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Understanding Chinese Government Guidance Funds

An Analysis of Chinese-Language Sources

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Executive Summary

China's government is deploying massive amounts of capital in an effort to "catch up with and surpass" the United States in advanced technology. As part of this effort, the Chinese government has invested financially and politically in **government guidance funds** [政府引导基金], public-private investment funds that aim to both produce financial returns and further the government's industrial policy goals. As of the first quarter of 2020, Chinese officials had set up 1,741 guidance funds, with a registered target size of 11 trillion RMB (1.55 trillion USD). However, these funds had only raised a total of 4.76 trillion RMB (672 billion USD) from private and public sources.

While guidance funds' ambitions are clear, their long-term prospects for success are not. Drawing exclusively on Chinese-language sources, this issue brief examines how guidance funds raise and deploy capital, manage their investments, and interact with other public and private actors. We find that many guidance funds are poorly conceived and implemented, and that the mechanism as a whole is often inefficient. Nonetheless, these funds have many advantages over traditional industrial policy mechanisms, and they are unquestionably helping mobilize money and other resources for new businesses and emerging technologies. The guidance fund model is no silver bullet, but it should not be casually dismissed.

As an industrial policy tool, guidance funds have several potential advantages:

- Guidance funds allow the Chinese state to leverage market discipline and expertise.
- Guidance funds offer patient capital, a critical resource for emerging technologies.
- Guidance funds can complement and amplify other industrial policy measures, producing robust, holistic support for emerging and high-tech businesses.

In practice, however, most guidance funds fail to live up to their ambitions, weakened by unrealistic goals, bureaucratic constraints, incompetent management, risk aversion, and a lack of market discipline. Our research shows that:

- Guidance funds often raise much less money than planned.
- Much of the money guidance funds raise is never actually invested in projects.
- There are too many guidance funds, leading to redundancy and inefficiency.
- Many guidance funds are poorly managed.
- Guidance fund capital has been wasted on nonstrategic and illicit activities.
- Guidance funds do not invest in early-stage companies as intended.
- Guidance funds often fail to attract truly private capital, and in some cases may even crowd private capital out of the market.

Even with these flaws, however, guidance funds still have advantages over China's traditional industrial policy mechanisms. And today, a subset of disciplined, market-oriented guidance funds is successfully raising money and investing in projects. These funds are especially likely to find success when their government sponsors are willing to tolerate some risk and allow professional fund managers to make market-oriented decisions.

As the guidance fund model undergoes reforms, more funds may succeed in bringing public and private capital together to advance China's strategic industries. To better track how the model may evolve, we provide a set of performance indicators to apply over the coming years.

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Introduction

As part of its efforts to accelerate China's rise as a global technology leader, the Chinese state has used **government guidance funds** [政府引导基金] to channel capital into strategic industries. Guidance funds are public-private investment funds that aim to both produce financial returns and further the state's industrial policy goals, including China's pursuit of leadership in artificial intelligence (AI) and other strategic and emerging technologies. As of the first quarter of 2020, Chinese officials had set up 1,741 guidance funds, with a cumulative registered target size of 11 trillion RMB (1.55 trillion USD). In reality, however, these funds had only raised a total of 4.76 trillion RMB (672 billion USD).

China's guidance funds have drawn a great deal of attention from policymakers, journalists, and market analysts abroad, but to date, there has been little systematic research reported in English into the funds' strengths, weaknesses, and historical performances. This paper fills this gap by drawing from hundreds of open source Chinese-language documents, including official policies and statements, audit reports, press coverage, interviews, research reports, and blogs. Together, these documents reflect the diverse views of China's guidance fund stakeholders, from government officials to investors, fund managers, and third-party researchers. We use these sources to gauge guidance funds' development and prospects for success.

The following sections present a brief summary of the guidance fund model, and then describe the intended benefits and observed weaknesses of guidance funds as reflected in Chinese sources. We then review the trends described by these sources and provide performance indicators to track the success and failure of guidance funds in the coming years. Throughout, we include relevant, representative excerpts from Chinese-language documents. Appendix 1 includes fuller excerpts, translated from Chinese; Appendix 2 has further details on the underlying sources, their credibility, and their authoritativeness.

Guidance Funds in a Nutshell

How guidance funds work

Guidance funds are public-private investment funds with a dual mandate to produce financial returns and further the state's industrial policy goals.[1] They raise money from public and private sources and make investments consistent with government priorities. For example, a guidance fund might be meant to promote a strategic industry, such as semiconductors or photonics; support a particular type of business activity, such as startup formation or modernizing production capacity; or attract industry to a particular city or region.[2]

The fund itself is an entity formed by or at the behest of a central, provincial, or local government agency.[3] Typically, the governmental sponsor creates the fund, sets a fundraising target, allocates capital to part of that target directly from budget outlays, and tries to raise the rest from other investors, whose contributions are called "social capital" [社会资本].[4] Guidance funds commonly use the limited partnership structure common in equity finance worldwide.[5] A general partner makes investment decisions and handles day-to-day operations, while limited partners contribute capital and take returns (or losses).[6] A guidance fund's general partner may be a fund management institution established by a government agency, a state-owned investment company, or a third-party professional fund manager.[7]

A guidance fund's limited partners are often called "social capital" investors. Most guidance funds aim to raise 70 to 80 percent of their funding from these investors, with the public sponsor providing the rest.[8] Many commentators implicitly or explicitly equate "social capital" with *private* capital–that is, capital raised from profit-motivated investors, with no connection to the government. In practice, though, many limited partners in guidance funds are state-funded entities, such as state-owned enterprises (SOEs) and state-run banks.[9]

Guidance funds use different investment strategies. Some invest directly in companies or tangible projects, such as factories and industrial parks.[10] Others employ a fund-of-funds approach: they invest in other investment funds (including other guidance funds), and these "sub-funds," in turn, invest in actual projects and businesses.[11] Each guidance fund also has its own investment conditions. For example, a fund might only invest in businesses or sub-funds that are located in a particular province or focused on a particular technology.[12] In addition to the general partner, bureaucrats and government-appointed expert review committees influence the overall strategy and individual investment decisions to varying degrees, depending on the fund.[13]

To entice social capital investors, guidance funds' government sponsors may forgo their own interest payments, assume other investors' losses, or provide other incentives.[14] The government's sizable capital contributions also reduce other investors' exposure and signal the government's commitment to the relevant industries,[15] in each case making participation more attractive.[16]

Development and current status

Chinese government guidance funds have developed in three phases:

- **First phase - gradual start:** Central government agencies and a few local and provincial governments began establishing guidance funds in the early- to mid-2000s.[17] Numbers increased gradually into the mid-2010s, and a legal framework took form to regulate and promote subnational guidance funds.[18]

- **Second phase - sharp uptick:** Between 2015 and 2018, guidance funds saw a massive boom, especially at the local and provincial levels.[19] Major causes included the central government's promotion of the guidance fund mechanism,[20] central government plans, and policies encouraging investment in strategic and emerging technologies.[21] The boom was also due to relatively loose regulation of guidance funds and certain guidance fund investors,[22] as well as new restrictions on other, previously common types of local and provincial government spending[23] along with trend-chasing and imitation among local bureaucrats.[24]

- **Third phase - slowdown:** Growth fell beginning in 2018 and 2019,[25] as China's economy slowed down,[26] regulations tightened,[27] and new local and provincial funds began facing the difficult realities of investing in emerging technologies and companies.[28] Many funds reported having trouble raising money and finding suitable targets.[29]

According to Zero2IPO, a Chinese independent market research firm, 1,741 guidance funds were operating in China as of the first quarter of 2020.[30] These funds had raised about 4.76 trillion RMB (672 billion USD) in total, and had a cumulative target size (as reflected in their fund registration documents) of 11 trillion RMB (1.55 trillion USD).[31] Local and provincial funds far outnumbered national-level guidance funds, but the national-level funds were typically several times larger in terms of target size as well as capital raised.[32] Most local and provincial funds are established with target sizes under 10 billion RMB, while national-level funds are typically in the 10 billion-plus range.[33] Local and provincial funds operate throughout the country, but are concentrated in the more developed eastern and southern provinces and in existing technology hubs such as Beijing, Shanghai, and Shenzhen.[34]

Guidance Funds’ Intended Benefits and Observed Weaknesses

To assess the benefits and weaknesses of the guidance fund model, we reviewed hundreds of open source Chinese-language documents, including official policies and statements, audit reports, press coverage, interviews, research reports, and blogs. This section collects and contextualizes insights from these documents, with fuller, translated excerpts provided in Appendix 1. The documents generally range from November 2014 to November 2020, corresponding roughly to the second and ongoing third phases discussed previously.

We reviewed documents from a variety of sources. Some of these sources, such as the *People's Daily* and the National Audit Office, are considered authoritative, meaning they reflect the Chinese authorities’ official positions and policy priorities. It is important to note, however, that authoritative sources may not be factually accurate or complete.

