and shared commonalities that facilitate collaboration between centre-specific institutions (Wójcik, 2013).⁵ This has led to a focus on structural explanations including legal frameworks, political systems, labour flows and cultural norms (Hall, 2010). Within this literature, most research highlights the relationships between Western IFCs such as the ‘New York–London axis’ (Wójcik, 2013) and London–Frankfurt relations (Beaverstock, Hoyler, Pain, & Taylor, 2005). This has led to a focus on explaining institutional stability over institutional change, whereas questions of politics and power have been sidelined, especially in non-Western contexts.

To bring the IFC literature into closer dialogue with the politics of change in Chinese finance, we combine insights from political geography and political economy on global finance. Political geographers emphasize the role of the state in shaping the spatial underpinnings of different currency regimes (Agnew, 2009; Cohen, 2011). Accordingly, the transition of currencies from a nationally confined status toward transnational or reserve currency status is shaped by the strategic motivations behind governments’ ‘money games’ and the political–economic circumstances in which they are embedded (Agnew, 2012). We apply these insights to the largely unexplored field of RMB centres by exploring how state–private relations shape their development.

For this purpose, the emphasis on government incentives in political geography is coupled with insights into political bargaining in Chinese political economy and China area studies. This literature tends to focus on the role of firm–government bargaining in regional development (Hu & Lin, 2013) including foreign direct investment (FDI) policies (Wei, 2015), notably in industrial sectors such as Chinese car manufacturing (Chin, 2010; Oh, 2013). What unites these works is their emphasis on interdependent bargaining between Chinese

political elites, vested domestic interests and foreign investors to explain economic outcomes.

With a few notable exceptions (Chen, Henderson, & Cai, 2015; Töpfer, 2015), the area of indirect foreign investments has, however, been less frequently studied.⁶ This paper adds to this growing body of research by extending the conceptual premises of interdependent bargaining beyond the firm–government nexus and applying them to government–IFC relations. We conceptualize the development of offshore RMB centres as a bargaining outcome between the Chinese government and financial sector and state agents operating within an RQFII-licensed IFC. Rather than concentrating on self-reinforcing complementarities, the main premise is that agents will seek to change institutional features of RMB centres if they no longer satisfy their interests. This echoes the emphasis on conscious political choices in political geography and is the defining feature of what we term ‘selective adaptation’. We posit that the adaptation of established IFC architectures to RMB finance becomes ‘selective’ if state–private sector bargaining shifts from strategic alignment toward a bifurcation of interests. Such changes can be triggered by external shocks such as financial crises, or due to gradual learning effects that may alter agent preferences (Hall & Thelen, 2009). This focus on political bargaining dynamics provides a useful heuristic for examining how adaptation occurs in situations of uncertainty when no ‘best practice’ template exists for agents to follow. This responds to calls for examining how agency shapes financial geographies (Coe, Lai, & Wójcik, 2014) and adds to the literature on institutional isomorphism (Bassens et al., 2013; Di Maggio & Powell, 1983).

Analysing offshore RMB centres also requires conceptualizing ‘offshore finance’. Based on the global financial networks literature (Coe et al., 2014), recent works have conceptualized places of offshore finance as ‘any jurisdiction through which financial claims pass to avoid policy constraints elsewhere’ (Kurdle, 2013, p. 2). Applying this definition to the analysis of RMB centres clarifies that offshore finance is not about any type of financial services, but the booking of financial claims, also known as financial instruments or assets (Clark et al., 2015). For example, if a UK company holding an RQFII quota issued in London provides advice on RMB investments to an American company without an RQFII quota, this is not treated as offshore finance.⁷ However, if the same UK firm sold some of its own RQFII quota to the American company for RMB market access, then this would count as offshore finance.

Equating places of offshore finance with 'jurisdictions' nonetheless risks downplaying the role of the state. The global expansion of RMB centres is not driven by the ability of their legal system to 'avoid policy constraints', as Kurland's definition suggests. It serves the purpose of satisfying the Chinese government's strategic objectives to promote the more widespread use of RMB in international transactions. This suggests that the legal emphasis in 'offshore jurisdictions' is not sufficient to capture the political underpinnings in offshore RMB finance. Recent works have acknowledged that governments are important agents in offshore finance because they devise national and international laws and even create new places of offshore finance (Clark et al., 2015). This paper extends these works on IFC 'offshore jurisdictions' by specifying how state-firm bargaining shapes their development.

DATA AND METHODS

Grounded in new economic geography research, the main objective of this study is to trace the evolution of London's offshore RMB hub. The City of London's RMB market covers various financial activities. These include foreign exchange trading, commercial and private banking, and market-specific investment products such as the RQFII quota required to purchase Chinese securities. These activities are first approved by Chinese financial authorities and then undertaken by Chinese, British and international banks, law firms and asset managers. These financial institutions are supported through UK financial authorities including the Bank of England (BOE), HM Treasury and the London Stock Exchange. Grasping how London's RMB market developed requires a detailed understanding of the characteristics, practices and relations of these financial institutions and policy-makers. Using snowball sampling, in-depth personal interviews were chosen as the predominant form of enquiry to investigate such micro-level factors. Interview questions were divided into two subsections. The first investigated the policy motivations and external environment that gave impetus to the RQFII scheme in the context of RMB internationalization. The second explored the specific role London plays in this process relative to other offshore RMB centres.

This study faced two challenges: untangling the cross-cultural nature of RMB networks in London, and tracing their evolution over time. To ensure the validity of findings across geographical contexts and time horizons, the method of triangulation was applied. This study draws on an original dataset of

121 multi-stakeholder interviews carried out in London and in China's main financial and political centres, that is, Beijing, Shanghai, Hong Kong and Shenzhen. This dataset covers a period of three years, which spans the year of London's RQFII approval in 2013 until 2015. This enabled us to account for shifts in attitudes and decision-making over an extended time horizon and across geographical locations. In China, 75 elite interviews were carried out. These focused on officials from the main RQFII administrative authorities, namely the Securities Regulatory Commission (CSRC), the State Administration of Foreign Exchange (SAFE) and the People's Bank of China (PBOC). Relevant offshore counterparts in Hong Kong included the Securities and Futures Commission (SFC) and the Hong Kong Stock Exchange (HKSE).

To gauge the extent to which RMB finance has been integrated into London, 46 interviews were conducted with London-based executives from Chinese and non-Chinese financial services institutions. These included banks involved in RMB trading and China-dedicated practice groups of securities law firms. Follow-up interviews were carried out with the aforementioned respondents in China and London. This allowed for longitudinal comparison of policy motivations and private sector attitudes towards the role of RMB finance in London's IFC development.

Potential bias may nonetheless be introduced, as some regulators and financial institutions may strategically downplay or hide political interference. To ensure the robustness of findings, responses from Chinese political elites were triangulated with responses from other important stakeholder groups. These included the Stock Exchange Committees in Shanghai (SHSE) and Shenzhen (SZSE) and government think-tanks such as the Institute of World Economics and Politics (IWEP). Similarly, financial sector interviews in London were verified against responses from the BOE and HM Treasury, which oversee the City's RQFII hub. These multi-stakeholder interviews were cross-checked against Chinese and English news sources including the *South China Morning Post*, *Xinhua* and the *Financial Times*, and official documents from the PBOC, SAFE and CSRC. UK equivalents included policy reports from the HM Treasury and Office for National Statistics (ONS). Overall, this triangulation methodology minimized the interpretational freedom of interview responses across cultural contexts and allowed for reconstructing how London's RMB centre evolved over time.

RESULTS AND DISCUSSION: CONTEXTUALIZING LONDON'S FIRSTMOVER ADVANTAGE

Before examining London's development path as an RMB centre, it is necessary to contextualize its creation by analysing the decision-making process behind its initial selection as the first RMB hub outside Asia. This provides an important foundation for understanding what drives the uneven geographical distribution of offshore RMB centres.

The 2008 global financial crisis triggered a paradigm shift in Chinese policy attitudes. It eroded the legitimacy of the Anglo-American financial model and strengthened the view across the spectrum of Chinese elite opinion that the notion of 'free markets' is a 'Western trap' to undermine Chinese sovereignty (Kirshner, 2014). China's overreliance on the US dollar resulted in excessive exposure to global liquidity crises, which undermined trade finance (SAFE, personal interview, April 2014). Such spillover effects were a key concern for the Chinese party leadership since sustained economic growth continues to depend on trade. It is against this backdrop that the Chinese authorities decided to develop the RMB into a global reserve currency to reduce dependency on Western markets and thus maintain financial stability in the long-run (PBOC, 2009). Capital market reforms such as the launch of the RQFII scheme in 2011 provided a central link to achieve this objective. Creating incentives for foreign investors to hold RMB-denominated assets would boost the inflow of RMB into domestic capital markets and thus promote the use of RMB in international transactions (PBOC, personal interview, June 2014). The advent of the RQFII scheme should therefore be understood from the perspective of externally induced shifts in Chinese political choices. A global offshore RMB market provided a strategic tool to leverage domestic capital market development for the purpose of RMB internationalization and thus ensure stable economic growth.

Initially, the RQFII programme was only open to Hong Kong-based subsidiaries of mainland Chinese firms. This provided Chinese policy-makers with a regional testing ground for RMB internationalization (SZSE, personal interview, June 2014). Given its *de facto* role as China's offshore financial centre, Hong Kong has by far the largest deposits of RMB outside mainland China (Hong Kong Monetary Authority (HKMA), 2015). It was thus the obvious choice in

geographical location to experiment with the development of the RMB offshore market in a controlled regional setting. This is also reflected in the RQFII quota allocation, as Hong Kong still holds the single largest quota volume granted to any IFC (Figure 1). In 2013, the Chinese authorities extended the RQFII scheme to all foreign investors, providing that these are domiciled in Hong Kong. This clarifies that the home bias in selecting RMB centres has an inclusive effect: what mattered is not a firm's country of origin but its chosen geographical location. The necessity for foreign investors to register their entities in Hong Kong to access RMB assets was designed to reinforce Hong Kong's location-specific competitive advantage over other IFCs (HKSE, personal interview, May 2014). Hong Kong's close relational proximity to mainland China therefore translated into a powerful resource for establishing itself as the main RMB gateway under the 'one country, two systems' framework.

Given the policy emphasis on controlled regional experimentation, the subsequent expansion of the RQFII scheme is perplexing. London was chosen to become the world's first foreign RMB centre, even outcompeting regional Asian competitors such as Singapore, Seoul and Taipei (Figure 1). This clarifies that RMB deposits alone cannot explain which IFCs receive early RQFII approval. If that were the case, Taipei would have been chosen before London since Taiwan's RMB pools are only second to Hong Kong and far exceed those in Europe (Hsu, 2014).

Financial trading volumes offer a plausible explanation. Alongside New York, London continuously ranks top in this respect. To accelerate RMB internationalization, it made sense for the Chinese government to leverage the financial power of these leading foreign exchange trading centres (SAFE, personal interview, April 2014). Yet, New York has thus far remained outside the club of offshore RMB centres. The exclusion of Taiwan and New York therefore suggests that there is another important variable at play that trading volumes and RMB liquidity cannot capture.

What unites the cases of Taiwan and New York is that the relations of their respective governments with China are relatively weak compared with the UK and Singapore. For example, Taiwanese relations with China have been tense since the 1949 Chinese civil war due to which bilateral trade has suffered (IWEP, personal interview, November 2015). Chinese policy-makers have therefore used RQFII access as a 'bait' to revive economic relations by making Taiwan's RQFII approval conditional on its ratification of a Cross-Strait trade deal (RQFII-licensed bank, personal interview, November 2013). In light of anti-China protests, the Taiwanese

government retreated from the trade deal, thus giving the Chinese government an excuse to put RQFII approval on hold (RQFII-licensed asset manager, personal interview, June 2014).

Similarly, New York is not among RQFII licence holders despite its status as a leading 24-hour trading centre. According to Chinese policy-makers, the ‘US is not a destination for Renminbi [trading]’ (CSRC, personal interview, April 2014). In fact, it conflicts with China’s policy goals to reduce dependency on the US dollar in trade finance. Reciprocally, the political appetite in the United States for establishing an RMB centre is limited. One reason is that the American government has accused China of currency manipulation, thus straining Sino-US relations (SFC, personal interview, May 2014). Furthermore, the RMB is seen as a viable alternative to the US dollar as a reserve currency (RQFII-licensed bank, personal interview, April 2014). The cases of Taiwan and New York therefore demonstrate that bilateral tensions between China and an IFC’s respective home government have an exclusionary effect on securing privileged RMB hub status.

In contrast, London’s strategy of nurturing relational proximity with Chinese policy-makers paved the way for its first-mover advantage in the offshore RMB network. Whilst London received RQFII status in 2013, the UK government had been pushing for RMB rights long beforehand. These aspirations were rooted in the context of the 2008 crisis, which clarified that staying competitive in the global IFC landscape required London to enter new

markets (London-based investment bank, personal interview, June 2015). As part of this reorientation strategy, the City turned to RMB-denominated trading alongside other newly emerging forms of financial services provision including Islamic finance (Bassens, Derudder, & Witlox, 2010) and climate finance (Knox-Hayes, 2013). To exploit the opportunities afforded by RMB finance, policy-makers and financial professionals alike were keen to develop London’s capabilities as a leading RMB centre (London-based securities law firm, personal interview, February 2015). These objectives matched China’s strategic interests of expanding the RMB’s use in international payments to overcome its limited convertibility (IWEP, personal interview, April 2014).

High-profile state visits provided an important tool to cultivate close relations and mutual policy agendas. For example, the Chinese vice-premier was invited to visit the UK in September 2011, after which a joint plan was announced to transform London into a leading RMB centre (BOE, personal interview, November 2015). Sino-UK ties were further strengthened when the British Chancellor of the Exchequer announced that London would launch a forum with the Hong Kong Monetary Authority to promote RMB-denominated trade (HM Treasury, 2012). British banks and financial institutions backed this policy agenda. They urged HM Treasury to obtain RQFII status to secure a major share of what it viewed as a rapidly growing market in foreign exchange and bond issuance (HM Treasury, personal interview, November 2013). This

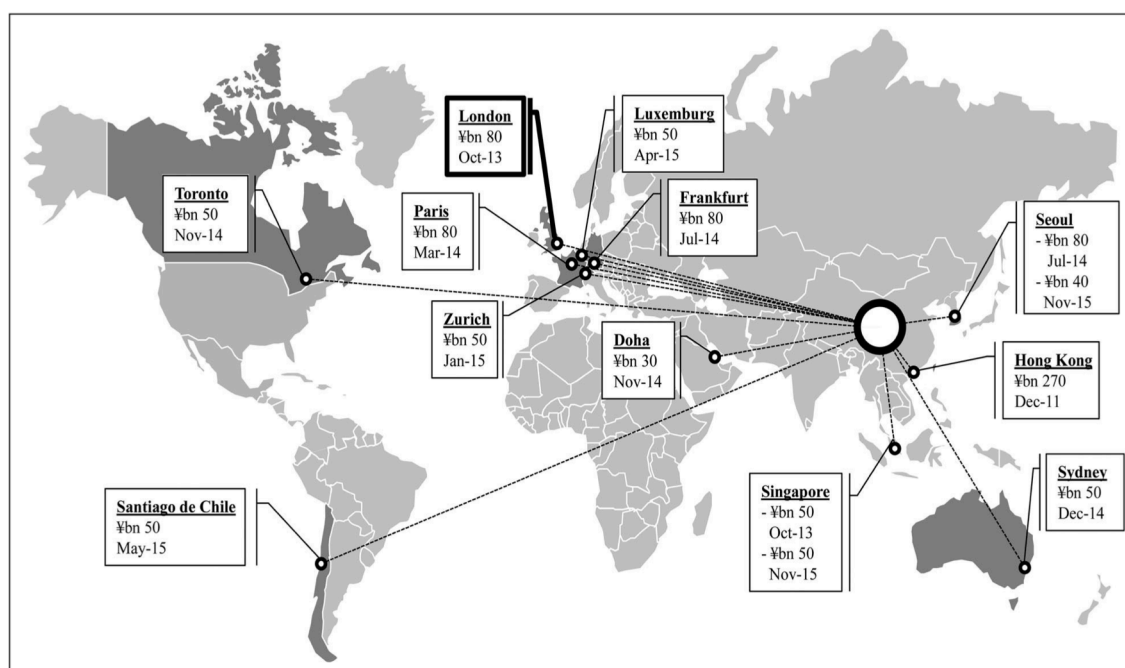


Figure 1. Geography of renminbi-qualified foreign institutional investor (RQFII) hubs.

Note: The RQFII investment quota is in RMB, billions; RQFII licences are by approval year. Source: Authors; figures are from the State Administration of Foreign Exchange (SAFE).

alignment of public–private interests on RMB finance was a decisive enabling mechanism for relational proximity with Chinese leaders, which helped secure RQFII privileges for London.⁸

Similarly, strategic gains for China and the UK were reciprocal. In exchange for RQFII hub status, Chinese policy-makers were able to negotiate better investment conditions in overseas markets including for its sovereign fund (RQFII-licensed Chinese asset manager, personal interview, April 2014). According to an official at the HKSE: ‘It is all about exchanging policy gifts. London got the first RQFII hub beyond Hong Kong. In return, the British government has agreed to start talks to allow Chinese banks to set up wholesale units in the UK’ (personal interview, April 2014). The creation of London’s RMB hub and, by extension, the geographical distribution of RMB offshore centres, is thus best understood as an interdependent foreign policy game. UK and Chinese policy-makers exchange resources they each require, whereby RQFII status represents the ‘golden carrot’. Successful approval depends on whether an IFC and the regulatory regime within which it is embedded can supply the Chinese government with the resources it requires to promote RMB internationalization.

Location-specific advantages also contributed to London’s first-mover advantage. For example, as its time zone bridges the United States, Europe and Asia, London accounts for 40% of global foreign exchange dealings, trading more US dollars than New York and more euros than all Europe combined (TheCityUK, 2015). This dominant position in currency markets is reflected in London’s highly skilled and internationally diverse labour force in the banking sector. London is a ‘genuine international financial centre – it dominates in forex [foreign exchange] markets and is much more outward looking than New York’ (London-based Chinese bank, personal interview, March 2015). This competitive edge in servicing international markets dates back to London’s pioneering role in developing euro currency markets in the 1950s (Burns, 1999). Combined, this unique blend of institutional features provided both the resources needed for China’s closer financial integration with the West and an ideal launch pad for RMB internationalization (PBOC, personal interview, March 2014). This is reflected in several policy decisions: for one, the Chinese government selected London as the first IFC to issue an RMB-denominated bond outside China in 2012. Furthermore, it allocated RMB80 billion in RQFII quota to London, thus outcompeting regional Asian competitors such as Singapore. Other leading

money centres such as New York were considered to lack:

the historic emphasis on foreign exchange markets. ... There isn’t the political appetite to work together [with Beijing] and London has a much longer commercial history with China, particularly through Hong Kong. [Compared with New York] this makes [London] a much more attractive RMB proposition. (Chinese securities law firm, personal interview, March 2015)

In sum, the evidence highlights that an IFC’s ability to leverage its financial capital and knowledge pools in RMB markets is conditioned by an interdependent exchange of resources with the Chinese state. In essence, RMB internationalization is an economically driven process. But the political dividends of securing RQFII status are reserved for those money centres whose home jurisdictions have cultivated strong bilateral relations with China. Without such ties, an IFC is unlikely to secure RQFII approval even if it pools financial and knowledge-specific resources that the Chinese government desires. Accordingly, London was able to secure first-mover advantages because it offered a bundle of resources in direct support of RMB internationalization, which its competitors were unable to offer.

SELECTIVE ADAPTATION OVER INTEGRATION: LONDON’S RQFII EXPERIENCE

To understand the subsequent development of London’s offshore RMB centre, it is necessary to look beyond UK and Chinese policy motivations and examine the City’s internal adaptation process. This section shows that resistance among London’s private sector vis-à-vis China’s prescribed path of RMB internationalization changed the nature of private–state bargaining dynamics, which resulted in the selective adaptation of the City’s financial architecture to RMB finance. Two main manifestations of selective adaptation stand out and warrant further analysis: the demand for RMB-denominated securities among London’s fund managers and the development of Chinese financial institutions within the City’s local market structures. Each of these features is discussed in turn.

State capitalism versus private interests: market demand for RMB-denominated assets

Although UK policy-makers have expressed strong commitment to London’s RMB centre development, private sector appetite for RMB-denominated investment products has been limited. This

discrepancy can be explained by fluctuations in Sino-UK relations and the effect this had on expectations among London's financial community. For example, in April 2012, the UK government decided to host the Dalai Lama in London, which was viewed as a significant 'faux pas' by Chinese authorities (RQFII-licensed Chinese asset manager, personal interview, June 2015). The political relations between the UK and China 'froze' as a result (Chinese securities law firm, personal interview, March 2015). This effectively stalled London's development as an offshore RMB centre throughout the remainder of 2012. This situation generated considerable uncertainty within London's financial sector about the City's future role in RMB internationalization. Consequently, asset managers turned towards more stable Asian currency markets such as Japan and Korea, which undermined the demand for RMB-denominated assets (RQFII-licensed investment bank, personal interview, December 2015).

To break the political deadlock and stimulate investment appetite for RMB investments, UK policy-makers mobilized London's financial sector as a foreign policy tool rather than relying on foreign office discussions. For example, in February 2013, the UK central bank governor visited his Chinese counterpart to discuss London's future in offshore RMB finance. This meeting culminated with the UK being granted the privilege to launch an RMB-sterling currency swap line as the first G7 country (BOE, personal interview, November 2015). These agreements are a key element of China's RMB strategy, as they facilitate deeper financial and monetary integration with the signatory countries (PBOC, 2011). Another state visit to China followed shortly afterwards, in October 2013, where the British Chancellor of the Exchequer granted Chinese banks the privilege to establish wholesale branches in the UK (HM Treasury, personal interview, November 2013). These policy moves highlight the shift in the UK's bargaining position: Maintaining a head start in the growing offshore RMB market was dependent on adapting London's regulatory infrastructure in line with Chinese demands and thus restore the relational proximity between UK and Chinese policy-makers.

The City's private sector community, however, did not share this willingness to adapt. This is because the positive stabilization effect that closer Sino-UK bilateral relations had on investor confidence was undermined by increased volatility in RMB currency markets (RQFII-licensed bank, personal interview, November 2013). Since 2009, the RMB had a virtual peg to the US dollar, which led many investors to bet on its appreciation (RQFII-

licensed asset manager, personal interview, June 2014). However, this trend came to a halt for two main reasons: first, in 2014, the US central bank ended its bond-buying programme aimed at lowering long-term interest rates, thus putting depreciation pressure on the RMB. Second, the Chinese government intensified this depreciation with three consecutive currency devaluations in 2015. This weakened the RMB's value by over 3% (SHSE, personal interview, December 2015). These policy moves triggered a rush to invest in non-RMB funds as investors who had previously bet on RMB appreciation suffered considerable losses (RQFII-licensed asset manager, personal interview, December 2015). Consequently, this dampened the appetite for RMB-structured products, as the stable interest rate differentials to invest in such products were effectively wiped out (RQFII-licensed bank, personal interview, December 2015). Paradoxically, this also undermined Beijing's efforts to accelerate RMB internationalization, by eroding confidence in the RMB as an investment currency and store of value.

The low demand for RMB-denominated investments is best illustrated by the stagnation in RQFII quota and RMB flows passing through London in the wake of RMB volatility. Initially, the City's RQFII quota of RMB 80 billion exceeded that of Asian competitors including Singapore and Korea, with RMB 50 billion each. However, the latter both received quota top ups of 50% and 100% respectively, whereas London received none (Figure 2). This decision reflects the fact that demand for RQFII quota has been lowest in London among top-ranked RMB hubs. Both the overall quota allocation and their distribution across investor types illustrate this well (Figure 2). What explains this leap forward by Singapore and Seoul is regional trade finance, which has been the main driver behind the demand for RQFII quota (SAFE, personal interview, April 2014). Although RMB volatility depressed quota demand worldwide, regional trade finance provided Singapore and Seoul with a buffer, since both are located in places with strong trade links to China.

RMB trading activity reveals a similar pattern. In 2014, Singapore overtook London as the top foreign IFC location for processing RMB payments: Its share of total offshore RMB trading flows increased to 6.8%, whereas London accounted for 5.9% (SWIFT, 2014). Processing trade payments with Asian neighbours using Chinese currency has provided a 'regional testing ground' to experiment with RMB internationalization (SZSE, personal interview, June 2014). Unlike London, Singapore's location in Southeast Asia, and its sizable build-up of RMB deposits, enables it to support China's regional

trade as the largest foreign exchange centre for Asian currencies (RQFII-licensed asset manager, personal interview, June 2014). Market-driven features such as RMB deposits may thus not determine which IFCs receive early RQFII approval, but they do play a vital role in shaping which IFCs get ahead in the subsequent development of offshore RMB business. London's relatively slower development, therefore, highlights an expectations-capabilities gap between the policy agenda for its role in RMB internationalization and what can realistically be achieved without support from the private sector. Relational proximity between governments may go a long way in helping IFCs secure first-mover advantages in RMB finance, but it does not guarantee their endurance.

The evidence suggests that the development of offshore RMB centres needs to be understood as a twofold sequencing process: whereas the initial creation of RMB hubs is largely the result of intergovernmental bargaining, much of their subsequent development depends on the successful alignment of politics and economics. The key arbiter in determining if offshore RMB markets develop is whether the private sector can identify and satisfy any underlying demand for RMB assets (BOE, 2012). The demand for RMB-denominated trade finance in East Asian markets therefore explains why IFCs in this region were able to overtake London, where

the appetite for RMB securities remained relatively low. This point is instructive, as it suggests that location matters considerably in offshore RMB finance: those IFCs situated within close geographical proximity to China benefit from the positive economic spillover effects that inter-regional trade has on RMB markets.

State capitalism versus private interests: Chinese commercial banks in London

The selective adaptation of London's financial architecture to RMB finance is also visible in the extent to which Chinese commercial banks are incorporated into the domestic labour market. Before 2014, Chinese banks could only open subsidiaries rather than branches in London (London-based Chinese bank, personal interview, March 2015). This reflected the cautious and risk-averse approach of UK regulatory authorities towards foreign banks following the 2008 financial crisis. Bank subsidiaries were favoured because they have more stringent liquidity and capital requirements compared with bank branches (BOE, personal interview, November 2015). This need to operate as tightly supervised subsidiaries made it difficult for Chinese banks to expand (London-based Chinese bank, personal interview, April 2015). In turn, this threatened London's status as the leading Western RMB hub.

To avoid losing this position, the UK government engineered a policy U-turn by permitting Chinese

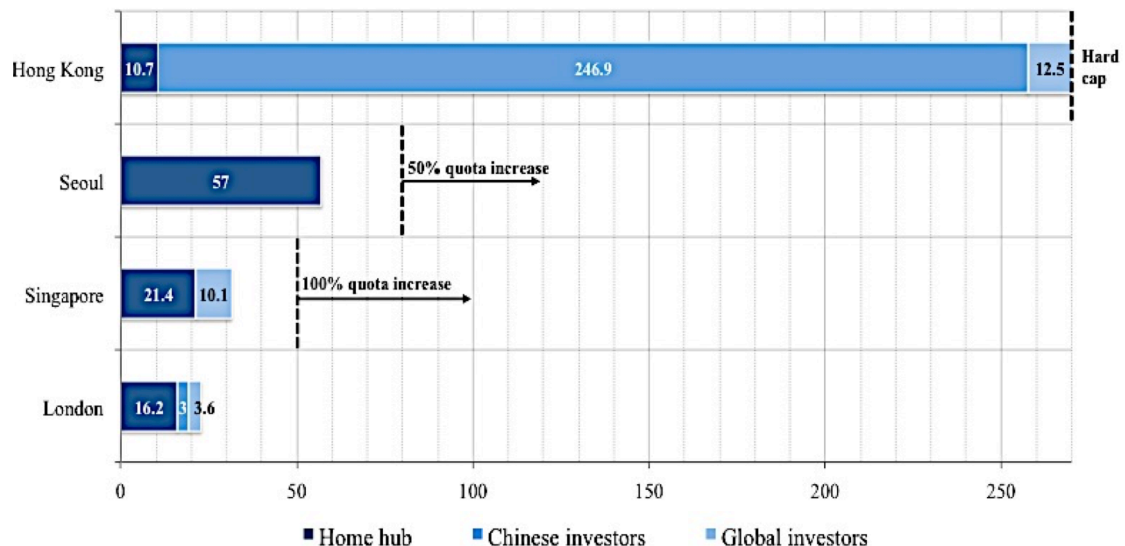


Figure 2. Distribution of the renminbi-qualified foreign institutional investor (RQFII) quota across the top RMB hubs (RMB, billions).

Note: Whether an international financial centre (IFC) counts as a 'top offshore RMB centre' is measured based on the respective volumes of both the allocated quota allowance to the IFC and the quota allocated to licensed investors.

Sources: Authors based on Z-Ben Advisors (2015), China Securities Regulatory Commission (CSRC) (2015) and State Administration of Foreign Exchange (2015).

banks to operate as branches instead. The Industrial and Commercial Bank of China (ICBC) was the first Chinese bank to be granted a UK bank branch licence in 2014. These branch licences enabled Chinese banks to better exploit the resources of their home lenders and move supervision to the Beijing authorities (London-based Chinese bank, personal interview, April 2015). Furthermore, the China Construction Bank (CCB) was granted approval to open Europe's first RMB clearing bank in London. Although the bank also started trading in Paris and Frankfurt later on, it made London its European headquarters (Fleming & Parker, 2014). This underscores that mutual political interests served as an initial enabling mechanism for inserting Chinese banks into London's IFC architecture.

Successful institutional insertion does, however, not equate to successful institutional integration. Whilst all four of the largest Chinese state-owned banks have now established local branches, their development within London is hampered by their limited engagement with the City's labour force. This is reflected in their staffing policies, which are subject to strict controls by the Chinese government. In line with government requirements, Chinese offshore entities are managed by secondees from mainland China rather than by local professionals (London-based Chinese bank, personal interview, March 2015). This is partly due to the so-called 'party supervises the cadre' rule (*Dang Guan Ganbu*) according to which the Chinese Communist Party appoints top managers in state-owned enterprises (Gong, 2014). Internal management appointments and career progression are all strictly controlled by party agencies rather than determined by market demand (IWEP, personal interview, April 2014). Consequently, this highlights the clash between the state-led labour market practices of Chinese banks and the market-led labour market standards within the City.

This clash poses three main challenges for Chinese commercial banks operating in London. First, their rigid staffing policies impede the successful integration into London's IFC infrastructure. Second, these same staffing policies prevent the stimulation of market-led incentives. Secondees are more focused on 'managing their own careers [at home] rather than taking risks and making new business opportunities in London' (London-based Chinese bank, personal interview, March 2015). Third, and as a direct consequence of the previous two points, Chinese financial institutions remain cut off from the pool of financial expertise and specialist financial services concentrated in the City. According to the head of

the China practice group at a London-based securities law firm:

the reliance on Chinese talent is an issue [for Chinese banks in London] as there remains a lack of overlap between domestic and Chinese labour markets and this isn't helping educate the wider market into the process of RMB internationalisation, London's role within it and the opportunities for market participants that might exist.