Other sources, such as reports from state-sponsored media and academic institutions, can be considered quasi-authoritative, meaning they interpret official sources consistent with the authorities’ views. Finally, we cite some non-authoritative sources, such as reports from private consulting firms and non-state media. These sources convey candid reactions and analyses on guidance funds and help contextualize the governance and development of funds. Quasi-authoritative and non-authoritative sources may be (and often are) factually accurate, but they do not carry the same authority as authoritative sources.

Appendix 2 has further details on our sources and their authoritativeness.

Intended Benefits

Guidance funds allow the Chinese state to leverage market discipline and resources.

Chinese policymakers begin to recognize the flaws of subsidy schemes and other traditional industrial policy tools, from inefficiency and waste to outright corruption.[35] By bringing the profit motive into industrial policy, guidance funds aim to avoid these problems. The assumption is that professional fund managers with "skin in the game" and limited partners expecting financial returns will discipline the funds in which they participate.[36]

> *"To be honest, compared with the government's past practice of directly allocating resources to different projects and industries, this way of allocating resources to [a] fund of funds, from there re-allocating to marketized [sub-]funds, and from there re-allocating to specific companies and projects can be regarded as progress or improvement."*
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> -Xu Lin, chairman of a joint U.S.-China sustainable investment fund and former high-ranking Chinese development official, in a 2018 opinion piece in *Caixin News*.[37]

As part of this vision, government guidance fund sponsors hope and expect that their profit-oriented partners will bring unique resources to the funds—capital above and beyond what the government itself can provide, clearly, but also information, contacts and expert judgment. One director of a city's Finance Bureau observes that "because capital is the best 'selector,' 'amplifier' and 'accelerator' of [a] project . . . [it] has become the preferred way to attract investment."[38] An expert advisor to major guidance funds notes that "the government is not a business, it lacks the people and mechanisms to screen projects, and it is not good at making business judgments. Therefore, the government began to introduce teams and entrust professional institutions to manage the funds while attracting social capital."[39]

> *"Since last year, we have established long-term cooperative relations with professional investment institutions. . . . These specialized investment firms . . . [have] a large amount of high-quality resource information and projects in hand [and] connect the guidance funds established by the government with other [investors]. After they [announce these] investment institutions as [their] investment partners, many project institutions will come knocking at the door [推荐上门]. The traditional way of attracting investment can't compare with this."*
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> -Wang Jinxiang, director of Weifang City Finance Bureau in Shandong province, in a 2019 interview.[40]

Guidance funds offer patient capital, a critical resource for emerging technologies.

With their high research and development (R&D) expenses and uncertain, longer-term returns, companies focused on emerging and fundamental technologies often struggle to raise money from the private sector. One state-run outlet points out that "social capital" investors favor areas with short investment periods and quick returns over nationally strategic areas that require long-term financial support.[41] "Investment in science and technology [startups] will take at least five or six years of cultivation, through which, after going through the valley of death stage, it [will be] possible to see the results of development and verify the overall success rate," one general manager of a leading guidance fund noted in a 2019 interview. "[T]he level of LP maturity and the degree of project recognition [i.e., investors' familiarity with this type of project] is the problem, and a lot of social capital [investors] are not willing to focus on this field."[42] Even promising startups with strong initial funding may encounter the "valley of death," an in-between stage of development often associated with scaling-up and commercialization, when capital needs outstrip revenues—making fundraising difficult. Without long-term investments to fill in the gap, innovation achievements are typically lost in the valley of death.[43]

Guidance funds can supply stable, long-term investment capital to technology startups, allowing them to focus on developing high-quality technologies and moving from discovery to commercialization.[44] Leaders of major guidance funds stress their ability to provide patient capital, support investment in strategic emerging industries, and help China realize its technology ambitions in the long run.[45] "As our first strategy, we need to provide patient capital [耐心资本]," explains the director of a major Beijing guidance fund. "We are primarily positioned as a patient capital fund. However, patient capital is not only measured by time. What is the core function of patient capital? Its core function is to invest in S&T innovation and cover the entire process of the transformation of S&T achievements into commercial products, thereby helping innovative S&T companies cross the valley of death."[46]

> *"In previous years, we have accumulated a lot of successful experience in the operation of government guidance funds. For example, Weifang local business Shengrui Transmission Co., Ltd. [盛瑞传动股份有限公司] successfully developed a front-end 8-speed automatic transmission, which filled a gap in the domestic automobile industry. However, due to capital constraints, large-scale production encountered a bottleneck. We set up a fund specifically around this project, injecting 13.2 million RMB (1.9 million USD) of equity investment and 100 million RMB (15.1 million USD) of debt funding to help the enterprise build a production line. . . . This is also a successful case of [our city fund's strategy of] 'looking for projects first, setting up funds later' ['先找项目、后设基金']."*
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> -Wang Jinxiang, director of Weifang City Finance Bureau in Shandong province, in a 2019 interview.[47]

Guidance funds can complement and amplify other industrial policy measures, producing robust, holistic support for emerging and high-tech businesses.

Guidance funds don't operate in a vacuum. They usually exist alongside other industrial policy measures, such as state-sponsored technology parks, R&D incentives, and talent recruitment plans. "Many governments have begun to recognize that any government's fiscal endurance has its limits," explains one prominent economist. "Simply relying on funding support is not enough to bring in high-quality corporations and build industry ecosystems. In order to attract enterprises, governments have turned to providing supportive services, such as long-term corporate strategy consulting, industry resource grafting, capital engagement and other value-added services."[48]

In addition to adding capital to these multifaceted schemes of support, guidance fund institutions can help coordinate them, making them more effective as a whole. "Government guidance funds are often able to use their own communication channels with relevant government departments in order to obtain various local preferential policies and related benefits for sub-funds and invested companies," one independent market research firm explains.[49] "For example, the Beijing Daxing Internet Guidance Fund [北京大兴互联网引导基金] has set up high-quality services for things such as location space, administrative services, policy subsidies, resource linkage, talent recruitment and so on," the chief economist of a financial research institute writes, "It has also specially formed professional industry service teams to provide enterprises full-lifecycle service."[50] A prominent investment consulting firm also notes that some guidance funds broker relationships between cities—for example, "the Zhejiang Provincial Industrial Transformation and Upgrading Fund [浙江省转型升级产业基金] will invest 1 billion RMB (144.7 million USD) to promote joint investment in cities, counties and social capital, and form a provincial specialized town fund with a total scale of 10 billion RMB (1.45 billion USD)."[51]

"'Give me a lever long enough and a fulcrum on which to place it, and I shall move the world.' The words of Archimedes, an ancient Greek philosopher, leap from the pen. Is Haihe Industry Fund [a Tianjin guidance fund] not a fulcrum? It will leverage the 478 square kilometers of land resources in Beichen [a district of Tianjin], and it will guide investment institutions, listed companies, outstanding talents, high-quality projects and other factors in gathering and bouncing off one another, energizing this homeland of innovation and entrepreneurship. In the future, Beichen's 'industry-city integration' [产城融合] will be brilliant."

-Commentary in *Tianjin Daily*, an official newspaper, in 2020.[52]

Ideally, these diverse resources form comprehensive ecosystems of support, fostering local economies of scale and helping emerging and strategic businesses take off. One market research firm points out that "fund towns . . . have become an important launch vehicle for regional financial agglomeration and financial innovation. . . . [I]n addition to preferential policies such as tax and rent exemptions, the government has also set up guidance funds and support operations for fund towns, which have become new tools for attracting local investment."[53] In conjunction with other industrial policy measures, another consulting firm argues, "the guidance fund [mechanism] can accelerate the integration of real industrial resources."[54] The goal is for interventions to have greater effect together than each would on its own. A Shenzhen fund manager boasts that "the great development opportunities present in Shenzhen are due to the environment, capital, talent, and policies of the city. By properly combining these factors, we have formed an accelerator."[55]

Observed Weaknesses

Guidance funds often raise much less money than planned.

New guidance funds routinely plan to raise hundreds of millions or even billions of yuan to invest in emerging technologies, but they often end up raising much less. A 2016 audit by China's National Audit Office reported that "235 government investment funds had been set up in 16 provinces, [but] only 15% of funds in place actually raised social capital."[56] In 2019, one prominent research firm pointed to "a noticeable slowdown in the rate of launching [guidance funds], and . . . a large decline in the scale of fundraising."[57]

State-run media and independent analysts report that guidance funds have struggled to raise money from both public sponsors and the "social capital" sector, with local debt burdens, broader economic headwinds, and stricter regulation by the national government cited among the reasons.[58] Analysts also note that private investors are reluctant to invest in the lower-return, longer-term projects that guidance funds are meant to favor.[59]

> *"We no longer manage government guidance funds. Many local governments cannot come up with the money. We once signed a 10 billion RMB (1.5 billion USD) contract [i.e., a contract to manage a 10 billion RMB guidance fund]. In the end, it fell through because the government couldn't afford to [keep up with the contract]. And even if the government can afford it, it's hard to raise money."*
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> -An unnamed fund management company manager, as quoted in 2018 in the *China Economic Times*, a state-run daily newspaper.[60]

Much of the money guidance funds raise is never actually invested in projects.