(personal interview, March 2015)

This clarifies that the regulatory grip over Chinese banks undermines their responsiveness to market needs and thus their ability to connect with financial knowledge flows in London. Consequently, this prevents their offshore operations from integrating effectively into London's financial architecture, which Chinese policy-makers had set out to achieve. These restrictions highlight that the Chinese party-state was not only a major enabling force behind London's RQFII hub; ironically, it also acted as a 'brakeman', by prioritizing state control over market demands. This exposes an inherent paradox in China's RQFII strategy: without letting market forces play a greater role in determining staffing policies, it will thus be difficult for Chinese financial institutions to leverage fully London's locational advantages as a resource for RMB internationalization.

CONCLUSIONS

This paper sought to explain the uneven development of London's RMB trading centre. The City of London was the first foreign IFC approved by the Chinese government to become an offshore RMB centre. Despite this first-mover advantage, its subsequent development was hampered by the City's selective adaptation to RMB finance, thus forfeiting its position as the largest offshore RMB hub outside Hong Kong. The findings show that this puzzling shift from first-mover to relative laggard can be explained by tracing how state and private sector interests co-evolved over time. Mutually reinforcing interests facilitated close relations between Chinese and UK policymakers, which enabled London to become the first foreign offshore RMB hub. However, state-private sector interests started to diverge over the subsequent development of London's RMB business. This was underpinned by the financial sector's limited appetite for RMB-denominated assets and the insufficient integration of Chinese banks into the City's labour market. Combined, these factors led to the selective absorption of RMB finance into

London's financial architecture. This was not only reflected in the under-allocation of RQFII licences, but also caused London's share of the offshore RMB trading market to fall behind other money centres.

These findings provide important insights for the IFC literature by extending the focus beyond structural IFC complementarities such as knowledge and labour flows (Hall, 2010; Wójcik, 2013). As the results demonstrated, it was the constant ad hoc bargaining between state and private agents with competing interests that explained the uneven development of London's RMB hub. This suggests that the ideas of agents about political and economic outcomes matter considerably for the evolution of RMB centres. Rather than focusing on IFC complementarities, future research should therefore delve deeper into the politics of change behind IFC development.

The findings highlight that the role of states in offshore finance is multidimensional rather than singular: the Chinese government not only regulates and stabilizes offshore RMB centres, but also actively creates and expands them to achieve its objective of building a global offshore RMB market. Similarly, the UK government was a decisive enabling force behind London's first-mover advantage by cultivating close relations with Chinese policy elites. By specifying these variegated roles of the state, this paper extends the focus on the state's regulatory function in the offshore finance literature. It also lends empirical support to existing claims within this literature that 'offshore' transactions can occur in places typically considered to be 'onshore' money centre such as London (Clark & Monk, 2013).

Finally, this paper adds to debates in the global financial networks literature that the attraction of offshore finance stems from 'jurisdictional autonomy rather than being centres of finance professionals or expertise' (Clark et al., 2015, p. 244). This perspective suggests that in offshore finance IFC characteristics matter less than the nature of jurisdictions. The findings of this study suggest that this claim may not be universally applicable to all forms of offshore finance. Although important, finance-friendly laws and regulations within the sub-national jurisdiction of the City are not the main determinant of its appeal in the case of offshore RMB finance. It was instead London's capacity to contribute to RMB internationalization. In this endeavour, jurisdictional autonomy was less important. What mattered for Chinese policy-makers was whether a place had strong political relations with China, a track record of foreign exchange expertise, and a 24-hour bridging point to trade with East and West. These 'resources'

supported Chinese efforts at creating a global offshore RMB market. The demonstrated centrality of financial centre characteristics in RMB offshore finance therefore calls for revising existing premises about the making of offshore finance.

At the policy level, the revealed tensions between state elites and London's financial sector clarify that the Chinese government can catalyse but not command offshore RMB markets outside its own jurisdiction. This is because, unlike Hong Kong, foreign RMB hubs such as London are not directly controlled by the Chinese party-state. From a policy perspective this is instructive, as it highlights that the emphasis on tight government control, in fact, undermines the creation of a global offshore RMB market. For Chinese policy-makers, the success of RMB internationalization will therefore depend on their political willingness to loosen their grip over capital markets including the recruitment policies of their financial institutions.

For foreign jurisdictions hosting RMB centres including Frankfurt or Luxemburg, this study highlights the conditional nature of growing offshore RMB business. The case of London revealed that strong inter-state relations are a crucial enabling condition behind the formation of new RMB hubs. Yet, shared policy interests between Chinese authorities and overseas governments are not a sufficient condition for their subsequent integration into existing IFC structures. The successful development of RMB business depends on securing private sector support at home. This requires that foreign governments adopt a more inclusive approach that is mutually beneficial for public and private sector agents alike. Without the continuous alignment of public-private interests, the development of RMB centres outside China will likely remain a tale of selective adaptation.

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NOTES

1. Before 2004, RMB-denominated trading was not allowed outside China.
2. Since Hong Kong is a special administrative region (SAR) of the People's Republic of China, it is not treated as a 'foreign' offshore RMB hub.
3. Hong Kong was the first offshore RMB centre established outside mainland China. However, as a formal part of Chinese territory, the mainland Chinese government directly shapes its institutional landscape. Given this special political status, Hong Kong therefore does not provide a template of 'organisational mimicry' for RMB centres located in Western contexts.
4. Financial globalization is defined as the free movement of financial flows across national boundaries without restrictions, enabled by the international diffusion of liberalizing measures (Büthe & Mattli, 2011).
5. This paper defines 'institutions' as formal or informal norms, rules and enforcement mechanisms that are grounded in the common expectations between social agents and, therefore, guide their behaviour.
6. Foreign indirect investments differ from FDIs. In the case of FDI, the investor owns the assets himself and may thus exert a significant degree of control over the investee company. Investments typically count as FDI if an investor owns at least 10% of a firm's voting stock (Organisation for Economic Co-operation and Development (OECD), 2008). In contrast, foreign indirect investments are made by foreign institutions that pool investor money to buy or sell financial assets in another country. Examples include investments by foreign mutual funds into stocks listed in another economy.
7. This is because the UK firm did not sell any of its own RQFII quota to provide the American company with access to the RMB market. The transaction between the two parties did not involve the booking of financial instruments but merely the provision of financial advice. Consequently, this

type of financial service would not classify as 'offshore finance' according to Kurdle's (2013) definition.

8. In addition to securing RQFII hub status in 2013, London was granted permission to set up the first Western RMB clearing bank, following a 2014 state visit by China's president.

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CHAPTER 6

Shared Ethnicity or Shared Nationality?

How culture shapes shareholder engagement in China

6.1 Abstract

Focusing on pension funds and insurance companies in China, this study investigates the role of cultural similarities in shaping shareholder engagement. By examining ‘culture’ through the lens of common ethnic origins, the paper combines cultural perspectives in behavioural finance, Chinese area studies and the shareholder engagement literature to examine the claim that shared ethnicity between local and foreign investors reduces information asymmetries and increases the latter’s involvement in the target market. The analysis presents the first original dataset that compares shareholder practices of national Chinese and ethnic Chinese investors. Spanning three years of data collection, this dataset combines interviews with fund managers, annual reports and participant observation. We find that active ‘stewardship’ behaviour toward investee companies is concentrated among foreign ethnic Chinese investors, whereas national Chinese investors favour passive practices and momentum-driven ‘alpha’ engagement. The findings challenge existing cultural perspectives that shared ethnicity reduces information asymmetries and motivates similar behaviour between local and foreign investors in culturally close markets. They also challenge ‘universal ownership’ claims, which emphasise that the behaviour of institutional investors such as pension funds is driven by long-term accountability towards the assets they own. The paper highlights the need to rethink the ‘long-termism’ assumptions that inform both Western and Chinese policies aimed at leveraging the financial clout and investment expertise of institutional investors to promote more accountable corporate governance.

6.2 Introduction

The 2008 global financial crisis compelled scholars and policymakers alike to call for more accountable corporate governance²⁰, by leveraging the financial clout of

²⁰ Corporate governance is understood as ‘the system by which companies are directed and controlled’ (FRC, 2012).

institutional investors²¹ such as pension funds and insurance companies (OECD 2012; Lydenberg, 2014). These pleas are based on the assumption that such large investors are guided by ‘universal ownership’: They recognise that, through their diversified asset portfolios, they own a representative part of the whole economy, and thus act as long-term²² corporate ‘stewards’ to lift absolute returns in the entire market (Hawley and Williams, 2007). This ‘universal ownership’ thesis has been primarily investigated in Western liberal market economies (Urwin, 2011; Hebb, 2008). Focusing on Anglo-American contexts and Western Europe, existing works highlight the importance of varying legal environments (McNulty and Nordberg, 2015; Rock, 2015), long-term asset liabilities (Clark et al, 2013; Clark and Monk, 2014; Gjessing and Syse, 2007) and fund managers’ interpretations of ‘fiduciary duty’ (Tilba and McNulty, 2013). Such organisational and country-level features have been linked to different levels of shareholder engagement²³ (Crespi and Renneboog, 2010; Conyon and Sadler, 2010; Monk and Sharma, 2015). However, few studies investigate whether these linkages hold in non-Western geographies. Notable exceptions have examined Asian liberal market economies with mature capital markets such as Japan (Mizuno, 2010; Clark et al, 2015) and South Korea (Jang and Kim, 2003). Yet, little is known about shareholder practices in China’s state-controlled investment environment.

The neglect of regional variety is problematic, as global financial assets have shifted towards fast-growing Asian economies. Mainland China has now overtaken Japan in holding the world’s second largest pool of financial assets, following the US (Allianz, 2015). With this shift in global assets, Chinese institutional investors have emerged as important new actors in finance. Although their share of global assets remains limited due to China’s capital controls, their significance in the domestic market has increased from only 5% of Chinese tradable shares in 2001 to about 60% of total tradable equity in 2010 (Gong, 2014). This has been accompanied by growing shareholder activism such as voting to dismiss board directors (SHSE, 2012) and

²¹ Institutional investors are legal entities with large capital assets under management (OECD, 2012). These legal entities cover various investment organisations including mutual funds, pension funds, foundations, sovereign wealth funds, investment banks and insurance companies.

²² We define long-term investment as investing with the expectation of holding an asset for a ten-year period or longer (WEF, 2012).

²³ Shareholder engagement refers to the motivations and practices that investors use toward investee companies.

forming investor coalitions to influence corporate compensation (Liu, 2012). However, in China's authoritarian regime, such investor behaviour is riddled with political influence. The Chinese one-party state controls competitive resources in the domestic capital markets such as the pricing of stock market launches and the composition of boards and corporate management in investee firms (Walter and Howie, 2012). The growing influence of institutional investors in China, and the rise of state control that comes with it, thus calls for reassessing Anglo-American premises on shareholder engagement. Focusing on pension funds and insurance companies, this study contributes to filling this research gap, by examining whether 'universal ownership' claims hold in the Chinese context.

The paper explores the less frequently studied role of cross-cultural similarities in shaping the shareholder behaviour of institutional investors toward listed private companies in China. To this end, the paper compares the practices of domestic Chinese investors with foreign investors licensed under China's Qualified Foreign Institutional Investor programmes. As such, the paper focuses on direct investors themselves rather than external asset managers, which indirect investors may rely on for investment intermediation. To examine the role of cultural similarities, the shareholder engagement literature is integrated with cultural perspectives in behavioural finance and Chinese area studies. Behavioural finance research highlights that shared cultural values between shareowners' home market and target markets reduce information asymmetries and facilitate participation in target markets (Berecha et al, 2014; Choi et al, 2017). Similarly, Chinese area studies emphasise that common ethnic origins between foreign and domestic investors promote trusted personal relationships and enable comparative advantages (Luo et al, 2012; Chen et al, 2015). What unites both literatures is their emphasis on cultural similarities in facilitating local information advantages that motivate increased engagement in culturally close markets. This paper takes these insights as its conceptual starting point to explore how cultural proximity shapes shareholder practices toward investee firms along the active-passive spectrum of engagement.

Given the conceptual complexity of 'culture', we investigate cultural similarities, by focusing on shared ethnic origins. Borrowing from Chinese area studies, we explore whether the benefits of familiarity and mutual trust enjoyed by national

Chinese investors also extend to foreign investors with ethnic-Chinese origins such as Singapore and Taiwan. This analysis exploits a rare methodological reference point based on the common cultural background of these investors but their classification as 'foreign investors' by the Chinese government (CSRC, 2015). We draw on an original dataset of 34 semi-structured interviews with senior executives from both national Chinese and foreign ethnic-Chinese investors operating in Mainland China. Interviews were conducted over the course of three years (2014-2016) and triangulated with corporate reports and participant observation of investors' committee meetings.

This study makes several contributions to the corporate governance and finance literatures. It breaks new empirical ground, by shifting the focus on culture within organisations (Luo and Chung, 2013) and comparisons of 'national versus foreign' markets (Hooghiemstra et al, 2015; Berecha et al, 2014) to *clusters* of culturally close countries as an alternative unit of analysis. We also approach the measurement of shareholder behaviour from a new angle. Existing works distinguish between 'active/passive' behaviour based on direct or indirect means of engagement (Goranova and Ryan, 2014). However, indirect practices such as 'exit' threats can be used as an active means of changing firm behaviour (Admati and Pfleiderer, 2009). Our analysis therefore differentiates between proactive and reactive investor motivations to classify shareholder behaviour, thus adding to recent studies on 'ownership ethos' (Hernandez, 2012; Tilba and McNulty, 2013; Sandberg, 2013). In addition, by analysing the shareholder practices of insurance companies and pension funds, this study extends the China-focused shareholder engagement literature beyond the focus on mutual funds (Yuan et al, 2009), the perspective of target companies (Gong, 2014) and the regulatory context (Hu and Sun, 2016).

The paper unfolds in four parts. The first part reviews the literature and develops the theoretical framework. The second part outlines the dataset and methods. The empirical findings are then discussed in the third part. The paper concludes, by summarising the results and highlighting limitations and key implications for future research.

6.3 Conceptualising Shareholder Engagement

The theoretical foundation of this paper draws on cultural perspectives in behavioural finance and Chinese area studies and connects them to the shareholder engagement literature. The latter identifies different categories of shareholder engagement, broadly divided into passive and active behaviour. Rather than engaging directly with companies, passive investors often follow market indexes (Wong, 2010) or adopt reactive practices such as proxy voting (Monk and Sharma, 2015). Active behaviour has been classified into short-term ‘alpha’ engagement or longer-term ‘inside’ engagement. Short-term ‘alpha’ investors seek to generate returns in excess of benchmark indices typically within a one-year period (Zenner et al, 2015). Common ‘alpha’ practices include ‘exit’ threats (Admati and Pfleiderer, 2009), public campaigns (Katelouzou, 2013) and activist investor coalitions (Crespi and Renneboog, 2010). In contrast, ‘inside’ engagement echoes the premises of universal ownership and thus emphasises longer-term ‘stewardship’ toward investee companies (Celik and Isaksson, 2014). Such stewardship behaviour includes direct share voting, board responsibilities and shareholder proposals on oversight issues (Conyon and Sadler, 2010; Rehbein et al, 2013). In contrast to binary ‘voice-exit’ conceptions in early works (Hirschman, 1970), these studies thus highlight varying *degrees* of shareholder engagement.

Nonetheless, it remains unclear how shareholder practices are assigned to the ‘active-passive’ spectrum. If an otherwise passive investor is ‘nudged’ into putting forward a shareholder proposal due to company-internal changes, should this behaviour be classified as ‘active’ or ‘passive’? To avoid such conceptual impasses, we propose a different method of categorising ‘active’ and ‘passive’ behaviour, by distinguishing between proactive and reactive *motivations*. Seen from this perspective, the above example of ‘nudge’ behaviour classifies as passive engagement, since the use of shareholder rights is a reaction to an external catalyst rather than the outcome of a proactive decision to engage with target firms.

Whilst descriptions of active-passive behaviour shed light on how investors engage with investee companies, they remain silent on *why* they differ in their means of engagement. Recent works have therefore started to pay attention to varying investor characteristics. It has been shown that asset size shapes whether investors

decide to use active means of engagement. Large organisations, typically with more than USD 5 billion in asset size, have superior in-house resources to monitor target firms and occupy large shareholding positions (Monk and Sharma, 2015; Tilba and McNulty, 2013). This equips them with greater bargaining power over corporate governance decisions than smaller investors (Bauer et al, 2012). Nonetheless, large shareholdings are not a direct determinant of active engagement; their impact depends on the pursuit of an active investment strategy (Hebb, 2008). Consequently, this requires examining how business model characteristics shape the incentives underpinning the decision-making process of fund managers.

Recent studies highlight behavioural incentives tied to legal ownership. A privately owned joint stock entity generates profit-maximising obligations to owners, which incentivises investors to actively engage with investee companies. In contrast, public institutions are insulated from competitive pressures of maximising shareholder wealth, which reduces engagement incentives (Celik and Isaksson, 2014). This is especially relevant in authoritarian one-party regimes²⁴ such as China, where the state has majority ownership of many investment organisations and listed companies. The party-state can thus directly influence the composition of boards and corporate management (Gong, 2014). Such insider control reduces the need to rely on visible activist practices and instead favours covert or passive engagement with investee companies.

Others highlight the duration of asset liabilities, whereby longer-term obligations such as those of pension funds and insurance companies create stronger incentives for 'universal ownership' (Hawley and Williams, 2007). However, the specific engagement incentives of pension funds depend on whether payments are based on defined contributions (DC) or defined benefits (DB), and non-life or life insurance products for insurance companies. For DB plans and life insurances, future payouts do not change according to asset performance, which means owners bear the risks of poor investment decisions (Besley and Prat, 2003). Internalised costs thus incentivise active stewardship behaviour toward investee firms. In DC plans, however,

²⁴ The regulatory context significantly influences shareholder behaviour (Coffee and Palia, 2014). Since all investors in this study are subject to the same legal environment, this paper discusses regulatory aspects only insofar as they relate to governance features such as state/non-state ownership.

the cost of poor investment decisions is transferred to contributors who receive lower retirement benefits (Clark and Monk, 2014). Similarly, non-life insurance liabilities such as accident claims are shorter, as typical underwriting cycles last between three to five year and their value is often unknown. As costs are uncertain or externalised, the incentive to act as 'stewards' toward investee firms is thus lower. To capture these behavioural dynamics, this paper therefore considers the impact of business model characteristics²⁵ on agency costs.

The trouble with the focus on governance-driven incentives is that, at any given time, investors are subject to many incentives. This includes cultural incentives such as similar social values between investors' home markets and target markets. Cross-cultural psychology studies in behavioural finance have linked such similarities to better investment performance (Choi et al, 2017), successful cross-border mergers (Ahern et al, 2015) and higher trading volumes (Berecha et al, 2014) in target markets. They highlight that active involvement increases in culturally close target markets, as foreign investors are more familiar with the local investment environment than in culturally distant markets.

The problem with measuring cultural similarities according to 'home markets versus target markets' is that they are based on national averages. This neglects within-country diversity and common value systems among culturally close countries such as Mainland China, Hong Kong, Taiwan and Singapore. These countries have ethnic Chinese majorities and share a group identity based on a common language, ancestry and social values. Chinese area studies highlight that such ethnic networks facilitate 'family-type' relationships known as *guanxi* (关系). Such relationships form an important basis of trust in Chinese social contexts including business transactions (McNally, 2011). This is because Chinese society is a highly collectivist culture²⁶, where people define their self-image in terms of 'in-groups' that support each other in exchange for loyalty (Huang, 2009). In cross-border business transactions, personal

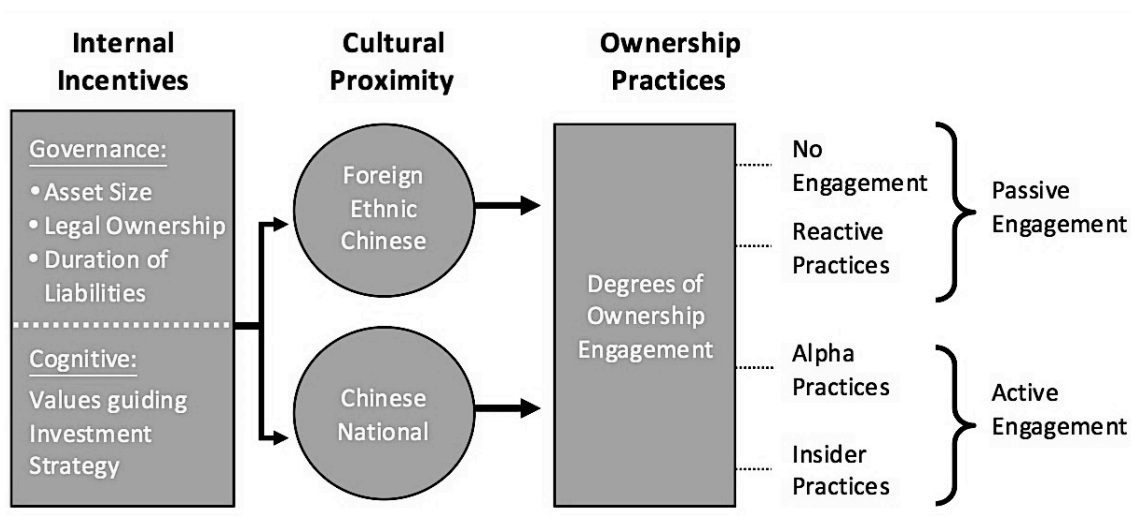
²⁵ Another important feature is portfolio diversification (Prado-Lorenzo et al, 2009), as high levels of diversification reduce the resources available to monitor each investee company. Yet, this dimension is excluded in this study, as all investors have comparable levels of diversification (≤ 500 companies).

²⁶ Relations of trust also matter because formal institutions are weak in China. Existing works show that *guanxi* enables superior access to market resources including lower information asymmetries, cheaper borrowing costs (Chen et al, 2015) and preferential capital market access (Töpfer, 2017).

relationships with colleagues are thus cooperative with trusted ‘in-groups’, whereas they are distant or even hostile toward ‘out-groups’ (Luo et al, 2012).

This paper connects these insights on ethnic networks with the aforementioned cultural perspectives in behavioural finance and the shareholder engagement literature. As ‘culture’ is a notoriously difficult concept to measure, we focus on common ethnic origins. This allows for capturing both the logic of shared value systems with trusted ‘in-groups’ and information advantages in culturally close target markets. Echoing these premises, we posit that cultural proximity based on ethnic Chinese background translates into similar shareholder behaviour between foreign and national Chinese investors (Figure 1). The following analysis thus teases out whether it is shared national identity or shared ethnic identity that matters for shareholder engagement.

Figure 1. Conceptual Framework



Source: authors’ own; based on McNulty and Nordberg (2015); Clark and Monk (2014); Gong (2014); Luo et al (2012).

6.4 Data and Methods

Semi-structured interviews were chosen as the main form of inquiry, as little is known about how common ethnic origins shape shareholder engagement in China. Interviews allowed for exploring these dynamics, by gaining a deeper understanding of fund

managers' motivations and engagement practices. The paper focuses on engagement practices toward listed private companies, as state ownership of Chinese investee firms tends to discourage shareholder engagement (Gong, 2014). To identify relevant interviewees, it was vital to consider China's regulatory environment. Whilst domestic insurance companies have been permitted to invest in the Chinese equity market since 2004, pension fund eligibility has been limited to corporate pension funds and the National Social Security Fund²⁷ (Gong, 2014). Our data collection therefore focuses on these three types of institutional investors. The sampling procedures exploit the fact that insurance companies and pension funds require an investment licence from the Chinese government and are therefore listed in official directories. Records of domestic players were obtained from the Chinese Insurance Regulatory Commission, the National Council for Social Security Fund and the Ministry of Human Resources and Social Security (CIRC, 2016; NCSF, 2016; MOHRSS, 2016). The population of foreign pension funds and insurance companies was identified using the directories of Qualified Foreign Institutional Investor approvals (CSRC, 2015).

Sampling procedures

Based on the above data sources, a population of 11 pension funds and 76 insurance companies (n=87) was obtained. This relatively small number of firms reflects the concentrated nature of tradable Chinese insurance and pension assets among large players (CIRC, 2016). Based on this sampling frame, 34 interviews were conducted using snowball sampling (Appendix B). Of these, 21 interviews were held with investment directors and fund trustees from national Chinese pension funds and insurance companies, and 13 interviews with foreign ethnic Chinese counterparts. This data sample covers the full list of foreign ethnic Chinese investment organisations approved by the Chinese government, which includes predominantly Taiwanese entities (CSRC, 2015). To determine whether a foreign investor counts as 'ethnic Chinese', the percentage of ethnic Chinese in an investor's country of origin was used as a reference point. At least 50% of a country's total population had to be ethnic

²⁷ NSSF is a supplementary reserve fund to support the future demands of China's pension system.

Chinese to classify as ‘common ethnic origins’. Relevant data was obtained from Taiwan’s Overseas Community Affairs Council²⁸ (OCAC). Furthermore, data from CIA World Factbook was collected to measure whether Chinese is spoken in an investor’s home market. Only places with Chinese as an official language were included, which yielded Hong Kong, Taiwan, Macao and Singapore. They all share common ethnic origins with Mainland China but are classified as ‘foreign investors’ by the Chinese government (CSRC, 2015).

In sum, although the concentrated nature of Chinese pension and insurance assets limits the sample size, this study captures almost the entire population of relevant investors. The sample covers 62% of China’s total tradable insurance assets, whilst pension funds account for 73% of total tradable pension assets²⁹. It is thus possible to draw representative conclusions about shareholder engagement in China’s insurance and pension market.

Data analysis

A two-step approach was used to analyse interview responses. In the first step, shareholder engagement was classified based on four categories identified in the literature review: disengagement and reactive behaviour describe the passive spectrum of engagement, whilst ‘inside’ engagement and ‘alpha’ activism denote active behaviour. To avoid previous pitfalls associated with measuring ‘active/passive’ engagement based on ‘direct/indirect’ practices (Goranova and Ryan, 2014), this study uses shareholder *motivations* as a reference point. Proactive motivations are classified as active engagement. Such proactivity is measured based on frequency of initiative. To count as ‘proactive’, investors must rely on a designated engagement practice at least once a year. This includes both ‘inside’ engagement and ‘alpha’ activism. To measure these two types of active engagement, we distinguished between investment targets based on *absolute* and *relative* returns. Echoing universal ownership, ‘inside’

²⁸ OCAC is a cabinet-level council of Taiwan that collects data relevant to cultural and economic exchanges between Taiwan and ethnic-Chinese overseas communities.

²⁹ Calculations based on total corporate pension fund and insurance assets obtained from China’s Insurance Regulatory Commission, National Council for Social Security Fund and the Ministry of Human Resources and Social Security.

engagement is about longer-term commitment that seeks to maximise *absolute* returns, by lifting performance in the entire equity market (Gjessing and Syse, 2007). This includes interaction-driven means such as board responsibilities but also ‘softer’ written/phone communication that does not require face-to-face interaction (Conyon and Sadler, 2010). In contrast, ‘alpha’ investors are mandated solely to generate *relative* returns in excess of market indices over shorter-term horizons (Coffe and Palia, 2014). ‘Alpha’ activism thus seeks to discipline managers with immediate effect, by threatening them with corporate restructuring or divestment. Following Admati and Pfleiderer (2009), we thus treat proactive ‘exit’ threats as a form of voice.

‘Nudging’ is used to measure reactive engagement, which describes respondents that actively engage with companies only if they are prompted to do so by company-internal changes or sudden market movements. It also covers investors whose investment strategy is based on arms-length principles including proxy voting and ‘piggybacking’, that is, supporting campaigns waged by activist investors (Appel et al, 2016). Lastly, disengagement classifies investors who do not engage with target firms, neither actively nor reactively, but instead prefer buy-and-hold methods such as index tracking.

In the second step, ownership practices were grouped according to national Chinese (NC group) and foreign ethnic Chinese origins (FE group). Investors were then classified according to similar governance features to verify whether the revealed engagement patterns hold despite the incentives from varying business models. Any percentage point differences of +/-10% were recorded as a change in engagement pattern. Based on the above literature review, we focused on liability duration and legal ownership. Asset size was excluded since all organisations in the sampling frame were ‘large’ investors, that is, with at least USD 5 billion in asset size (Monk and Sharma, 2015). To gauge liability duration, non-life insurance companies and DC pension plans were classified as ‘shorter-term liabilities’, following previous works (Besley and Prat, 2003). Correspondingly, life-insurance companies and DB pension plans were assigned to ‘longer-term liabilities’³⁰. Legal ownership was measured, by

³⁰ The asset liabilities of China’s National Social Security Fund (NSFF) are similar to DB pension plans. Its purpose is to create a national long-term reserve fund to offset the gap between pension expenses and future demands of China’s rapidly aging population (NSSF, 2016). Since its owner, the Chinese state,

distinguishing between privately owned and state-owned investment organisations defined as 51% majority share-ownership.

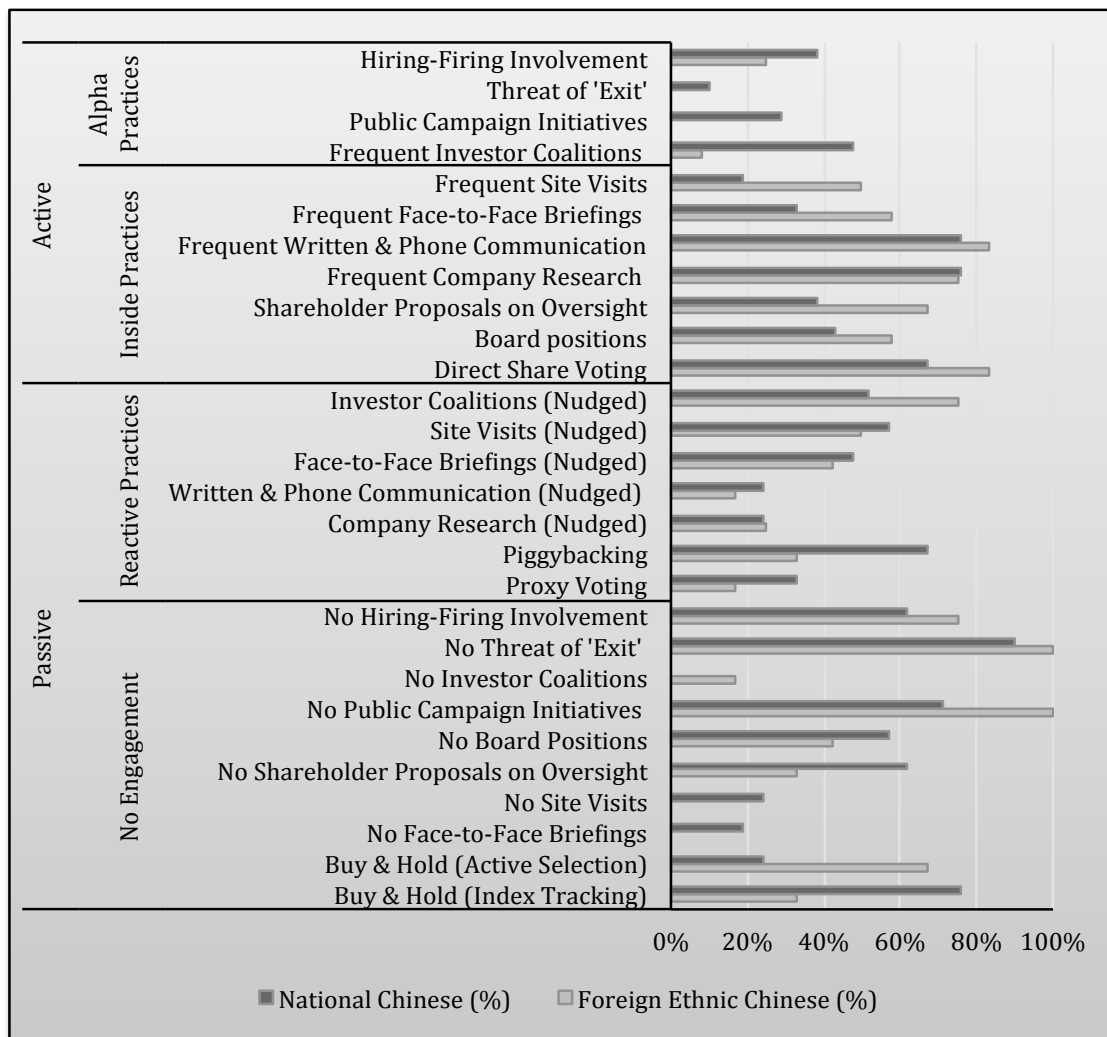
Finally, interview findings were cross-checked against annual reports, shareholder meeting announcements and participant observations from committee meetings at 16 insurance companies and 7 pension funds (Appendix B). These additional insights enabled us to gather insights on shareholders' engagement objectives, attendance, resolutions and voting outcomes to verify the validity of interview responses.