Guidance funds that are able to raise funds may have trouble finding suitable targets, so the capital is never actually invested.[61] A

2018 National Audit Office spot-check of provincial venture capital guidance funds found that one out of every six funds examined had *never* made any external investment [对外投资].[62] To effectively deploy large amounts of capital, guidance funds need good prospects and capable personnel. Often, they have neither.[63]

The government sponsors behind guidance funds also tend to be risk-averse, and many limit investing to certain industries or geographies, further narrowing the pool of potential targets. "Many regions have jumped on the bandwagon [跟风] of establishing artificial intelligence (AI) industry development funds," one independent market research firm reports, "even though there are few local companies in the AI field. In some cases, local fund managers invest in projects that 'toe the line of eligibility' ['擦边球'], in order to work around requirements related to administrative measures governing the investment process and to restrictions on which industries can be invested in."[64]

> *"Suddenly, government guidance funds had massive inflows of funding, but how could they spend it? The local governments seem not to have given enough thought to this issue."*
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> -Fan Yuan, "Another Secret Behind Government Guidance Funds' 'Sleeping,'" *China Economic Times*, January 16, 2017.[65]

There are too many guidance funds, leading to redundancy and inefficiency.

Provincial and local governments have established hundreds of guidance funds in recent years, leading to an overcrowded and inefficient investment market.[66] One independent market research firm reports that by the first half of 2019, there were nearly 1,300 guidance funds at the city and district levels alone. Many of these had overlapping policy objectives; the firm notes that "one western province has several special government guidance funds for investing in biotech and pharmaceuticals, and one city in central

China has nearly ten government guidance funds for strategic emerging industries."[67]

> *"A biotech and pharmaceutical industry cannot be developed in every province, but every province is blindly trying to create such an industry through [guidance] funds. Investment is cyclical. In the beginning, everybody wants in. It's 'national strategic industry' this, 'emerging industry' that. However, if every province is investing in [these industries], we will have excess capacity within three years. . . . Government guidance funds have entered an era of wild growth and we must get to the root of the problem."*
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> -An anonymous financial official [金融官员], speaking to the *China Economic Times* in 2016.[68]

Meanwhile, local funds often unnecessarily duplicate the central government's efforts. One government researcher notes that "when the central government proposed the seven strategic industries [七个方向][*], it did not expect each province to invest in all seven at once. . . . [However,] in the eyes of local governments, adding a new area of investment means receiving more funding from the central government."[69]

As government officials explained to state-run media in 2016, nonstrategic and duplicative funds lead to overcrowded markets, unproductive use of capital, and shortages of capital and managerial talent.[70] "Competition between government guidance funds is becoming increasingly fierce," an anonymous industry insider commented in 2017, as "thousands of government guidance funds at all levels and of all kinds are competing for fund managers. . . . Just as local governments now do to attract

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[*] As outlined in the 12th Five-Year Plan of 2010, the "seven strategic industries" include energy conservation and environmental protection, new-generation information technology, biotechnology, high-end equipment manufacturing, new energy, new material, and new-energy automobile.

investment, they come up with a variety of preferential policies to attract fund managers."[71]

Many guidance funds are poorly managed.

Local governments often rely on inexperienced, poorly incentivized bureaucrats to manage their guidance funds. One venture capital investor notices that "some local governments are keen to show off their accomplishments and follow the current fad [赶时髦] . . . [so they] give guidance fund money to new groups with no professional investment experience, who then gamble on various projects."[72] In some cases, guidance funds' government sponsors [基金政府发起人] also serve as fund managers, and "still rel[y] on the personnel system of public institutions [事业单位] and a salary system similar to that of SOEs."[73] In 2016, China's National Audit Office found that "among [the 235 guidance funds], 122 fund management companies are directly appointed by government departments, while 103 fund management companies have 342 executives or investment committee members directly appointed by government departments."[74] As of 2019, the state still had a direct role in many funds' investment decisions. [75]

"31% of government guidance funds [include] government fiscal departments [财政部门] or state-owned asset supervision departments [国资监管部门] as observers in the investment decision-making process; for 29% of government guidance funds, government fiscal departments or state-owned asset supervision departments have final approval authority over investment decisions; and for 25% of government guidance funds, government fiscal departments or state-owned asset supervision departments occupy seats on the investment committee. This shows that governments are still very active in the investment decision-making process of guidance funds."

-From Zero2IPO Research Center's 2019 report.[76]

Government-affiliated fund managers are frequently inexperienced and politically motivated, leading to bad investment decisions. One private equity research center reported in 2019 that "guidance fund management teams are uniformly weak in market acumen and professional ability, because they are established at the behest of government."[77] Most informed observers agree that government-affiliated fund managers lack the market experience and negotiation skills to invest in good projects.[78]

Over time, having recognized these flaws, some local governments have begun hiring professional, market-oriented fund managers, allocating guidance fund capital to "sub-funds" run by these professional managers, or both. A 2018 article in the state newspaper *Securities Times* reported that "many leading guidance funds have tried to wean their management team members from their former [bureaucratic] roles altogether . . . [and] entrust a VC/PE institution with rich experience in local or external fund management as a manager."[79]

However, red tape and vague or unrealistic evaluation criteria can interfere with effective management, and progress is uneven.[80] According to a 2019 audit, Dalian city's guidance fund raised 450 million RMB (64 million USD) but has yet to implement "the effective separation of investors and managers . . . [T]he performance appraisal system has not been established, and [the guidance fund] has not achieved the incentive objective of linking the performance appraisal system with the guidance fund's management fee. . . . 11 of the 15 projects invested in by the sub-fund failed to meet investment expectations, and 8 [of these] were involved in court litigation at the time of withdrawal [while] earnings are uncertain."[81]

> *"Because most [guidance fund] performance evaluation standard creators are government departments, they have limited experience and lack a comprehensive understanding of the regional economy, finance, management, statistics, and industrial fields. Therefore, when setting performance evaluation indicators, they will inevitably focus on preserving the value of state-owned assets, so their performance metrics are not comprehensive or scientific . . . Some institutions use external third-party intermediaries to conduct performance evaluations of guidance funds, but it is difficult to find high-quality third-party institutions."*
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> -From Zero2IPO Research Center's 2019 report.[82]

Analysts further note that there is already a market-wide shortage in professional investment management talent, and the state's traditional management model, with its unrealistic goals and bureaucratic hurdles, drives many talented individuals away from guidance funds.[83]

Guidance fund capital has been wasted on nonstrategic and illicit uses.

Guidance funds are meant to invest in strategic, high-impact projects. But in practice, some funds have served as vehicles for nonstrategic, wasteful, or unauthorized activities, creating, as one independent market research firm wrote in 2016, "a hotbed of rent-seeking, corruption and other malpractices."[84] Some funds subsidize local companies that are already well-resourced, facilitate unauthorized borrowing by local governments, or use fund capital to guarantee social capital investors' returns.[85] For example, Shandong Province's audit office reported in 2016 that nearly 2 billion RMB (300 million USD) in guidance fund capital had been used "to issue entrusted loans, purchase asset management plans, etc."[86]

> *"The investments made by some industrial funds do not comply with regulations. For example, the 90,785,800 RMB [13,429,900 USD] Kaihua County Government Industry sub-fund [开化县政府产业子基金] was used by the fund manager to acquire equity in listed companies on the New Over-the-Counter (OTC) Market [新三板]. This is far from the original intention behind industrial funds."*
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> -From the Zhejiang provincial government's 2017 audit report.[87]

New regulations and tighter budgets may now be helping reduce these practices, but they were widespread as recently as a few years ago, and still persist to some extent. Researchers note that some guidance funds still manage to adopt "a [loan making] investment model of 'equity + debt' ['股 + 债'] or 'debt disguised as equity' ['明股实债'] . . . [some funds] have, in actual operation, developed into 'government subsidy funds' ['财政性补贴基金'] that use disguised government funding subsidies to reduce the risk to [the fund capital]."[88]

Guidance funds do not invest in early-stage companies as intended.

Many guidance funds are meant to support early-stage ventures, but they more often end up investing in mature companies. In 2018, a major state financial news outlet reported that "6.41% [of guidance fund investments] are in the seed stage, about 18.69% are in the start-up stage, 42.30% in the expansion stage, [and] 31.21% in the mature stage."[89] Even in areas where venture capital-oriented guidance funds exist, there is still little capital deployed. An independent market research firm found that as of the first half of 2019, despite accounting for 31.3 percent of all guidance funds, venture capital guidance funds only comprise 8 percent of the funds' aggregate target size.[90]

Governments and state-owned fund managers have little appetite for the risk and uncertainty that early-stage investing entails. Unlike traditional venture capital investors, they demand high capital security and are less focused on high returns.[91] One independent commentator notes that although guidance funds require their sub-funds to invest in startups, the relevant regulations define startups to include relatively mature companies, which means in practice, there is little investment in true startups.[92]

On the other hand, even when guidance funds want to invest in early-stage companies, high-quality targets can be hard to find, reinforcing the bias toward mature companies. This is especially true for funds that focus on a particular industry or geographic region.[93] Guidance funds are also unwilling to hire many venture capital and seed investment institutions as fund managers due to the institutions' "short establishment times, small teams, and unspectacular historical performance."[94] As one prominent economist notes, "high-quality project financing is highly efficient, change in valuations is rapid, and it is difficult for government guidance funds to participate in it, given their current mechanisms with burdensome processes and long application cycles."[95]

"'Although [the] funds' balances are very large, small businesses still struggle to get guidance funds. We've always wanted to [produce] low-sugar, low-salt, and low-oil foods, but we haven't been able to apply for relevant funds.' On January 10, the head of a food company in Hangzhou told a China Times reporter in an interview that even if he got a guidance fund investment, there would be all sorts of problems. For example, one of his peers applied for [funding from] a local guidance fund, but the repayment period was only two years, and his business would have been hard-pressed to repay the loan in that narrow window of time."

-Wang Xiaohui, "The 40 Billion RMB of Venture Capital Funds Only Spent Over a Billion, 'Sleeping' Government Guidance Funds," *China Times* (state-supervised economic newspaper), January 15, 2016.[96]

Guidance funds often fail to attract truly private capital, and in some cases may even crowd private capital out of the market.

In many cases, government guidance funds' so-called "social capital" investors are state-backed. In one typical example, the Shandong provincial government noted in its 2018 audit report that "among the capital contributions to four [Shandong] provincial . . . funds, [direct] government investment and provincial state-owned enterprise [limited partner] contributions accounted for 80.52%" and two funds with the size of 6 billion RMB (904 million USD) are entirely funded by the government and state-owned enterprises.[97]

> *"[Guidance funds] have not attracted much social capital. Take the National Integrated Circuit Industry Investment Fund Co. [国家集成电路产业投资基金股份有限公司], as an example: In addition to the Ministry of Finance (25.95%) and China Development Bank Capital Corporation (CDB Capital) (23.07%), state-owned enterprises such as China National Tobacco Corporation (14.42%), Beijing E-Town International Investment and Development Co., Ltd. (7.21%) and China Mobile Communications Corporation (7.21%) all own shares. No private capital [民营资本] participated [in the fund's first phase] at all."*
>
> -Jiang Liang, "Government Guidance Funds: A 12 Trillion RMB Predicament and Contradiction", *Sina News*, December 15, 2018.[98]

These state-owned limited partners may be less likely than private investors to contribute to informed, disciplined governance of the funds in which they participate. One former high-ranking official notes that state-owned investors prefer investing in guidance funds because even if the funds they invest in "make bad investments and lose money, [they] don't carry a lot of risk and political responsibility, because they are responding to government policy requirements. On the other hand, if they give money to market-oriented investment institutions, and investment goes wrong, causing losses, they have to assume a lot of responsibility.

So, for them, the choice to fund government guidance funds aligns with China's current market and political climate."[99]

At the same time, guidance funds can crowd truly private investors out of the market in some cases, undermining these funds' goal of increasing the pool of capital available for strategic industries and potentially making the market, as a whole, less efficient. In 2014, an academic study found that guidance funds in mature venture capital markets "fail to guide social funding into the venture capital field [and] materially crowd out social capital."[100] One expert advisor to a leading national fund explains that "social capital financing [i.e., financing from private investors] is hard to come by right now, but getting the guidance funds' money is easier. A good [investment] manager in this situation would be in an awkward position [in dealing with guidance funds]. They should not take money from a government guidance fund because it would erode business returns. Balancing commercial returns with policy requirements [i.e., to invest in less profitable but strategic ventures] makes it hard for funds to excel. However, as other institutions take increasingly larger sums from government guidance funds, they are under a lot of pressure."[101]

Trends and Assessment

Guidance funds' weaknesses are real. Overcapacity, diversion, incompetent management, and excessive government intervention are widespread, and so far, the funds have raised and deployed much less capital than intended. In many cases, these problems are not merely "growing pains," but are rooted in basic issues of institutional capacity and contradictions in the model—between Chinese Communist Party (CCP) aims and the profit motive, and between national visions of technological development and local, shorter-term economic development interests.

But although guidance funds may never achieve perfect efficiency, or live up to the sky-high ambitions of their government sponsors, they could still contribute significantly to China's economic and technological development. Already, there is evidence that the more disciplined, market-oriented funds that exist today are successfully raising and deploying large amounts of capital.[102] Some funds report high rates of return and success in fundraising from meaningfully private third-party investors.[103] Others have demonstrated an ability to self-govern and learn from experience—for example, by ending unsuccessful investment partnerships, reconsidering unrealistic goals, and improving evaluation systems.[104] And many guidance funds are now run by professional fund managers, described by both government officials and market analysts as more resourceful and knowledgeable than the bureaucrats they replace.[105]

Recent policy reforms may also strengthen the mechanism and accelerate the deployment of capital.[106] For example, recognizing that unrealistic investment conditions have narrowed their investment opportunities, some regionally and locally oriented guidance funds have relaxed these restrictions. In 2017, the director of a leading consulting firm sorted through more than 60 local guidance funds and found that "many funds still require 50 percent of their money to be invested locally, although some have fallen to 40 percent. However, that's a bit less than the 70 percent that was generally required a few years ago."[107] In 2020, the Qingdao municipal government loosened some capital restrictions, increasing guidance funds' capital contribution in sub-funds to as high as 50 percent and lowering the required rate of return for fund investments.[108]

In other cases, guidance funds have begun to tighten selection standards for sub-funds and fund managers, including by showing preference for those with professional experience and understanding of local industries and projects.[109] The central government has also strengthened regulations.[110] In 2020, for example, the Ministry of Finance released regulatory updates targeting guidance funds that "are idle for a long time . . . [or] fail to set up or carry out business according to the agreed timeline, or the social capital raised is lower than the agreed minimum limit."[111]

It remains to be seen whether these reforms will make a practical difference. Steps toward more efficient, effective guidance fund practices appear localized and uneven. But even with its flaws the guidance fund mechanism is very likely better than the traditional industrial policies the Chinese government might otherwise use to support strategic industries, such as direct government ownership or cash handouts to state-favored companies.[112] As the director of the Chinese Academy of Fiscal Sciences has observed, such traditional mechanisms give "[t]he government department [the] final say on whom to give to and whom not to give to, which is prone to result in phenomena such as money not being spent or even rent-seeking."[113]

"It is more and more difficult and unsustainable to rely on preferential policies related to land and taxation to achieve leapfrog development [跨越发展] . . . Because capital is the best 'selector,' 'amplifier' and 'accelerator' of the project, not only can it fulfill urgent requirements for funding, technology and talent, it also completely accords with current regulatory requirements, and has become the preferred way to attract investment. . . . The traditional way of attracting investment cannot compare with this."

-Wang Jinxiang, director of Weifang city's Finance Bureau, in a 2019 interview with the *Economic Observer*.[114]

By instead incorporating the profit motive, competitive fundraising and allocation of funds, and professional management into industrial policy—however incompletely—China may be able to accelerate its technological development.

Performance Indicators

The guidance fund mechanism is still developing.[115] Most funds were established in the last five years, and are still gathering and deploying capital. In the coming years, guidance funds might accelerate the development of strategic technologies, build competitive domestic industries, and help China "leapfrog" its way to global technological leadership, particularly in AI.[116] Or, the mechanism could founder, undermined by bureaucracy, unfavorable market conditions, and the model's own internal contradictions. As the model continues to develop, individual funds and investments begin to pan out (or not), and investors, fund managers and regulators gain experience with the model, many futures are possible.

In any event, the Chinese state continues to invest, financially and politically, in government guidance funds, and we expect they will continue to be a pillar of China's development strategy.[117] The United States and its allies should closely monitor these funds as they track China's development as a technological superpower. To this end, Table 1 defines indicators of guidance funds' improvement or failure, derived from the research in this paper, for use in the coming years.