6.5 Findings and Discussion

This section presents the empirical findings. The first part compares the shareholder practices in the FE group with those in the NC group. The second part places these practices into the context of China's regulatory environment and verifies whether the revealed behavioural patterns hold in light of varying business model features. If the cultural proximity logic holds, then investors within the NC and FE group should display similar patterns of shareholder engagement regardless of their governance characteristics.

bears the cost of poor investment decisions, NSSF's incentives to monitor companies resemble DB pension funds. NSSF is thus assigned to the 'longer-term liabilities' category.

Figure 2. Ownership Engagement Practices by Ethnic Origin (%)



As figure 2 illustrates, shareholder behaviour in the NC and FE group is similar insofar as both rely on a combination of active-passive practices. However, they differ in the *degree* of engagement. National Chinese and foreign ethnic Chinese shareowners both rely on passive means of engagement but reactive behaviour is concentrated among the former. A major difference also emerges along the spectrum of active engagement. Short-term 'alpha' activism such as participating in hiring-firing changes is concentrated in the NC group, whereas 'inside' practices are concentrated in the FE group. The remainder of this section discusses the findings in greater detail.

Active engagement

Along the active-passive spectrum of shareholder engagement, 'inside' practices are the main means of engagement among foreign ethnic Chinese investors. Although the FE and NC group display similar use of fundamental company research and written communication, they diverge considerably when it comes to face-to-face interaction with company managers. For example, all foreign ethnic Chinese shareowners indicated that they carry out site visits, half of them on a frequent basis. In comparison, 19% of national Chinese investors conduct frequent site visits, whereas over a quarter of them stated that they never inspect their investees' premises. Similarly, more than half of foreign ethnic Chinese investors frequently attend face-to-face briefings with managers and board members, compared to a third of national Chinese investors. In fact, 19% of respondents in the NC group indicated that they do not engage in face-to-face meetings. In addition, about 67% of foreign ethnic Chinese investors have issued shareholder proposals on oversight issues such as executive remuneration and board composition, whilst 62% of national Chinese investors have not. More than half of foreign respondents also indicated that they assume board responsibilities, whereas more than half of national Chinese investors do not. The findings therefore highlight that interaction-driven 'inside' practices are more common among foreign investors with ethnic Chinese origins than among their national Chinese counterparts.

Rather than being inactive owners, national Chinese investors rely on different *channels* of active engagement. They favour 'alpha' practices that seek to create excess returns over shorter horizons, typically within a one-year period (Zenner et al, 2015). For example, 29% of national Chinese investors use public campaigns as a tool to instigate support from other investors and secure alpha returns. In comparison, investors in the FE group refrained from using this practice altogether. Furthermore, reliance on 'exit' threats reveals less pronounced but nonetheless noteworthy differences. In the NC group, 10% of respondents use 'exit' threats based on partial or complete divestment of shares if they are dissatisfied with companies. By comparison, none of the respondents in the FE group indicated reliance on 'exit' tactics. In the NC group, almost half of respondents also frequently form coalitions with other investors

to pool resources and initiate changes in target firms. In contrast, 8% of foreign ethnic Chinese investors resort to this practice. Consequently, alpha-driven activism is concentrated among national Chinese investors.

In sum, whilst the FE and NC group both rely on active engagement, they differ significantly in their specific means and motivations. Whereas 'alpha' activism is more common within the NC group, 'inside' practices are concentrated within the FE group.

Passive engagement

Similar to 'alpha' practices, the findings also reveal that reactive engagement is concentrated among national Chinese investors. For example, compared to one-third of investors in the FE group, about two-thirds in the NC group use 'piggybacking', In other words, they support campaigns waged by activist investors rather than launching their own initiatives. Similarly, about twice as many national Chinese investors buy advice from proxy services. Although the differences are less pronounced, comparable patterns also apply to 'nudging' behaviour. Investors in the NC group tend to rely on 'inside' practices such as site visits and face-to-face briefings only when prompted by external catalysts such as sudden market movements. An important nuance emerges also with respect to buy-and-hold strategies. Passive index tracking is concentrated in the NC group. As investors follow pre-defined index weightings rather than select firms themselves, this approach creates a disincentive for active engagement. Whilst foreign ethnic Chinese shareowners also use buy-and-hold practices, two-thirds make an initially active decision on which companies to select and keep for investment. This adds an important nuance to existing works, which argue that institutional investors blindly follow pre-set indexes and proxy advice rather than exercise deliberate judgment (Coffee and Palia, 2014). As the findings suggest, institutional shareholders in China do indeed follow such arms-length practices but this does not automatically preclude them from making deliberate investment choices.

In sum, what unites the FE and NC group is that fund managers make simultaneous use of proactive practices and arms-length practices. If we focus solely on these broader patterns, this would suggest that passive and active shareholder engagement is complementary rather than mutually exclusive. However, when taking

a closer look it becomes clear that the specific means of engagement differ between the FE and NC group. To make sense of these differences, it is necessary to put the observed behavioural patterns into context. Foreign investors highlight the need to be proactive. To acquire similar informational insights to local investors, they favour the more costly route of active monitoring and site visits (Singaporean Insurance Company, Interview, April 2014). The observed concentration of 'inside' engagement in the FE group is thus not driven by the goal to change corporate governance but by the 'softer' motivation of gathering deeper insight into investee firms. In the Chinese context, investment organisations are thus passive investors by design and proactive owners by necessity.

The combination of passive behaviour and 'alpha' engagement among national Chinese shareowners needs to be understood in relation to their organisational governance. As discussed earlier, majority state ownership reduces the need to rely on visible 'voice', as the Chinese party-state exercises insider control over domestic investment organisations and listed companies alike (Gong, 2014). This creates a strong incentive for passive shareholder behaviour among state-owned Chinese investment organisations. Furthermore, long-term asset liabilities provide a strong incentive for corporate stewardship (Clark and Monk, 2014), whereas shorter-term obligations encourage the pursuit of immediate profits (Pacces, 2016). The latter therefore incentivises shareholders to adjust their investments to sudden market movements ('reactive') and extract return premiums as quickly as possible ('alpha'). Following this logic, the next section splits the investor sample according to similar legal ownership and duration of liabilities. The remainder of this paper shows that these differences in governance characteristics have a considerable impact on how fund managers respond to the Chinese regulatory environment.

Duration of Liabilities

The findings reveal that the duration of asset liabilities indeed changes the nature of shareholder engagement. In the FE group, it is investors with longer-term liabilities that make proactive use of 'inside' engagement relative to those with shorter-term

liabilities (Table 1). This is particularly evident for practices that afford deeper insight into company management including board responsibilities and shareholder proposals on oversight issues. However, longer horizon investors rely less on ‘softer’ means of inside engagement, that is, practices that do not require face-to-face interaction such as written and phone communication. This can be explained by their general preference for proactive face-to-face engagement. Interestingly, the reverse applies to national Chinese investors. Face-to-face practices are more common among organisations with shorter-term asset obligations than among long horizon investors. Consequently, whilst the behavioural patterns in the FE group largely support the claim that longer-term liabilities incentivise corporate stewardship (Monk, 2009), these claims do not hold for national Chinese investors.

Table 1. Long-term vs. short-term liabilities (%- point difference in FE & NC group)

Type of Shareholder Practice	Foreign Ethnic Chinese (FE)	National Chinese (NC)
Inside		
Direct Share Voting	-11%	-34%
Board positions	33%	-32%
Shareholder Proposals on Oversight	44%	-39%
Frequent Company Research	22%	-18%
Frequent Written & Phone Communication	-22%	2%
Frequent Face-to-Face Briefing /Conference	22%	-27%
Frequent Site Visits	22%	-22%

Note: Positive percentage point (pp) differences reflect greater reliance on a certain practice among investors with long-term liabilities, whereas negative pp differences reflect a greater use among investors with shorter-term liabilities. Practices in line with theory are highlighted (10 percentage-point positive difference).

Similar patterns apply to ‘reactive’ and ‘alpha’ engagement. In line with the literature, ‘reactive’ engagement in the FE group is concentrated among investors with shorter-term liabilities (Table 2). A notable exception is ‘nudge’ behaviour with respect to activist investor coalitions. Shareowners with longer-term liabilities more often require a nudge to galvanise support from other investors compared to shareowners with shorter-term obligations. This reflects the general reluctance toward ‘alpha’ activism among long horizon shareowners. In contrast, shorter horizon investors in the FE group make *proactive* use of ‘alpha’-driven investor coalitions, alongside other ‘alpha’

practices such as participating in corporate hiring-firing decisions. These findings support the claim that shorter horizon liabilities disincentivise investors' corporate stewardship (Clark and Monk, 2014) and encourage the pursuit of more immediate return premiums (Hendry et al, 2007). Surprisingly though, the reverse applies to national Chinese investors. As table 2 illustrates, both reactive engagement and the formation of alpha-driven investor coalitions is associated with *longer-term* liabilities in the NC group. Similarly, 'exit' threats are more common among long horizon investors than investors with shorter-term obligations. Previous works have typically linked such 'alpha' activism to investors such as hedge funds that seek to provide clients with prompt excess returns as quickly as possible (Coffee and Palia, 2014). However, the evidence highlights that the potential for a return premium also leads Chinese pension funds and insurance companies to use 'alpha' practices. These findings thus challenge 'universal ownership' premises that long-term asset obligations lead pension funds and insurance companies to emphasise corporate stewardship and stable returns (Urwin, 2011).

Table 2. Short-term vs. long-term liabilities (%-point difference in FE & NC group)

Type of Shareholder Practice	Foreign Ethnic Chinese (FE)	National Chinese (NC)
Reactive		
Proxy Voting	-11%	-34%
Piggybacking	0%	-35%
Company Research (Nudged)	22%	-18%
Written & Phone Communication (Nudged)	-22%	2%
Face-to-Face Briefings /Conferences (Nudged)	33%	-16%
Site Visits (Nudged)	22%	-52%
Investor Coalitions (Nudged)	-56%	24%
Alpha		
Frequent Investor Coalitions	33%	-16%
Public Campaign Initiatives	0%	22%
Threat of 'Exit'	0%	-15%
Hiring-Firing Involvement	100%	39%

Note: Positive percentage point (pp) differences reflect greater reliance on a certain practice among investors with short-term liabilities, whereas negative pp differences reflect a greater use among investors with longer-term liabilities. Practices in line with theory are highlighted (10 percentage-point positive difference)

The curious combination of ‘alpha-reactive’ engagement among long horizon Chinese pension funds and insurance companies needs to be understood in the context of China’s ever-changing regulatory environment. According to a fund manager at a Chinese life insurance company,

‘the government dominates what happens in the market. Take the government’s stabilisation fund that was established after the [2015] stock market plunge to safeguard market stability. When the market slides downward, the stabilisation fund will halt any stock selloffs. When the market skyrockets, the fund will sell stocks. The problem with that is it becomes impossible to make an informed judgement call on where the market is going based on past experience. Nobody knows how to invest in such an environment so our [shareholder engagement] approach must be flexible’ (Interview, July 2016).

Similarly, another fund manager from a Chinese corporate pension fund emphasises that

‘Sometimes you have to react to fluctuations in the market from the outside-in, and sometimes you have to steer [investee companies] from the inside-out. You need to be able to adjust things when new [return premium] opportunities arise’ (Interview, June 2016).

This highlights that the constant market intervention by the Chinese government generates uncertainty, which encourages long horizon asset owners to adopt momentum-driven investment strategies. In turn, this encourages ‘cherry-picking’ of ‘inside-out’ alpha activism and ‘outside-in’ reactions to external nudges such as sudden market movements. These two approaches are at opposite ends of the active-passive engagement spectrum. What unites them, however, is the motivation to extract short-term gains from information inefficiencies in China’s state-dominated market.

Such uncertainty-driven incentives at the market level are complemented by incentives arising from remuneration systems at the organisational level. The differences between the FE and NC group regarding bonus payouts to fund managers illustrate this well. All organisations in the FE group fell into three bonus payment categories: Annual payouts, multi-year awards or overlapping cycles, that is, annual payouts that are tied to multi-year awards. Because these rewards are paid in the

future, they provide a strong motivational and retention tool for creating shareholder value over long-term horizons. In contrast, national Chinese investment organisations issued bonus payouts on an annual or biannual basis. Of all interviewees, only one organisation paid multi-year awards. These shorter-term reward structures encourage fund managers to focus on more immediate profit margins. According to a fund manager at a national Chinese insurance company,

‘turnover of employees is high and bonuses are paid every six months depending on how well you perform. So if you want to be up there with the top-performing [investment] portfolios you have to be responsive to changes in the market if prices jump too much’ (Interview, April 2014).

This highlights the importance of career risk in shaping shareowner behaviour. Biannual bonus payouts discourage fund managers in the NC group from acting in the long-term interest of beneficiaries. As matching liabilities can negatively affect their compensation and career development, they favour reactive trading behaviour to maximise short-term return premiums. This suggests that short-term reward systems can offset fund managers’ incentive to match long-term asset liabilities and act as a steward towards the companies they invest in.

In sum, the combination of regulatory uncertainty at the market level and short-term remuneration systems at the organisational level creates mutually reinforcing disincentives for ‘universal ownership’ in the NC group. They fuel a tendency to focus on immediate performance, which encourage *ad hoc* adjustments to new market regulation (‘reactive’) and activist interventions to secure short-term excess returns (‘alpha’).

Legal Ownership

Whether an organisation is state-owned also shapes the nature of shareholder engagement. The Chinese government’s insider control over state-owned investment organisations and listed companies insulates them from competitive pressures (Gong, 2014). As a result, this reduces the need for visible ‘voice’ and incentivises state-owned Chinese organisation to behave as passive shareowners. In contrast, privately owned

joint stock organisations have an obligation to maximise shareholder wealth, thus providing a stronger incentive to actively engage with investee companies (Celik and Isaksson, 2014).

Table 3. State-owned vs. Non-State (%-point difference within FE and NC group)

Type of Shareholder Practice	Foreign Ethnic Chinese	National Chinese
Disengagement		
Buy & Hold (Index Tracking)	0%	14%
Buy & Hold (Active Selection)	0%	-14%
No Face-to-Face Briefings/Conferences	0%	14%
No Site Visits	0%	7%
No Shareholder Proposals on Oversight	0%	14%
No Public Campaign Initiatives	0%	36%
No Investor Coalitions	67%	14%
No Threat of 'Exit'	0%	14%
No Hiring-Firing Involvement	33%	14%
Reactive		
Proxy Voting	22%	36%
Piggybacking	0%	0%
Company Research (Nudged)	22%	29%
Written & Phone Communication (Nudged)	22%	7%
Face-to-Face Briefing /Conference (Nudged)	-11%	-7%
Site Visits (Nudged)	11%	-21%
Investor Coalitions (Nudged)	-56%	-50%

Note: 'Majority shareholder refers to at least 51% ownership of tradable shares. Positive percentage point (pp) differences reflect greater reliance on a certain practice among state-owned investors, whereas negative pp differences reflect a greater use among non-state investors. Practices in line with theory are highlighted (10 percentage-point positive difference).