Table 1. Guidance Funds' Future Performance Indicators

Indicator of improvement	Indicator of failure
Fundraising	
Average size of guidance funds increases; fewer funds smaller than 1 billion RMB (144.7 million USD), more funds over 5 billion RMB (723.59 million USD)	Guidance funds mostly remain small and scattered
More "social capital" participation by	State-controlled "social capital"

investors unaffiliated with the Chinese government	investors such as SOEs continue to predominate
More guidance funds attract foreign investors	Guidance fund investors remain overwhelmingly Chinese nationals
Declining gap between fundraising targets and capital actually raised	Funds continue to routinely raise significantly less capital than intended
Investment	
More investment in early-stage companies	Investment remains concentrated in well-established companies
Declining gap between capital raised and capital invested in projects	Guidance fund capital sits idle; funds and sub-funds continue to report difficulty finding suitable targets
More guidance funds report strong financial returns of more than 1.5 times their capital contribution[118]	Funds see low returns; governments make up social capital investors' resulting losses
More guidance fund portfolio companies achieve exit; pathways to exit (e.g., listing, secondary market transactions, M&A) become more accessible	IPOs remain the dominant exit strategy, and relatively few portfolio companies exit[119]
Guidance fund investment strategies are more insulated from politics; professional fund managers have greater authority to make independent investment decisions	Investment decisions are politically motivated, and professional fund managers are overruled or sidelined

Operation and Management	
Fewer new guidance funds in regions or sectors that already have good access to finance, or that are unsuitable for investment	Governments continue to set up guidance funds in markets or regions where they are not needed
Governments eliminate funds and sub-funds that fail to raise or deploy capital	Governments prop up ineffective funds
Governmental audit reports more often confirm guidance funds' compliance with regulations	Audits continue to document nonstrategic guidance fund investment, illicit practices, and idle capital
Guidance funds provide more information on their operations and investments	Transparency remains limited
Guidance funds collaborate on large financings	Efforts for vertical integration[120] fail to take off, and funds still compete for scarce resources
Subnational guidance funds become more willing to relax restrictions on investment when appropriate	Unrealistic investment criteria related to targets' geographies, industries, etc. remain in place
Guidance funds are competitive for management and investment talent	Continuing reports of guidance fund "brain drain," such as reports of guidance fund managers leaving for private investment firms

More guidance funds use professional fund managers	Bureaucrats remain in charge in many cases
More guidance funds are run by top-tier, internationally active fund managers	Slow growth in funds managed by top-tier professionals
An effective, standardized management evaluation system is established	Vague, unrealistic evaluation criteria are still used to measure guidance fund performance

Conclusion

The Chinese government is using guidance funds to channel massive amounts of capital into strategic industries. These funds are meant to help the Chinese state leverage market discipline and professional expertise, nurture emerging technology companies with long-term capital, and strengthen a broader ecosystem of support for high-tech businesses. In practice, however, guidance funds suffer from unrealistic goals, excessive government intervention, incompetent management, risk aversion, and a lack of market discipline, and they have not raised or deployed nearly as much money as intended.

Though imperfect, guidance funds have become a central mechanism in Chinese industrial policy. The mechanism appears to be improving over time, and some well-run funds are achieving promising results. Fundamentally, guidance funds have important advantages over the traditional policy incentives the Chinese government might otherwise use to promote high-tech development.

As outlined in this paper, the United States should closely monitor the performance indicators for guidance funds' improvements and failures. In the long run, the success or failure of the guidance fund mechanism will strongly shape how and to what extent China develops cutting-edge industries, such as AI, to compete with the United States and U.S. allies.

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Appendix 1: Primary sources on guidance funds

Intended Benefits

Guidance funds allow the Chinese state to leverage market discipline and expertise.

"'In the past, government budget funding used to support enterprises was mostly in the form of project subsidies. The government department has the final say on whom to give to and whom not to give to, which is prone to result in phenomena such as money not being spent or even rent-seeking.' Liu Shangxi believes that the establishment of a government investment fund, in which the government generally does not participate in the day-to-day management of the fund, is beneficial to the establishment of a more equitable and effective new mechanism. Given an effective incentive and constraint mechanism, government funding can guide the investment orientation of the fund by forgoing a reasonable amount of [potential] profits [合理让利] to promote the realization of policy objectives."

> -From a 2015 *People's Daily* report on new guidance fund regulations. Liu Shangxi is director of the Chinese Academy of Fiscal Sciences.[121]

"Government guidance funds are regarded as powerful tools [利器] that use the 'visible hand' [有形之手] to bring to bear the government's ability to guide and amplify, to make up for 'market failures' in investment and financing, to coordinate regional economic development, and to improve the effectiveness of government funding."

> -Jiang Liang, "Government Guidance Funds: A 12 Trillion RMB Predicament and Contradiction", *Sina News*, December 15, 2018.[122]

"Through 'allocations, improvements, and investments' [拨改投], and by leveraging social capital, [guidance funds] help make the use of government funding more efficient and create a win-win situation between the government and the market."

-Zhang Ke, "Government Funds to be 'Allocated, Improved, and Invested' into National Guidance Fund for Venture Capital Investment in Emerging Industries, was Unveiled", *China Business News*, May 9, 2017.[123]

"Venture capital guidance funds are policy funds established by the government and operated in a market-oriented manner. They serve mainly to support enterprise development through venture capital investment and guide social capital into the venture capital investment field. Under normal circumstances, such guidance funds adopt a parent/sub-fund structure to give full play to the leverage amplification effect of government funding. By encouraging venture capital firms to invest in seed, startup, and other early-stage businesses, these funds make up for the deficiencies of normal venture capital companies that mainly invest in companies in the growth, maturity, and restructuring stages."

-From a 2019 report by Zero2IPO Research Center, a Chinese independent market research firm.[124]

"To be honest, compared with the government's past practice of directly allocating resources to different projects and industries, this way of allocating resources to [a] fund of funds, from there re-allocating to marketized [sub-]funds, and from there re-allocating to specific companies and projects can be regarded as progress or improvement."

-Xu Lin, chairman of a joint U.S.-China sustainable investment fund and former high-ranking Chinese development official, in a 2018 opinion piece in *Caixin News*.[125]

"It is more and more difficult and unsustainable to rely on preferential policies related to land and taxation to achieve leapfrog development [跨越发展] [by attracting investors] . . . Because capital is the best ‘selector,’ ‘amplifier’ and ‘accelerator’ of the project, not only can it fulfill urgent requirements for funding, technology and talent, it also completely accords with current regulatory requirements, and has become the preferred way to attract investment. . . . The traditional way of attracting investment cannot compare with this.”

-Wang Jinxiang, director of Weifang city’s Finance Bureau, in a 2019 interview with the *Economic Observer*.[126]

“The point of government intervention is to complement the gains or share the risks with social capital by making them willing to invest in early-stage companies. In the past, the government used subsidies and direct investment to improve the quality of social capital investment objects. But after all, the government is not a business, it lacks the people and mechanisms to screen projects, and it is not good at making business judgments. Therefore, the government began to introduce teams and entrust professional institutions to manage the funds while attracting social capital. At the same time, professional institutions can also provide entrepreneurial management experience, upstream and downstream business resources and other assistance as early-stage companies grow.”

-Li Jianliang, expert advisor to the National Venture Capital Fund and independent director of the National IC Industry Fund, in a 2017 interview.[127]

“Since last year, we have established long-term cooperative relations with professional investment institutions. . . . These specialized investment firms . . . [have] a large amount of high-quality resource information and projects in hand [and] connect the guidance funds established by the government with other [investors]. After they [announce these] investment institutions as [their] investment partners, many project institutions will come knocking at the door [推荐上门]. The traditional way of attracting investment can't compare with this.”

-Wang Jinxiang, director of Weifang City Finance Bureau in Shandong province, in a 2019 interview.[128]

Guidance funds offer patient capital, a critical resource for emerging technologies.

"Social capital generally favors areas with a short investment period and quick return on investment. However, projects such as biotech and pharmaceuticals, energy conservation, environmental protection, and new energy that have a huge role in promoting national industrial adjustment and development have not received attention from social capital due to their long growth period and slow return on investment. The establishment of government guidance funds is helpful to break this dilemma of investment."

> -Wang Xiaohui, "The 40 Billion RMB of Venture Capital Funds Only Spent Over a Billion, 'Sleeping' Government Guidance Funds", *China Times*, a state-supervised economic newspaper, January 15, 2016.[129]

"At this stage, Yang Li said, the most important thing is the cultivation of science and technology projects, rather than concrete returns for the GP. 'I think investment in science and technology [startups] will take at least five or six years of cultivation, through which, after going through the valley of death stage, it [will be] possible to see the results of development and verify the overall success rate.' . . . the level of LP maturity and project recognition is the problem, and a lot of social capital [investors] are not willing to focus on in this field. This has left some innovation achievements in the seed and angel stages with a death of capital, which is exactly the capital gap to be filled by the Science and Technology Innovation Fund [科创基金]."

> -From a 2019 interview with Yang Li, general manager of the Beijing Science and Technology Innovation Fund, in *Guangming Online*, an official website for STEM news.[130]

"Government guidance funds are characterized by strong fund stability, strong investment sustainability, and long funding periods . . . which have become an ideal fundraising vehicle and source of funding for long-term investment in the equity investment industry."

-From Zero2IPO Research Center's 2019 report.[131]

"I think it is very important that government guidance funds bring patient capital to the market. . . . Compared with other institutions, government industry funds are undoubtedly a patient industrial investment [instrument] with long-term arrangements and plans. They can support investment, research, and development in strategic emerging industries for a long time, and can help China gradually narrow the gap with developed countries."

-Wang Hanbing, chairman of the Yangtze River Industry Fund, in a 2018 interview.[132]

"As our first strategy, we need to provide patient capital [耐心资本]. At 15 years, the duration of the Beijing S&T Innovation Fund is the longest among its peers . . . . We are primarily positioned as a patient capital fund. However, patient capital is not only measured by time. What is the core function of patient capital? Its core function is to invest in S&T innovation and cover the entire process of the transformation of S&T achievements into commercial products, thereby helping innovative S&T companies cross the valley of death."

-Liu Kefeng, chairman of the Beijing Science and Technology Innovation Fund, in a 2019 interview.[133]

"In previous years, we have accumulated a lot of successful experience in the operation of government guidance funds. For example, Weifang local business Shengrui Transmission Co., Ltd. [盛瑞传动股份有限公司] successfully developed a front-end 8-speed automatic transmission, which filled a gap in the domestic automobile industry. However, due to capital constraints, large-scale production encountered a bottleneck. We set up a fund specifically around this project, injecting 13.2 million yuan of equity investment and 100 million RMB (15.1 million USD) of debt funding to help the enterprise build a production line. . . . This is also a successful case of [our city fund's strategy of] 'looking for projects first, setting up funds later' ['先找项目、后设基金']."

-Wang Jinxiang, director of Weifang city's Finance Bureau, in a 2019 interview with the *Economic Observer website*.[134]

Guidance funds can complement and amplify other industrial policy measures, producing robust, holistic support for emerging and high-tech businesses.

"Many enterprises do not bring in investors purely for the capital; rather, it is for their behind-the-scenes resources and post-investment services. . . . Many governments have begun to recognize that any government's fiscal endurance has its limits. Simply relying on funding support is not enough to bring in high-quality corporations and build industry ecosystems. In order to attract enterprises, governments have turned to providing supportive services, such as long-term corporate strategy consulting, industry resource grafting, capital engagement and other value-added services; and they are utilizing the resource amplification ability of specialized [market-oriented] investment institutions to link policy resources, spatial resources, industry resources, capital resources and even markets. . . . For example, the Beijing Daxing Internet Guidance Fund [北京大兴互联网引导基金] has set up top-end services for things such as location space, administrative services, policy subsidies, resource linkage, talent recruitment and so on. It has also specially formed professional industry service teams to provide enterprises full-lifecycle service."

-Guan Qingyou, president and chief economist of a financial research institute, in a 2019 post on *Sina Finance*, a popular, privately run web portal.[135]

"The value-added services provided by government guidance funds focus on three main areas: 1) [facilitating] access to project, LP and third-party intermediary resources; 2) providing policy-related professional opinions/recommendations; and 3) compet[ing] for policy benefits [at higher levels of government] or, when necessary, pushing for relevant preferential policies [to be enacted]. Of these services, [facilitating] access to project resources mainly refers to the government guidance fund's use of its own advantages to connect sub-funds with various types of high-quality project resources and improve the sub-funds' efficiency in selecting invested companies. . . . In addition, some government guidance funds make policy declarations [i.e., provide official approvals and recommendations] [in order] for invested funds/enterprises to connect with government resources. At the same time, various preferential policies issued by local governments are of great significance to the development and growth of sub-funds and invested companies. Government guidance funds are often able to use their own communication channels with relevant government departments in order to obtain various local preferential policies and related benefits for sub-funds and invested companies. This is also a competitive advantage of government guidance funds over other LPs."

-From Zero2IPO Research Center's 2019 report.[136]

"As one of the important forms of financial service to the real economy, the guidance fund [mechanism] can accelerate the integration of real industrial resources. At present, many industrial parks and economic development zones or specialized towns [特色小镇] in China have cooperated with government and financial institutions to create industrial park funds and town funds. They also provide comprehensive support services and facilities for the industrial system, and promote the transformation and upgrading of industrial parks or towns through the development of key industries and projects. [For example,] the Zhejiang Provincial Industrial Transformation and Upgrading Fund [浙江省转型升级产业基金] will invest 1 billion RMB (144.7 million USD) to promote joint investment in cities, counties and social capital, and form a provincial specialized town fund with a total scale of 10 billion RMB (1.45 billion USD). The fund carries out investment focused on entities and enterprises in provincial specialized towns and provides professional investment and financing services and know-how for the industrial development of specialized towns."

-From a 2020 online post by Chinese Venture, an investment consulting company.[137]

"'Give me a lever long enough and a fulcrum on which to place it, and I shall move the world.' The words of Archimedes, an ancient Greek philosopher, leap from the pen. Is Haihe Industry Fund [a Tianjin guidance fund] not a fulcrum? It will leverage the 478 square kilometers of land resources in Beichen [a district of Tianjin], and it will guide investment institutions, listed companies, outstanding talents, high-quality projects and other factors in gathering and bouncing off one another, energizing this homeland of innovation and entrepreneurship. In the future, Beichen's 'industry-city integration' [产城融合] will be brilliant."

-Commentary in *Tianjin Daily*, an official newspaper, in 2020.[138]

"Since 2016, many places in China have set up fund towns. . . . They have become an important launch vehicle for regional financial agglomeration and financial innovation, which can effectively enhance local financial competitiveness and improve the construction of multi-level capital markets. At the government level, in addition to preferential policies such as tax and rent exemptions, the government has also set up guidance funds and support operations for fund towns, which have become new tools for attracting local investment and play a positive role in promoting the development of the local economy."

-From a 2017 report by the China FOF Research Center, a private equity research organization.[139]

"In just over two years since the guidance fund was established, we have set up 157 sub-funds, and over 100 of them have already begun operations. . . . In 2018, our sub-funds invested over 90 billion RMB (13.57 billion USD) in 1,723 projects, producing a major capital magnification effect. The great development opportunities present in Shenzhen are due to the environment, capital, talent, and policies of the city. By properly combining these factors, we have formed an accelerator."

-Shen Shaojun, general manager of a major Shenzhen guidance fund, in 2019.[140]

Observed Weaknesses

Guidance funds often raise much less money than planned.

"Some government investment funds and measures to support small businesses have not achieved the desired effect. By the end of 2016, 235 government investment funds had been set up in 16 provinces, [but] only 15% of funds in place actually raised social capital."

-From the 2016 report of China's National Audit Office.[141]

"There has been a noticeable slowdown in the rate of launching [guidance funds], and there has also been a large decline in the scale of fundraising. . . . More government funding [财政资金] needs to be used for maintaining economic growth and ensuring the people's livelihoods, [so] the investment capacity for infrastructure construction and innovation and entrepreneurship has been significantly reduced. At the same time, due to the high local debt ratio of our country, especially as the invisible debts of various local governments continue to accumulate, local debt defaults have occurred in the first half of 2019. Local corporate debts are mainly guaranteed by local government revenue, so the local debt situation has worsened. All of this has greatly limited the ability of local governments at all levels to [allocate funding to] government guidance funds."

-From a 2019 report by the China FOF Research Center, a private equity research organization.[142]

"Two years ago, the standing committee of the city government approved the [creation] of the first city-wide industry guidance fund. As the person in charge of the city high-tech industrial park, for two years, Mr. Wang [老王, a pseudonym] has been running around the country trying to raise funds for the industry guidance fund. Since the funding problem has become more severe this year, guidance funds have been unable to put enough funds in place and have had to cease operating. Concerning government guidance fund operations, he can only helplessly sum up the situation in one word: 'difficult!'"

-From a 2018 online article by Guangcai Investment, an infrastructure investment management company.[143]

"With the implementation of the New Asset Management Regulations, the multi-layered nesting model of [investing] bank wealth management products [银行理财产品] and asset management products [资管产品] . . . n government guidance funds through second-tier asset management products will be banned. . . . As everyone knows, bank funds are an important source of funding for guidance funds. As the difficulty of bank funding increases in the future, government guidance funds will face even more severe fundraising difficulties."

-From Zero2IPO Research Center's 2019 report.[144]

"We no longer manage government guidance funds. Many local governments cannot come up with the money. We once signed a 10 million RMB (1.5 million USD) contract [to manage a particular guidance fund]. In the end, it fell through because the government couldn't afford to [keep up with the contract]. And even if the government can afford it, it's hard to raise money."

-An unnamed fund management company manager, as quoted in 2018 in the *China Economic Times*, a state-run daily newspaper.[145]

"Most [potential social capital investors] pursue short-term returns and have low willingness to make long-term investments. This has also increased the difficulty of raising funds in the market to a certain extent."

-From Zero2IPO Research Center's 2019 report.[146]

Much of the money guidance funds raise is never actually invested in projects.

"At the same time, in terms of the efficiency of fund use, government guidance funds have a serious problem with uninvested funds [资金结余]. Some government guidance funds have not made any external investment [对外投资] since their establishment. As a result, the capital from these funds remains dormant in the custodian banks, and the investment funds become bank deposits in disguise and cannot play a guiding role locally."

-From Zero2IPO Research Center's 2019 report.[147]

"By the end of 2014, 39.756 billion RMB (6.45 billion USD) (84 percent) of the venture capital funds raised in 14 provinces since 2009 had not been used, and four provinces had never spent any of it."

-From the 2014 report of China's National Audit Office.[148]

"6 of the 36 venture capital investment guidance funds in 11 provinces that were spot-checked have never made external investments [对外投资]."