As table 3 shows, state ownership shapes shareowner behaviour in the FE and NC investor group in similar ways. In both groups, reactive engagement such as proxy voting and reliance on external 'nudges' is more common among state-owned than privately owned entities. Furthermore, national Chinese investors tend to opt for disengagement if they are state-owned, whilst behavioural patterns remain largely unchanged in the FE group. Consequently, the findings support the literature on the role of state ownership.

Table 4. Non-State vs. State-owned (%-point difference within FE and NC group)

Type of Shareholder Practice	Foreign Ethnic Chinese	National Chinese
Inside		
Direct Share Voting	22%	36%
Board positions	-10%	0%
Shareholder Proposals on Oversight	0%	14%
Frequent Company Research	22%	29%
Frequent Written & Phone Communication	22%	7%
Frequent Face-to-Face Briefing /Conference	22%	7%
Frequent Site Visits	11%	-29%
Alpha		
Frequent Investor Coalitions	11%	7%
Public Campaign Initiatives	0%	36%
Threat of 'Exit'	0%	14%
Hiring-Firing Involvement	33%	14%

Note: Positive percentage point (pp) differences reflect greater reliance on a certain practice among non-state investors, whereas negative pp differences reflect a greater use among state-owned investors. Practices in line with theory are highlighted (10 percentage-point positive difference).

The findings also support the aforementioned claims on private ownership and active shareholder engagement. ‘Inside’ engagement and ‘alpha’-driven behaviour are favoured by privately owned organisations in both the FE and NC group (table 4). This is especially pronounced among national Chinese investors, where private ownership is associated with the proactive use of all ‘alpha’ practices examined. A notable exception in the NC group is site visits. These are more common among state-owned investors than their private counterparts. However, as table 3 shows, reliance on all other face-to-face means of ‘inside’ engagement decreases if investors are state-owned. This mismatch suggests that, as part of their site visits, state-owned Chinese investors may rely on other practices that are not captured in this study. We will return to this aspect later but for now the key point is that legal ownership shapes shareholder engagement in similar ways for national Chinese and foreign ethnic Chinese investors. Private ownership is linked to ‘inside’ and ‘alpha’-driven engagement, whereas state ownership is associated with passive engagement.

Despite these similarities, the motivations informing passive behaviour of state-owned investors differ between the FE and NC group. According to a fund

manager at a Taiwanese insurance company, state-owned foreign organisations manage

'public money [from their home market] and have it in [the] mandate agreements to invest that money with steady returns in mind. So the last thing you want to do is interfere and rock someone else's boat politically [i.e. the Chinese market]. [...] The smart thing to do is to diversify [shareholding positions] and wait' (Interview, November 2013).

This highlights that foreign shareholder activism is constrained by government-linked investment mandates at home. Activist practices risk upsetting vested political interests, by exposing bad corporate governance in Chinese target companies and thus jeopardising stable investment returns. To avoid breaching public mandates, government-owned entities therefore prefer 'safe bet' portfolio diversification based on passive buy-and-hold practices.

By comparison, the Chinese party-state controls the domestic investment environment with the help of various market-level and organisational channels. At the market level, the Chinese government imposes restrictions on allocating state assets and frequently requires state-owned investment organisations to outsource tradable equity investments to external asset managers (Chinese pension fund, Interview, December 2015). At the organisational level, the Chinese Communist Party (CCP) can appoint board members and directly influence the career progression of fund managers in China's state-owned investment entities (Gong, 2014). This encourages fund managers to give priority to political goals over investment returns and corporate stewardship. Such career risk incentives are amplified by the lack of a sense of ownership among investment managers, as it is not their funds that are allocated (Ruffle, 2014).

The Chinese government's control over domestic investment organisations also extends to listed companies. This includes 'block-holding' of voting stock in state-owned companies but also the creation of CCP supervision committees in many private firms (Yu, 2013). Listed Chinese companies thus share a common linkage to party elites with state-owned Chinese investment organisations. Given this insider control, the latter are better positioned to influence the corporate governance of domestic target firms than foreign investors. They can draw on less visible political relationships that

link shareholders and corporate managers, thus reducing the need to devote resources to visible shareholder 'voice'. The findings echo this logic. As we have seen, state-owned Chinese investors frequently conduct site visits but rely less often on conventional shareholder engagement such as direct share voting and shareholder proposals.

6.6. Conclusion

Focusing on pension funds and insurance companies, this paper examined the role that cultural similarities play in shaping shareholder engagement in China. Cultural perspectives in behavioural finance and Chinese area studies both emphasise that common ethnic origins between investors' home market and target markets facilitates economic engagement in the latter. This is because culturally close foreign investors are considered to be familiar with the investment environment and enjoy relations of trust with local 'in-groups' similar to those of domestic investors. Contrary to this logic, this study finds that foreign ethnic Chinese investors and national Chinese investors differ in how they engage with listed private companies in China. Longer-term 'inside' engagement is concentrated among foreign ethnic Chinese investors, whereas national Chinese investors favour reactive practices and momentum-driven 'alpha' engagement. These findings thus challenge the notion that shared ethnicity equips foreign investors' with local information advantages and thus motivates similar patterns of engagement in culturally close markets.

As we have seen, reliance on active 'inside' practices among foreign ethnic Chinese investors did not reflect the intention to change corporate governance; it mirrored the need to acquire more in-depth information about Chinese companies. Common ethnic origins with Mainland China may therefore lower information asymmetries but do not equate to local information advantage. This suggests that common ethnic background may provide an added incentive for active engagement but for different reasons than those suggested by transaction cost theories: Rather than enabling information advantages in culturally close markets (Berecha et al, 2014; Clark et al, 2015), it is the sustained informational *differences* between foreign ethnic

Chinese and national Chinese investors that drive the former's proactive behaviour. The revealed nuances in arms-length engagement also support this logic. Although both investor groups rely on buy-and-hold practices, the findings contrast passive index tracking among national Chinese shareholders with the initially active selection of target firms by foreign ethnic Chinese investors. In contrast to previous works (Coffee and Palia, 2014), this highlights that institutional investors in China are not passive investors by default but by design.

The findings also highlight the importance of governance features within investment organisations. State ownership was associated with a preference for arms-length practices among both foreign ethnic Chinese and national Chinese investors. This supports existing works on state ownership and passive engagement incentives (Gong, 2014; Clark and Monk, 2014). 'Inside' engagement was concentrated among foreign ethnic Chinese investors with longer-term liabilities, thus lending support to claims that long-term obligations to beneficiaries encourage 'stewardship' behaviour (Besley and Prat, 2003). Seen from this perspective, the revealed behaviour of national Chinese pension funds and insurance companies was perplexing. Rather than long-term stewardship, those with longer-term liabilities favoured momentum-driven 'cherry-picking' of reactive engagement and proactive 'alpha' engagement. These findings lend support to works comparing long-term asset owners to 'financial traders' driven by short-term profits (Hendry et al, 2006, 2007). This raises questions about what is 'universal' about 'universal ownership', as shareholder engagement grows in transition economies such as China. It therefore becomes necessary to rethink Anglo-American assumptions that link traditional institutional investors with long-term accountability towards the assets they own.

Given the exploratory nature of the above findings, this paper is nonetheless subject to some limitations. Although the sampling frame in this study affords significant generalisability, the findings establish associations rather than causal relationships. As studies on shareholder engagement in non-Western markets remain scarce, the theoretical premises may reflect an in-built bias toward Anglo-American practices that does not hold in the Chinese context. The observation that 'inside' engagement is relatively less common among national Chinese investors does therefore not automatically suggest that they are less active owners; they may rely

more on relationship-driven and thus less visible channels of 'inside' voice that nurture long-term engagement but have not been covered in this study. Indeed, recent works show that Chinese investment firms run by 'princelings' (*taizi dang*), that is, children of Chinese Communist Party leaders, are able to secure preferential access to share deals and lobby key decision-makers to approve deals (Robertson, 2015). Future research therefore needs to further disentangle the management structures of individual Chinese investment firms to verify whether the behavioural patterns identified in this study indeed reflect systemic cultural differences or isolated cases of privileged 'princelings'.

Despite these limitations, this study clarifies that the current 'long-termism' debate is misplaced to explain the desirability of shareholder engagement. Policymakers frequently link 'long-term' asset owners such as pension funds and insurance companies to 'good voice' (OECD, 2012). However, as we have seen, the *ad hoc* approach of national Chinese investors is driven by a mismatch between internal reward systems and asset liabilities, as well as external uncertainty arising from continuous government interference in the Chinese market. These findings clarify that focusing on the 'right' horizon for managing listed firms confounds the effect, that is, short-term engagement, with the cause, that is, uncertainty (Pacces, 2016). They also highlight the need to rethink the *level* at which incentives operate. Rather than being solely tied to market context and organisational structures (Reisberg, 2011), shareholder practices also reflect career risk incentives at the manager level. If these are poorly aligned with long-term liabilities to beneficiaries, they can replace fund managers' incentives to become 'stewards' of the companies they invest in.

The findings have important policy implications for the development of Chinese corporate governance. The Chinese government seeks to promote the role of institutional investors 'in the appointment of company directors, the compensation and supervision of management and major decision-making processes' (CSRC, 2002:11). As we have seen, such corporate stewardship is concentrated among foreign ethnic Chinese rather than national Chinese investors. Nonetheless, foreign investors continue to face strict shareholding limitations that domestic investors are not subject to. This exposes a major paradox in Chinese corporate governance policies: foreign shareholding restrictions undermine the policy objective to leverage market forces as a

tool to increase corporate accountability and transparency. Developing a capital market that demands and rewards good corporate governance requires aligning investor incentives, by loosening the party-state's dual grip as controlling shareholder and market regulator. This will be decisive for whether long-term institutional investors such as pension funds and insurance companies can fulfil a 'stewardship' role as envisioned by the 'universal ownership' perspective. Until then, 'universal ownership' will remain a geographically confined rather than a universally applicable concept.

CHAPTER 7

Conclusions

This thesis investigated the rise of Chinese cross-border finance. Work on this research project began in 2013 when media coverage of London's approval to become the first 'RQFII hub' outside Asia sparked my interest in China's accelerated capital market opening. Initially, the QFII/RQFII schemes were limited to Mainland China and Hong Kong, including only a dozen foreign entities with approval to invest their money into domestic Chinese securities. Since then, the development of Chinese cross-border finance has been on a fast track. The RQFII scheme has expanded globally to cover twelve international money centres with offshore RMB trading hubs. The QFII and RQFII schemes now each count several hundred rather than several dozen foreign investors. Together, this pool of investors has access to China's equity market, which has transformed from having eight listed companies in 1990 to surpassing Japan in 2015 as the world's second largest stock market (CSRI, 2015).

The global expansion of the RQFII scheme has facilitated an equally remarkable transformation of Chinese currency markets. Before 2004, RMB-denominated trading was not allowed outside China and the RMB had practically no international influence. Fast-forward ten years, the RMB is now the fifth most-used currency for international payments and part of the International Monetary Fund's basket of global reserve currencies (IMF, 2015). In sum, the vast scale and speed at which Chinese cross-border finance has developed, and the role of state capitalism that underpins this expansion, will fundamentally challenge how social scientists think about power in the international financial system. Despite the growing global importance, China's cross-border investment programmes remain little understood.

Against this backdrop, the overarching objective of this research project was to understand the driving forces that shape competitive hierarchies under China's QFII/RQFII programmes. To this end, this thesis conceptualised Chinese cross-border finance as a global network of interconnected agents, places and activities. Through four papers, the thesis explained how major formal and informal institutions govern this global network and shape competitive outcomes in China's capital markets. Each of the four papers presented a discrete piece of research. Yet, all of them proceeded from an agency-driven understanding of 'institutions'. In other words, they emphasised how choices, behavioural practices and bargaining dynamics shape institutional development. The multi-scale network approach adopted in this thesis

provided a helpful heuristic device in this respect, as it allowed for identifying interdependencies between multiple levels of government and firms from different locations. This way, it was possible to tease out differences *within* agent categories and avoid slipping into bounded notions such as ‘the state’ or ‘foreign versus domestic markets’.

Taken together, the papers sought to address three specific research goals: (1) to rethink analytical frameworks of global financial networks (GFN), by shifting the focus to channels of state power; (2) to investigate how such formal institutions shape competitive hierarchies in financial markets, both inside and outside of China; and (3) to demonstrate that informal social institutions such as a common cultural identity are equally important to explain behaviour and outcomes in Chinese cross-border finance. What united the four papers was the objective to shed light on the interplay between political, economic and social underpinnings of Chinese cross-border finance. The four-paper research design and mixed-method approach adopted in this thesis provided the toolkit required for realising these goals. The four-paper design allowed for connecting interrelated but often separately treated agents, network linkages and geographical settings. The methodological emphasis on data triangulation afforded a robust way of measuring formal and informal institutions, by combining in-depth qualitative inquiry with quantitative verification based on database analysis.

In pursuing the above goals, the findings showed that bargaining conflicts *inside* the Chinese party-state had a decisive impact on competitive outcomes and behaviour in Chinese cross-border finance, both domestically and globally. Strategic state interests formed an interdependent relationship with the resources supplied by foreign investors and domestic corporate players. Domestically, these resource interdependencies explained the asymmetrical nature of market access under China’s cross-border investment schemes (chapter 4). Globally, the shift in state-firm bargaining dynamics from strategic alignment to an increasing bifurcation of interests explained the patchy integration of RMB finance into London’s financial architectures (chapter 5). Through its ‘visible hand’, the Chinese party-state also affects access to information in Chinese equity markets. Constant government intervention contributed to informational differences between national Chinese investors and foreign ethnic Chinese investors despite their common cultural ties (chapter 6). Whilst their common

cultural background with national Chinese investors reduced information asymmetries for foreign ethnic Chinese investors, it did not translate into local information advantage. Overall, the intersection of state-firm relations and informal cultural dimensions thus has a decisive impact on who gets ahead and who lags behind in China's capital markets.

The findings make several contributions to the literature. If seen as a sum of their respective inquiries, the four substantive chapters offer the first comprehensive study of how formal and informal institutions govern Chinese cross-border finance. Together, the chapters explain the creation, evolution and consequences of this relatively new phenomenon in global capital markets. A major contribution lies in the multi-scalar analytical perspective of this thesis. Inside China, this thesis identified the drivers behind changes in RQFII/QFII approval criteria for different investor types (chapter 3-4). Outside China, it highlighted how state-firm relations shape the development of offshore RMB hubs in major international financial centres (IFCs) (chapter 5). The thesis also highlighted the links between cultural similarities and behaviour among different investor categories. This focus on a common group identity shed light on the 'intermediate space' between individual firms/state agents and IFCs. The final contribution derives from the mixed-method approach through which the above research questions were explored. This concluding chapter spells out these contributions in more detail.

The remainder of the chapter is divided into four parts. Section 7.1 summarises the findings and highlights their key contributions to the literature. Section 7.2 spells out the theoretical implications for studying how formal and informal institutions shape global financial networks. Section 7.3 shifts the attention to the practical implications that can be gleaned from this thesis. The final section discusses the limitations of this thesis and highlights avenues for future research.

7.1 Summary

The economic drivers and consequences of China's QFII/RQFII programmes are now thoroughly understood (Bredin and Liu, 2011; Li and Uchida, 2011; Ding, 2010). However, ahistorical scholarship has left us uninformed about the political and social

underpinnings of these programmes. This thesis demonstrated that formal state institutions and informal social institutions play a decisive role in explaining the creation and subsequent development of Chinese cross-border finance. This research focus thus fills an analytical void.