-From the 2017 report of China's National Audit Office.[149]

"There are two reasons for the large [unspent] balances of the guidance funds: On the one hand, driven by [favorable] government policies [政策红利], various regions have jumped on the bandwagon [跟风] and set up guidance funds, but some governments have not yet figured out how to use them. . . . On the other hand, although government guidance funds do not aim to maximize profits, the government attaches great importance to the safety of investment funds [i.e., is loss averse]. As a result, some of the guidance funds do not yet have sufficient professional ability to safely invest the money [i.e., with the degree of safety the government demands]."

-Fan, "Another Secret Behind Government Guidance Funds' 'Sleeping'" (citing the ChinaVenture Research Institute [投中研究院], a market research firm).[150]

"There are not many innovative regions and cities . . . that have a large pool of innovation and entrepreneurship projects. Without sufficient project reserves, some [geographically focused] funds encounter the embarrassing situation of having no suitable projects to invest in . . . because a fund cannot find good projects locally, some excellent [private-sector] venture capital institutions may be afraid to cooperate with it."

-Fan, "Another Secret Behind Government Guidance Funds' 'Sleeping'."[151]

"For example, many regions have jumped on the bandwagon [跟风] of establishing artificial intelligence (AI) industry development funds even though there are few local companies in the AI field. In some cases, local fund managers invest in projects that 'toe the line of eligibility' ['擦边球'], in order to work around requirements related to administrative measures governing the investment process and to restrictions on which industries can be invested in."

-From Zero2IPO Research Center's 2019 report.[152]

"Suddenly, government guidance funds had massive inflows of funding, but how could they spend it? The local governments seem not to have given enough thought to this issue."

-Fan Yuan, "Another Secret Behind Government Guidance Funds' 'Sleeping,'" *China Economic Times*, January 16, 2017.[153]

There are too many guidance funds, leading to redundancy and inefficiency.

"Although provinces, cities, and counties all over China have now established a large number of guidance funds, there is no unified planning, coordination, or management. This lack of overall planning has caused homogenization and fragmentation of guidance funds, whether they are in different localities, in the same locality but at different administrative levels, or in the same locality and at the same level but with different investment priorities. Competition between guidance funds managed by different departments has even led to waste of resources and ineffective use of government budget funds."

-From Zero2IPO Research Center's 2019 report.[154]

"Prefectural-level city and district or county funds account for the largest number of funds and are established at the fastest pace. By the end of the first half of 2019, the number of prefectural-level city and district or county government guidance funds had reached 790 and 490 respectively, with total target sizes of 3.15 trillion RMB (456 billion USD) and 1.29 trillion RMB (187 billion USD). . . . In some regions, there are multiple funds with overlapping policy objectives . . . one western province has several special government guidance funds for investing in biotech and pharmaceuticals, and one city in central China has nearly ten government guidance funds for strategic emerging industries."

-From Zero2IPO Research Center's 2019 report.[155]

"Today, if every province has a biotech and pharmaceuticals industry fund, the field of biotech and pharmaceuticals will wither away in five years. A biotech and pharmaceutical industry cannot be developed in every province, but every province is blindly trying to create such an industry through [guidance] funds. Investment is cyclical. In the beginning, everybody wants in. It's 'national strategic industry' this, 'emerging industry' that. However, if every province is investing in [these industries], we will have excess capacity within three years. . . . Government guidance funds have entered an era of wild growth and we must get to the root of the problem."

-An anonymous financial official [金融官员], speaking to the *China Economic Times* in 2016.[156]

"When the central government proposed the seven strategic industries [七个方向], it did not expect each province to invest in all seven at once. The central government's idea was that local governments would choose among these seven fields based on their own local advantages, so there would not be any overlap. However, this was not what happened at the local level. In the eyes of local governments, adding a new area of investment means receiving more funding from the central government. In the end . . . all provinces came to [invest in] these seven fields. Some provinces have advantages in fields outside these seven, so these fields were added as well. This is the result produced by this system. Likewise, a similar phenomenon occurs between provincial and municipal governments and between the municipal governments and industrial parks."

-Wu Qing, a researcher at the Development Research Center of the State Council, as quoted in the *China Economic Times* in late 2016.[157]

"The overlapping policy objectives of different government guidance funds have resulted in the repeated establishment of similar funds, excessive quantities of funds, and scattered use of their capital. It is necessary to adjust and clarify the roles and target areas of different government guidance funds in consideration of the key areas and weak links in the national and local industrial layout. Similar funds must not be established repeatedly in the same industry or field. The scale of government guidance funds should be reasonably expanded and long-term plans should be formulated for the development of government guidance funds to ensure the continuity of financial support."

-Ma Weihua, a member of the National Committee of the Chinese People's Political Consultative Conference (CPPCC) and chairman of the National Science and Technology Achievement Transformation Guidance Fund, as quoted in the *China Economic Times* in late 2016.[158]

"Competition between government guidance funds is becoming increasingly fierce. Thousands of government guidance funds at all levels and of all kinds are competing for fund managers who have the ability to drive and lead core industries. Just as local governments now do to attract investment, they come up with a variety of preferential policies to attract fund managers."

-An anonymous industry insider quoted in *Beijing Business Today*, a prominent state-sponsored financial newspaper, in 2018.[159]

Many guidance funds are poorly managed.

"Some local governments are keen to show off their accomplishments and follow the current fad [赶时髦]. They lack professional investment evaluation skills, and give guidance fund money to new groups with no professional investment experience, who then gamble on various projects."

-Li Wei, founding partner of venture capital firm Green Pine Capital Partners,as quoted in 2017 in the *21st Century Business Herald.*[160]

"Although the management of some government guidance funds is entrusted to market-oriented institutions, the main method for selecting guidance fund managers is to directly appoint the government sponsor of the fund [基金政府发起人] [i.e., the government entity that established the fund in the first place]. In this case, the fund is managed by the institutions or companies of the sponsor. This type of fund manager still relies on the personnel system of public institutions [事业单位] and a salary system similar to that of SOEs. This is very different from the incentive mechanisms of market-oriented management institutions, and has a certain negative impact on the enthusiasm of fund managers."

-From Zero2IPO Research Center's 2019 report.[161]

"The degree of marketization [市场化] in operation [i.e., market-oriented management] of some funds is not high. Among [guidance funds], 122 fund management companies are directly appointed by government departments, while 103 fund management companies have 342 executives or investment committee members directly appointed by government departments."

-From the 2016 report of China's National Audit Office.[162]

"These funds generally are strongly policy-oriented [较强的政策属性] and have many restrictive conditions . . . some guidance funds have set different restrictions on the investment areas, investment sizes, and qualifications of equity participation fund entities[. In others,] government investors generally hold pre-investment approval authority for investment decisions, or even veto power and other participation rights in investment decision-making . . . when the equity participation sub-funds [子基金] of government guidance funds [i.e., investment funds that receive money to invest from government guidance funds] make investment decisions, they need to go through a multi-layer approval process, which seriously affects the investment efficiency of the equity participation funds."

-From Zero2IPO Research Center's 2019 report.[163]

"31% of government guidance funds [include] government fiscal departments [财政部门] or state-owned asset supervision departments [国资监管部门] as observers in the investment decision-making process; for 29% of government guidance funds, government fiscal departments or state-owned asset supervision departments have final approval authority over investment decisions; and for 25% of government guidance funds, government fiscal departments or state-owned asset supervision departments occupy seats on the investment committee. This shows that governments are still very active in the investment decision-making process of guidance funds. Under normal circumstances, the evaluation opinions of the expert review committee are important references for the final investment decision. However, since the expert review committee is not a permanent organization, it does not generally participate in the entire due diligence process, and its investment judgments are mainly based on due diligence reports and brief on-site inquiries. Therefore, the validity and scientific nature of the decisions of the expert review committee are also debatable."

-From Zero2IPO Research Center's 2019 report.[164]

"Guidance fund management teams are uniformly weak in market acumen and professional ability, because they are established at the behest of government, rather than arising naturally as a result of market conditions. They are sub-par in areas such as fund screening, combining investments, risk control, post-investment management, and monitoring. All of these flaws water down the overall impact of guidance fund operations."

-From a 2019 editorial by the China FOF Research Center, a private equity research organization.[165]

"Market-oriented funds . . . that invest in order to get investment returns are more likely to succeed than those that spend all day seeking financial subsidies from the government. [For example,] E-Town International Investment and Development [亦庄国投] [a well-established, state-owned investment fund based in Beijing] invested indirectly in DiDi [滴滴], Meituan Dianping [新美大] and other Internet enterprises. If it's just a local state-owned [guidance fund], it's hard to have the corresponding channels, resources and negotiation ability to invest in such a good project."

-Tang Xuefeng, general manager of a major state-owned investment fund, in a 2017 interview.[166]

"In recent years, many leading guidance funds have tried to wean their management team members from their former [bureaucratic] roles altogether. There is also the vast majority of guidance funds that entrust a VC/PE institution with rich experience in local or external fund management as a manager. However, these changes have also accelerated the government guidance funds' brain drain problem. This phenomenon was even more prominent in 2017. . . . many senior executives at government guidance fund management institutions left their jobs to join or set up [non-state] fund management agencies. On the one hand, because the rapid growth of government guidance funds has contributed to increased demand for fund managers with experience and resources, there is a gap in professional management talent. On the other hand, the persistence of some traditional government guidance funds in sticking to their old management model may cause them difficulties in adapting to the changing market environment, causing a brain drain."