Understanding the role of formal state institutions required unravelling the bargaining dynamics between the CCP leadership and various financial authorities within the Chinese party-state. However, the international finance literature on China's QFII/RQFII schemes currently lacks a theoretical foundation to analyse these political dynamics. The first substantive chapter of this thesis (chapter 3) therefore developed a theoretical framework that mapped the interdependencies between different levels of Chinese government, foreign investors and domestic corporate players. To this end, an in-depth survey of relevant secondary literature was conducted. This included distilling conceptual insights on global financial networks (GFN) (Coe et al, 2014), variegated capitalism (Zhang and Peck, 2016) and institutional change (Thelen, 2012). These insights were then merged with theories of Chinese elite politics (Shih, 2008) as well as internal government records from key financial decision-makers (Appendix A). Blending secondary literature with Chinese primary sources allowed for mapping the strategic interests of different government bodies. This provided an empirically grounded conceptual foundation for linking political bargaining to the development of Chinese cross-border finance. In sum, chapter 3 advances GFN approaches, by conceptualising the channels through which *political* network layers feed into economic network layers.

The combination of Western and Chinese sources also enabled chapter 3 to remain sensitive to context-specific social features that underpin China's GFN. This included privileged personal relationships (*guanxi*) through linkages with children of Chinese Communist Party (CCP) leaders (*taizi dang*) and ethnic Chinese ties. The theoretical framework developed in chapter 3 formed a discrete piece of research that stands in its own right. At the same time, it anchored the empirical chapters, by highlighting the interconnections between state agents, firms and informal social relations. Throughout, this provided an overarching connecting thread to explain competitive hierarchies in Chinese cross-border finance.

Such competitive hierarchies were tied to several conditions:

For one, the alignment of strategic interests between the Chinese party-state and financial sector agents was the *sine qua non* for competitive 'lead' positions. As chapter 4 showed, changes in RQFII/QFII approvals reflected interdependencies between different levels of government within the Chinese party-state, domestic corporate interests and foreign investors. Those foreign investors that best served the objectives of Chinese political elites and vested domestic interests of state-owned financial institutions were most likely to secure preferential RQFII/QII approval. Such interdependencies mattered not only at the firm level; they also shaped the competitive hierarchies of IFCs in Chinese currency markets. Through the initial unison of state-firm interests, London secured a first-mover advantage as the first Western offshore RMB hub (chapter 5). However, as state-private interests shifted from strategic alignment to increasing divergence, other IFCs surpassed London in the quest for offshore RMB business.

What the findings from both chapters highlight is the importance of timing. The 2008 financial crisis triggered a U-turn in Chinese policy goals, which triggered substantial changes in R/QFII criteria (chapter 4). Similarly, demand for RMB-denominated assets dropped among London's fund managers due to shifts in international exchange rates and consequent monetary policy responses. As a result, London's RMB trading volumes fell, which transferred the City's competitive edge to offshore RMB centres in Asia (chapter 5). Competitive hierarchies in Chinese cross-border finance therefore reflect that interdependencies between government elites, firms and IFCs are *time-sensitive*.

Another important condition that shaped competitive outcomes was the institutional context of China's state apparatus. Its fragmented structure enabled policy entrepreneurs to exploit resource interdependencies at multiple access points. Inside the Chinese party-state, the Chinese central bank was a case in point (chapter 4). Multi-level government structures enabled the central bank to frame QFII/RQFII reforms in line with the strategic interests of the Politburo leadership and thus galvanise support from China's top decision-makers. Such policy framing allowed for shifting the balance of power within China's bureaucracy, by overcoming opposition

from other administrative bodies such as the Ministry of Finance. As a result, the central bank was able to strengthen its own policy autonomy over increasing the scope and speed of capital market reform.

Outside China, multi-level governance structures also enabled international policy entrepreneurs to advance their policy agenda. The actions taken by UK financial authorities to secure London's competitive edge in RMB finance illustrate this well (chapter 5). On separate state visits, they hosted and visited the Chinese President and the Head of China's central bank. They were thus able to exploit multiple political access points that hold major decision-making power over Chinese monetary policy. In turn, this allowed for winning support across different levels of Chinese government for London to become the first Western offshore RMB hub.

Overall, the empirical evidence on national and international policy entrepreneurs highlights an important condition under which adaptive state behaviour occurs across multiple geographical scales. The findings thus challenge assumptions that the state is resistant to change and add to debates on institutional learning and adaptation (Thelen, 2012; Hall and Thelen, 2009).

The final condition concerns the importance of informal relational assets. The findings highlight that privileged personal relationships are a decisive resource in affording competitive advantage. The results presented in this thesis allow for differentiating between two types of relational assets, that is, *acquired* relational proximity and *bequeathed* relational proximity. Chapter 4 demonstrated that market access under the RQFII scheme was initially only available to Mainland Chinese subsidiaries in Hong Kong. Yet, to promote the development of Chinese currency markets, Chinese regulators also extended this privilege to foreign investors willing to register their business in Hong Kong. The findings thus highlight the importance of *acquired* relational proximity, which can be obtained by means of geographical relocation. This not only cultivated familiarity with the local target market; above all, it served the strategic interests of the Chinese party-state.

In contrast, *bequeathed* relational proximity is based on family relations or ethnic ties, which facilitate mutual trust and the sharing of inside information. The analysis of QFII approvals in Chapter 4 revealed that hiring children of CCP leaders enabled first-mover advantages for foreign investment banks. Shared cultural

background had a similar competitive effect. Culturally close foreign investors from countries with ethnic Chinese majorities were granted first-mover privileges under the RQFII scheme. Bequeathed relational proximity thus bestowed firms with an important resource to attain competitive edge in Chinese cross-border finance.

However, this competitive effect did not extend to the access that firms have to local market information in Chinese equity markets. As chapter 6 showed, a shared cultural background with national Chinese investors did not equate to local information advantage for foreign investors. The significant behavioural differences between both investor groups reflected this. Compared with their national Chinese counterparts, foreign ethnic Chinese investors were proactive and willing to engage in more costly means of face-to-face interaction with their investee firms. This was driven by the need to acquire more in-depth information about local target companies. It was thus the sustained informational *differences* between national Chinese and foreign ethnic Chinese investors that mattered for how they behaved.

In sum, bequeathed relational proximity may provide a competitive edge over other foreign investors in financial policy games. But it does not translate into competitive edge over domestic investors. It was common national identity rather than common cultural identity that mattered for local information advantages. The findings therefore clarify that the hierarchy of relational assets in China's GFN remains profoundly localised. Whilst globalisation may have increased the connectivity between different network sites, we should not confound such connectivity with convergence.

7.2 Theoretical implications

This section spells out the wider theoretical implications for the findings. By returning to the structural benchmark introduced at the outset of this thesis, the section highlights key implications at the micro-level (state/firm agents), meso-level (ethnic networks) and macro-level of analysis (IFCs).

At the micro-level, this thesis has important implications for studying how ‘agency’ shapes institutional change in Chinese cross-border finance. On the surface, it is tempting to view the Chinese party-state as a ‘uniform’ agent given that financial regulation is centrally administered in China. This may lead us to assume that multi-level governance plays a limited role in shaping China’s QFII/RQFII market outcomes. Contrary to this logic, the findings highlighted underlying conflicts of interests between different bodies of central government. Effective policy entrepreneurship was decisive for how QFII/RQFII reforms unfolded. Policy entrepreneurs deployed key resources such as skilful framing and personal relations in governance games at national and global scales. In turn, this led to changes in QFII/RQFII criteria, which triggered shifts in the competitive hierarchies of firms and IFCs. To explain the development of Chinese cross-border finance, it is therefore necessary to adopt a multi-level perspective that remains sensitive to varying incentives and practices within the state.

The findings make an important conceptual intervention into the study of GFN. They highlight that changes in established network linkages are not simply the result of bargaining *between* different network layers such as ‘the state’ and ‘firms’. Such changes also reflect bargaining dynamics *within* a particular network layer. China’s GFN may appear ‘stable’ as formal linkages between network layers remain intact; but they can still undergo substantial functional adaptation that changes the logic behind these linkages. It is therefore necessary to further disintegrate seemingly homogenous actors such as ‘firms’ and ‘the state’. The literature on global economic networks has provided ample insight into the former. Future research should pay equal attention to internal differences of other key agents such as the state.

These insights have important implications for the literatures on GFN and business systems discussed earlier in the literature review (chapter 2). The specific channels of state-firm bargaining identified in this thesis may not lend themselves to broader generalisations but they highlight the need for a more inclusive approach to GFN governance. What makes the state-led GFN approach in this thesis more ‘inclusive’ is its emphasis on how bargaining between multiple *political* layers intersects with multiple economic layers of GFN. This multi-level political conception provides an opportunity to exploit conceptual synergies with multi-level economic governance of GFN frameworks (see Coe et al, 2014), by specifying key mechanisms

that link both governance forms. This idea that GFN governance is a *negotiated* outcome between different levels of government, firms and their respective institutional contexts is not specific to China but applies to GFN in any economic system.

The findings also showed that it was a combination of external crises and internal learning effects that triggered shifts in the power constellations of China's GFN. In turn, these shifts paved the way for new cross-border network linkages to emerge. This reference point of *time-sensitive* state-firm relations applies to GFN anywhere in the world irrespective of their economic system. These insights are not confined to non-Western contexts such as China. For example, external shocks such as the global financial crisis in 2008, triggered the revival of state capitalist tendencies in Western economies as illustrated by the bailouts of Western banks. The new US government under Donald Trump and the UK's Brexit vote may be the latest examples of a renewed emphasis on a stronger nation-state over liberal capitalism. If we accept the idea that the global economic system is a network of capitalisms, which differ in their national and regional contours but that are interlinked and constantly evolving, then the state-led GFN approach developed in chapter 3 opens up a broader research agenda on multi-level political bargaining in global economic networks. Rather than calling for 'Chinese exceptionalism', this thesis thus provides important insights for the study of GFN more generally.

These findings also enable us to revisit business systems approaches. As outlined in the literature review (chapter 2), this approach emphasises the state's provision of 'collective competition goods'. These 'goods' tie domestic firms to their respective institutional context, by creating distinctive organisational capabilities (Whitley, 2007; Crouch et al, 2009). This thesis advances this approach, by refining its conception of what counts as 'collective competition goods' and extending the focus beyond domestic agents. Previous works have argued that the rise of 'global business regulation' (Braithwaite and Drahos, 2000) has reduced the importance of state-provided collective competition goods such as a country's public science system or access to capital and skilled labour (Whitley, 2007).

However, the findings presented in this thesis suggest that competition goods are not limited to such direct conceptions; they can also take more indirect forms.

These included the Chinese government's provision of privileged market access for certain foreign investors and IFCs. The experimentation with such liberalising measures encouraged the development of Chinese capital markets. In turn, this enabled the government to unlock new sources of financing for domestic state-owned banks and enterprises. The findings thus suggest that the rise of global governance has not diminished the importance of state-provided competition goods. Rather, it has led to a *diversification* of the channels through which the state supplies these goods, including leveraging preferential capital market access for foreign firms to achieve domestic competition goals.

The findings also extend the domestic reach of business systems approaches. They highlight that foreign investors and international policy entrepreneurs also shape collective competition goods. As the analysis of the QFII/RQFII schemes showed, these international agents provided the Chinese government with politically relevant resources to achieve its strategic goals. Such resources included supplying foreign market expertise (foreign investors) and providing access to new financial territory (IFCs) in order to implement and advertise China's financial reform efforts. These findings make two important additions to a more nuanced perspective on collective competition goods: They identify important channels through which global agents feed into domestic economic organisation and clarify that space can function as a power resource in its own right.

In sum, this thesis advances the literatures on GFN and business systems, by demonstrating how internal differences within seemingly homogenous actors such as 'the state' shape outcomes in global finance. The findings clarify that focusing solely on agent capabilities and resources is not sufficient in this respect. It is necessary to specify the *conditions* under which agents' resources are mobilised across different locations and translate into actual influence over financial market outcomes. This requires paying close attention to the interdependent bargaining between state and corporate elites, multi-level governance structures as well as timing and external context. By shifting the focus from a capabilities-orientated perspective to a relational perspective on how agents from different locations 'trade' resources, this thesis contributes to a recurring question that has preoccupied generations of economic geographers: how to make a systematic assessment of 'geographies of power' (Allen,

2003).

At the meso-level, the findings suggest that informal social institutions such as privileged personal networks and a common cultural identity are equally important for the study of China's GFN. The thesis contributes to the measurement of such informal social institutions. Previous work on the social and cultural governance of global economic networks has been mostly limited to theoretical work (Ponte and Sturgeon, 2014) and an empirical focus on single cases (Saxenian, 2002; 2008; Li et al, 2001). This is partly because the measurement of social and cultural ties has concentrated on the firm level. To make headway, this thesis shifted the methodological focus to a firm's country of origin. It was therefore possible to classify 'culturally close' investors based on whether countries had ethnic Chinese majorities. This provided a useful proxy to capture the linkages between different *sites* of ethnic Chinese networks. This thesis therefore addresses the on-going problem of measuring informal social ties across a larger universe of ethnic networks.

At the macro-level, the broader implication is not simply that globalisation pressures give rise to variegated roles of the state in international finance. It is that the *interplay* between formal state institutions and informal social institutions matter for competitive outcomes in capital markets. This has important implications for how we think about 'markets'. Rather than viewing them as 'private' economic spheres, they are best understood as *negotiated* policy experiments that bridge conflicting strategic interests and thus inherent instability. The findings thus present an alternative to neoclassical economics, which views markets as homogenous and a-geographical spaces (Lee et al, 2009). Rather than following the logic of 'politics *against* markets' (Esping-Andersen, 1985), explaining the competitive landscape in Chinese cross-border finance requires understanding the politics *of* markets. By highlighting their inherently contested nature, this thesis clarifies that future research on Chinese cross-border finance need not be limited to the remit of financial economists.

On a broader level, the findings suggest that the spread of neoliberal economic ideas across borders is not a matter of institutional convergence or divergence; it is a matter of *selective* institutional adaptation. What makes the adaptation 'selective' is

the tension between state-firm interests and informal social dynamics. Combined, the interplay of these different forces translates into 'uneven' patterns of financial market development. This thesis thus poses a challenge to the 'end of geography' thesis that location no longer matters in finance and policymakers no longer exert full control over their regulatory territory (O'Brien and Keith, 2009). Rather than dismissing geography, this thesis affirms that space and place continue to matter to explain a variety of financial market outcomes.

7.3 Policy implications for capital markets and corporate governance

A number of practical policy implications follow from the findings. These concern the opportunities and risks emanating from state control over Chinese capital markets and the way this impacts corporate governance. The remainder of this section spells out these implications in greater detail.

The findings suggest that private sector support is crucial for developing a stable capital market inside China and a global RMB market outside China. Domestically, RQFII/QFII investors play a vital role in 'managing' the risks of an industry-wide banking crisis. Chapter 4 revealed that their capital inflows eased the burden of rising non-performing loans on state-owned banks and helped avert spill-over effects on state-owned asset management companies. Chinese policymakers continue to rely heavily on these financial institutions to finance economic growth. At the same time, they seek to curb the country's mounting debt load. QFII/RQFII capital inflows therefore provide a salient policy instrument, by providing an alternative source of bank financing. This point exposes an important paradox: Chinese policymakers have thus far prioritised strict capital controls due to concerns that 'hot' money could risk destabilising the market (Walter and Howie, 2014). Yet, the findings clarify that increased financial liberalisation can, in fact, assist Chinese policymakers in maintaining such stability, by helping curb credit growth and thus China's mounting debt problem.

At the global level, the recognition of such state-private interdependencies will also be decisive for the successful development of a global Chinese currency market. London's RQFII experience clarifies that overly stringent state control undermines such ambitions, by weakening private sector support in Western offshore RMB hubs and thus wider demand for RMB-denominated assets. Consequently, the alignment of state-private interests will be an essential condition for Chinese policymakers to achieve their longer-term goal of turning the RMB into a major global reserve currency. For Western policymakers of other offshore RMB centres such as Luxembourg the findings are equally instructive. They clarify that China's state-led approach to developing currency markets cannot easily be transferred to Western money centres. The liberal market context that they are embedded in operates free from comparable levels of state control. Forging and maintaining private sector support at home is therefore especially important for offshore RMB centres to thrive in liberal market settings.

In sum, the findings suggest that the successful development of RMB business is a *conditional* resource. Rather than focusing solely on strategic political interests, it requires governments to strike a balancing act, by adopting policies that benefit public and private sector agents alike. For the City of London itself, these policy lessons are particularly timely in light of the UK's forthcoming 'Brexit' negotiations to leave the European Union (Töpfer, 2016). They highlight the need for a joint public-private approach to maintain London's appeal as the leading RMB gateway to European markets in the future.

The emphasis on state control also conflicts with China's policy of leveraging the long-term horizons of institutional investors to incentivise more accountable corporate governance (see CSRC, 2002). Contrary to such long-term assumptions, the findings clarified that national Chinese pension funds and insurance companies adopt a momentum-driven approach towards the companies they invest in. These behavioural patterns reflected continuous government interference in the market, which gave rise to uncertainty. For Chinese policymakers, this clarifies that simply emulating Western corporate governance policies that link 'long-term' asset owners to 'good voice' is of little value. Such 'long-termism' propositions confuse the effect, that is, short-term investor behaviour, with the cause, that is, uncertainty. What Chinese policymakers

should instead focus on is the alignment of investor incentives. Such alignment requires loosening the party-state's dual grip as controlling shareholder and regulator in order to reduce information inefficiencies in the market. This would give shareowners a stronger incentive to demand and reward 'good' corporate governance.

7.4 Limitations and Avenues for Future Research

This thesis is not without shortcomings. This section discusses its conceptual and empirical limitations and suggests ways to overcome them in future research. Conceptually, the chapters proceeded from the assumption that 'the state' and 'firms' are multi-layered rather than cohesive agents. We have been attuned to the differences between investment firms, both geographically and culturally. Yet, the discussion of the Chinese party-state's internal fragmentation has been limited to the central level of government. This is because financial policy is centrally administered in China. However, this is set to change. New cross-border investment schemes have recently been created that are specifically tied to city-level financial centres such as Shanghai and Shenzhen (SCMP, 2015b). Limiting the analytical focus to China's central government may thus create misleading impressions of uniformity and cohesion. Future research would thus do well to unpack the increasingly important regional dynamics that underpin the governance of Chinese cross-border finance.

One promising research avenue could be to investigate the role of Shanghai's municipal government in securing a first-mover advantage over Shenzhen under China's Stock Connect Scheme. Combining the state-led GFN framework (chapter 3) with insights from the variegated capitalism literature (Zhang and Peck, 2016) would present a suitable conceptual foundation from which to unearth these regional dynamics.

Another limitation concerns the research design used to analyse the development of offshore RMB hubs. The single case of London's RQFII experience does not lend itself to broader generalisations about the integration of RMB finance into IFCs. It is thus important to acknowledge that the findings are tied to *contingent* generalisations based on particular conditions. The conclusions do not concern all

twelve offshore RMB centres that currently exist worldwide; they are specifically confined to the UK's institutional context. Future research examining other offshore RMB centres such as Frankfurt will thus need to take into account the different models of capitalism within which these cities are embedded.

Despite the limited empirical focus, the theoretical claims and methods used to study institutional adaptation apply to any economic system. The idea that institutional adaptation reflects shifts in state-firm interdependencies is not specific to London's offshore RMB hub. As we have seen, such shifts can be triggered by a combination of external crises and internal learning effects, which then create new paths for institutional development. This reference point of *time-sensitive* state-firm relations applies to offshore RMB hubs anywhere in the world irrespective of their economic system. Despite its empirical focus on London, this thesis thus provides important insights for the study of offshore RMB finance more generally.

Another constraint relates to the theoretical foundation used to examine the links between cultural similarities and shareholder behaviour in Chinese equity markets. The thesis relied on the shareholder engagement literature, which mainly focuses on Anglo-American contexts. This partly reflects the fact that few studies currently exist on shareholder engagement in the Chinese market. The theoretical premises in this thesis may therefore reflect an in-built bias toward Western assumptions that do not hold in the Chinese context. Future research needs to verify the revealed behavioural patterns.

A promising avenue of enquiry would be to use the findings of this thesis as a starting point for a more context-specific research programme. As the empirical chapters have demonstrated throughout, *guanxi* networks provide an important basis for trust and collaboration. To investigate their role in the context of shareholder engagement, future research could take a closer look at the management structures of Chinese investment firms. As suggested in Chapter 6, one way could be to classify management structures into those that include children of CCP leaders and those without such 'Princeling' background. This would allow investigating relationship-driven and thus less visible patterns of shareholder 'voice' that have been excluded in our analysis. It would also allow for verifying whether the observed behavioural

patterns indeed reflect systemic cultural differences or isolated cases of privileged 'princelings'.

The final limitation relates to the broader concern that competitive hierarchies in GFN are always changing. As such, this thesis presents a snapshot of current conditions in Chinese cross-border finance. As Chinese capital markets continue to mature, reliance on informal institutions might, for example, weaken. Such changes in institutional context would then require a re-evaluation of the findings presented in this thesis.

Despite the above limitations, it is important to remember that any global network analysis remains a simplification of a complex world. Simplifying requires considerable abstraction and exclusion. Whilst this thesis is no exception, it does not change the fact that its insights provide a foundation for future research on Chinese cross-border finance. By simplifying the complex interrelationship between political, economic and cultural drivers, this thesis was able to isolate specific interactions and mechanisms across different scales. The four-paper research design of this thesis therefore contributes to building 'good' social scientific theory on multi-level governance in Chinese financial markets.

In sum, this thesis redirects the focus away from economic relations, which continue to dominate the GFN literature. Instead, it opens up a broader research agenda on GFN governance that reflects the interplay between formal political and economic institutions and informal social institutions. Economic geography should follow suit.

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Appendix A: Primary Sources (Chapters 3-5)

I. Government records

Internal Government Journals & Data Sources

China Regulatory and Securities Commission (CSRC), List of Approved Qualified Foreign Institutional Investors, 2003-2014, Internal Report. (QFII托管行一览表).

State Administration for Foreign Exchange (SAFE), Allocated Investment Quota for Renminbi Qualified Foreign Institutional Investors, 2003-2014, Internal Report, (RQFII托管行一览表).

Leader's Policy-Making Information, Internal Journal. (领导决策信息).

Records from Financial Policymakers

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Other government documents

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Document Research Center of the CCPCC. *Selection of Important Documents since the 16th Party Congress*. Beijing, CN: Central Document Press, 2011.

Document Research Center of the CCPCC. *Selection of Important Documents since the 17th Party Congress*. Beijing, CN: Central Document Press, 2011.

People's Bank of China, *Selection of Financial Regulation Systems*. Beijing, CN: Financial Publishing House, Various Years.

II. List of Interviews

China (Beijing, Shanghai, Shenzhen, Hong Kong)

Government authorities

- China Securities Regulatory Commission (Beijing)
- State Administration for Foreign Exchange (Beijing)
- People's Bank of China (Beijing)
- Shanghai Stock Exchange Committee, Research Branch (Shanghai)
- Shenzhen Stock Exchange Committee, Research Branch (Shenzhen)
- National Development and Reform Commission (Beijing)
- Ministry of Finance (Beijing)
- China Association for Public Companies (supervised by CSRC, Beijing)
- Pudong Financial Service Bureau (Shanghai; part of Shanghai municipal government)
- Securities and Futures Commission (Hong Kong)

Stock Exchanges (Private)

- Hong Kong Exchanges and Clearing Ltd. (HK Stock Exchange, Hong Kong)
- Hong Kong Securities Clearing Company Ltd. (subsidiary of Hong Kong Stock Exchange, Hong Kong)

Financial Sector (State-owned)

- China Securities Depository and Clearing Corporation Ltd. (Beijing; owned by Shanghai Shenzhen Stock Exchanges)
- China Capital Market Development Co. (affiliated with China Securities Regulatory Commission)
- Sino-Europe Investment Corporation (Beijing; owned by Ministry of Foreign Affairs)
- Bank of China (Beijing)
- Ping An Bank (Beijing)
- Baoshang Bank (Beijing)
- Industrial & Commercial Bank of China (Beijing)

- China Construction Bank (Beijing)
 - China Merchants Bank (Beijing)
 - CITIC Securities (Beijing)
 - Minsheng Securities (Beijing)
 - National Equities and Quotation Association (Beijing)
- BOC International (China) Ltd. (Shanghai)

Financial Sector (Private)

- Hong Kong and Shanghai Banking Corporation (HSBC) (Hong Kong)
- Sun Hun Kai Fund (Hong Kong)
- Cephei Capital (Hong Kong)
- Goldman Sachs (Hong Kong)
- Asian Capital Ltd. (Hong Kong)
- Horizon Capital (Hong Kong)
- Charltons LLP (Hong Kong)
- JP Morgan China, Economic Research (Hong Kong)
- Barclays China (Hong Kong)
- Philip Capital (Hong Kong)
- Standard Chartered Bank, Equity Research (Hong Kong)
- China International Investment Corporation (Beijing)
- Matthews Asia (Beijing)
- Agricultural Investment of China Fund (Beijing)
- Sunshine Asset Management Limited (Beijing)
- KCCAPM Private Equity Fund (Beijing)
- Deutsche Bank China, Securities Services (Beijing)
- London Stock Exchange, China Office (Beijing)
- Société Générale China (Beijing)
- Pinsent Masons LLP (Shanghai)
- Z-Ben Advisors (Shanghai)
- Vistra China (Shanghai)
- Citi Bank China (Shanghai)
- Open Door Capital Group (Shanghai)
- Ernst & Young China (Shanghai)
- Boss & Young Attorneys (Shanghai)
- UBS (Hong Kong)

Academic institutions & think tanks

- Tsinghua University, School of Economics and Management (Beijing)
- China University of Law & Political Science, Centre for Economics and Law (Beijing)
- Beijing Normal University, School of Geography (Beijing)
- Chinese Academy of Social Sciences, Institute of World Economics & Politics (Beijing)
- Chinese Academy of Social Sciences, Institute of Finance and Banking (Beijing)
- Peking University, Guanghua School of Management (Beijing Campus)
- Peking University, HSBC Business School (Shenzhen Campus)

Other stakeholders

- Dow Jones Newswires, Beijing Office
- Wall Street Journal, Shanghai & Beijing Offices
- Financial Times, Shanghai & Beijing Offices
- Bloomberg, Shanghai Office
- Economist Intelligence Unit (EIU), Beijing and Shanghai Offices

UK (London)

- | | |
|---|--------------|
| • Allen and Overy (RMB Practice Group) | 4 interviews |
| • UBS (Group Strategy, China & RMB Internationalisation) | 2 interviews |
| • Bank of China (UK branch) | 5 interviews |
| • Agricultural Bank of China (UK branch) | 3 interviews |
| • Moody's (China Ratings) | 2 interviews |
| • Thomson Reuters (China Team) | 2 interviews |
| • HM Treasury (City of London) | 1 interview |
| • Chartered Financial Analysts UK (FX special interest group) | 8 interviews |
| • London Stock Exchange | 1 interview |
| • Clifford Chance (RMB Practice Group) | 1 interview |
| • Aviva Investors (RQFII Product Group) | 1 interview |
| • JP Morgan (RQFII Product Group) | 2 interviews |
| • Freelance journalists (RMB finance) | 3 interviews |
| • London Business School (China Business Forum) | 2 interviews |
| • HSBC (Global Banking & Markets, RMB Business Unit) | 1 interview |
| • Bank of England | 2 interviews |
| • Professional Network 'Chinese finance professionals in London' | 3 interviews |
| • LSE (Department of Finance, Chinese capital markets) | 2 interviews |
| • University College London (Law Faculty, Chinese securities law) | 1 interview |

Appendix B: Primary Sources (Chapter 6)

I. List of Interviews (2013-2016)

National Chinese

Tai Ping Corporate Pension Fund, Interview, 21 February 2016, Shanghai.

Taikang Corporate Pension Fund, Interview, 10 April 2016, Beijing.

Chang Jiang Corporate Pension Fund, Interview, 28 May 2015, Shanghai.

China Corporate Pension Fund (PRC), Interview, 10 April 2014, Beijing.

Ping An Corporate Pension Fund, Interview, 7 May 2014, Shenzhen.

CCB Life Insurance, Interview, 20 November 2015, Shanghai.

China Life Insurance (PRC), Interview, 30 April 2014, Beijing.

Funde Sino Life Insurance, Interview, 28 June 2016, Shenzhen.

Huaitai Life Insurance, Interview, 3 May 2014, Beijing.

HuaXia Life Insurance, Interview, 21 March 2016, Beijing.

Tianan Life Insurance, Interview, 14 April 2014, Beijing.

Sunshine Life Insurance, Interview, 27 June 2016, Beijing.

Guohua Life Insurance, Interview, 22 June 2015, Shanghai.

Pacific Life Insurance, Interview, 6 April 2016, Shanghai.

PICC Life Insurance, Interview, 17 March 2015, Beijing.

Ping An Life Insurance, Interview, 5 June 2016, Shenzhen.

Tai Ping Life Insurance, Interview, 20 June 2014, Shanghai.

Taikang Life Insurance, Interview, 12 April 2015, Beijing.

Union Life Insurance, Interview, 3 May 2014, Beijing.

Min Sheng Life Insurance, Interview, 28 April 2014, Beijing.

National Social Security Fund (NSSF), Interview, 20 December 2015, Beijing.

Foreign Ethnic Chinese

Asia Capital Reinsurance Group (Singapore), Phone Interview, 23 March 2015.

Great Eastern Life Assurance (Singapore), Phone Interview, 8 November 2016.

Cathay Life Insurance (Taiwan), Phone Interview, 6 June 2015.

Fubon Life Insurance (Taiwan), Written Communication, 14 November 2014.

Nan Shan Life Insurance (Taiwan), Phone Interview, 25 April 2015.

Hospital Authority Provident Fund (Hong Kong) Interview, 17 March 2015, HK.

Scheme Shin Kong Life (Taiwan), Phone Interview, 20 March 2015.

Taiwan Life Insurance (Taiwan), Written Communication, 10 November 2014.

CTBC Life Insurance (Taiwan), Phone Interview, 10 June 2016.

China Life Insurance (Taiwan), Phone Interview, 3 March 2015.

Seatown Holdings Ltd (Singapore), Phone Interview, 12 March 2015.

TransGlobe Life Insurance (Taiwan), Phone Interview, 2 April 2014.

BOC Life Assurance (Hong Kong), Interview, 15 November 2015, HK.

II. Participant Observation - List of committee meetings (2013-2016)

Insurance Companies

- Cathay Life Insurance (Taiwan)
- China Life Insurance (Taiwan)
- Chinese People's Insurance (National Chinese)
- Foresea Life Insurance (National Chinese)
- Fubon Life Insurance (Taiwan)
- Huatai Insurance (National Chinese)
- Hua Xia Life Insurance (National Chinese)
- Min Sheng life Insurance (National Chinese)
- Nan Shan Life Insurance (Taiwan)
- Pacific Life Insurance (National Chinese)
- Ping An Insurance (National Chinese)
- Funde Sino Life Insurance (National Chinese)
- Shanghai Life Insurance (National Chinese)
- Sunshine Insurance (National Chinese)
- Tianan Life Insurance (National Chinese)
- Union Life Insurance (National Chinese)

SUB-TOTAL: 16

Pension Funds

- An Bang Pension Fund (National Chinese)
- Changjiang Pension Fund (National Chinese)
- China Construction Bank (CCB) Pension Fund (National Chinese)
- Guoshou Pension fund (National Chinese)
- Ping An Pension Fund (National Chinese)
- Taikang Pension Fund (National Chinese)
- Taiping Pension Fund (National Chinese)

SUB-TOTAL: 7

TOTAL: 2