-Zhao Yong, "'Scanning' China's Funds of Funds: The Management Scale Exceeds 1.6 Trillion, But There is no Escape from the Fundraising and Talent Gap Problem," *Securities Times*, state-sponsored financial newspaper, April 28, 2018.[167]

"The Industry (Entrepreneurial) Guidance Fund [产业（创业）引导基金管理] management system has not been straightened out, and the investment has not met expectations. Since [Dalian] City set up the Industry (Entrepreneurial) Guidance Fund in 2012, and straight through to the end of 2019, a total of 450 million RMB (64 million USD) of investment projects have been allocated to the guidance fund. First, Dalian Venture Capital Co., is responsible for fund and business management, and [the guidance fund] has not achieved the effective separation of investors and managers. Second, the guidance fund's performance appraisal system has not been established, and [the fund] has not achieved the incentive objective of linking the performance appraisal system with the guidance fund's management fee. Third, 11 of the 15 projects invested in by the sub-fund failed to meet investment expectations, and 8 [of these] were involved in court litigation at the time of withdrawal [while] earnings are uncertain."

-From 2019 Dalian City Audit Report.[168]

"Some institutions use external third-party intermediaries to conduct performance evaluations of guidance funds, but it is difficult to find high-quality third-party institutions . . . Because most performance evaluation standard creators are government departments, they have limited experience and lack a comprehensive understanding of the regional economy, finance, management, statistics, and industrial fields. Therefore, when setting performance evaluation indicators, they will inevitably focus on preserving the value of state-owned assets, so their performance metrics are not comprehensive or scientific."

-From Zero2IPO Research Center's 2019 report.[169]

Guidance fund capital may be wasted on nonstrategic or illicit uses.

"To some extent, the characteristics of guidance funds have created a hotbed of rent-seeking, corruption and other malpractices. In particular, with the occurrence of illegal fundraising by some funds under the banner of government guidance funds, there are renewed doubts about the supervision of guidance funds. How to prevent government guidance funds from becoming a rent-seeking tool for some managers has become a top priority, and a strict and comprehensive regulatory and approval system is urgently needed."

-From a 2016 article by the Zero2IPO Research Center.[170]

"Some government guidance funds did not operate in accordance with market principles, and the government assumed unlimited responsibility, which undoubtedly laid down a lot of potential risks for the government guidance funds. [This occurs in two ways.] First, [guidance funds] guarantee social capital [investors] a minimum return, [so] when they fail to achieve the [minimum] return, [the gap] is made up by the government. Second, it is agreed that the government will eat [any] losses of the fund itself."

-Wang Xiaohui, "The 40 Billion RMB of Venture Capital Funds Only Spent Over a Billion, 'Sleeping' Government Guidance Funds" *China Times*, a state-supervised economic newspaper, January 15, 2016.[171]

"Six sub-funds [funded by provincial guidance funds] used the raised funds to issue entrusted loans, purchase asset management plans, etc., and this involved a total amount of 1.919 billion RMB (288.5 million USD)."

-From the Shandong provincial government's 2016 audit report.[172]

“The investments made by some industrial funds do not comply with regulations. For example, the 90,785,800 RMB (13,429,900 USD) Kaihua County Government Industry sub-fund [开化县政府产业子基金] was used by the fund manager to acquire equity in listed companies on the New Over-the-Counter (OTC) Market [新三板]. This is far from the original intention behind industrial funds.”

-From the Zhejiang provincial government’s 2017 audit report.[173]

“One of the more prominent problems is that some guidance funds that plan to adopt the equity investment model have, in practice, adopted a [loanmaking] investment model of ‘equity + debt’ [‘股 + 债’] or ‘debt disguised as equity’ [‘明股实债’] . . . [some funds] have, in actual operation, developed into ‘government subsidy funds’ [‘财政性补贴基金’] that use disguised government funding subsidies to reduce the risk to government funds.”

-From Zero2IPO Research Center’s 2019 report.[174]

Guidance funds don’t invest enough in early-stage companies as intended.

“There is a certain imbalance in government guidance funds' investments and exits. It is reported that 6.41% [of guidance funds] are in the seed stage, about 18.69% are in the start-up stage, 42.30% in the expansion stage, 31.21% in the mature stage, and the rest constitute about 1.4%.”

-Wang Ying, “An Evaluation System Should be Established to Solve the Exit Problem of Government Guidance Funds with a Size of 3.7 Trillion RMB,” *China Fund News*, a state-supervised financial newspaper, November 12, 2018.[175]

“Although some regions have set up special venture capital guidance funds and angel investment guidance funds, on the whole, government guidance funds provide little capital support for venture capital/seed investment. According to [our] statistics, as of the first half of 2019, a total of 528 venture capital government guidance funds were established, accounting for 31.3% of the total number of [guidance] funds[,] accounting for 8.0% of the total target size [across all guidance funds] and 13.8% of total secured funds."

-From Zero2IPO Research Center's 2019 report.[176]

"Government guidance funds set basic mandatory metrics for sub-fund managers, which are too demanding for venture capital and seed investment institutions. . . . In addition, although government guidance funds do not require high returns, they require extremely high capital security. However, compared with private equity funds, venture capital and seed investment institutions have inherently high risks and uncertainties. Because of this, coupled with their short establishment times, small teams, and unspectacular historical performance, many venture capital and seed investment institutions cannot meet the [selection criteria] for [guidance] fund managers."

-From Zero2IPO Research Center's 2019 report.[177]

"Guidance funds at all levels require [their sub-funds] to invest a certain percentage of all capital contributions in startups and early- to mid-stage enterprises. For example, [regulations enacted in 2011] stipulate that: 'Innovative enterprises in the startup period' refers to enterprises that meet the following conditions: they have not been in operation for more than 5 years, do not have more than 300 employees, S&T personnel directly engaged in R&D account for more than 20% of the total number of employees, total assets do not exceed 30 million RMB (4.52 million USD), and annual sales or turnover does not exceed 30 million RMB (4.52 million USD). . . . 'Innovative enterprises in the early- to mid-stage' refers to enterprises that meet the following conditions: they do not have more than 500 employees, total assets do not exceed 200 million RMB (30 million USD), and annual sales or turnover does not exceed 200 million RMB (30 million USD).' Obviously, innovative enterprises in the startup and early- and mid-stage defined in this way are already [businesses] in the growth stage. These conditions do not fit enterprises that are truly in the early stage of development."

-Jiang Liang, "Government Guidance Funds: A 12 Trillion RMB Predicament and Contradiction", *Sina News*, December 15, 2018.[178]

"On the other hand, because some guidance funds have an unclear position relative to the development stage of the local industry to be supported, the industries it actually invests in deviate from the fund's investment strategy. At present, the most prominent phenomenon is that some Chinese venture capital funds have difficulty finding high-quality entrepreneurial projects or are motivated to reduce investment risks. Therefore, they mostly invest in companies in the mid-to-late development stages, such as expanding and mature enterprises."

-From Zero2IPO Research Center's 2019 report.[179]

"Compared to marketized private equity funds, government guidance funds tend to miss investment opportunities, especially projects in the start-up and growth phases. Take the case of SenseTime, which in the short space of five years of growth has become a top unicorn enterprise in the global S&T world. In terms of its financing route, from July to November 2017, it took just four months to complete B round to B+ round financing of over 3.5 billion RMB (510 million USD); from April to September 2018, it took just five months to complete C round to D round financing totaling15 billion RMB (2.26 billion USD). Among the investment institutions participating, there was no lack of marketized equity investment funds, including Alibaba-linked firms, Qualcomm, and Singapore's sovereign wealth fund. This kind of high-quality project financing is highly efficient, change in valuations is rapid, and it is difficult for government guidance funds to participate in it given their current mechanisms with burdensome processes and long application cycles."

-Guan Qingyou, president and chief economist of a financial research institute, in a 2019 post on *Sina Finance*, a popular, privately run web portal.[180]

"'Although funds' balances are very large, small businesses still struggle to get guidance funds. We've always wanted to do projects [to produce healthier] low-sugar, low-salt, and low-oil foods, but we haven't been able to apply for relevant funds.' On January 10, the head of a food company in Hangzhou told a China Times reporter in an interview that even if he got a guidance fund investment, there would be all sorts of problems. For example, one of his peers applied for [funding from] a local guidance fund, but the repayment period was only two years, and his business would have been hard-pressed to repay the loan in that narrow window of time."

-Wang Xiaohui, "The 40 Billion RMB of Venture Capital Funds Only Spent Over a Billion, 'Sleeping' Government Guidance Funds" *China Times*, a state-supervised economic newspaper, January 15, 2016.[181]

Guidance funds often fail to attract truly private capital, and in some cases may even crowd private capital out of the market.

"The role of some [guidance] funds in leveraging social capital is not obvious. Among the capital contributions to four [Shandong] provincial . . . funds, [direct] government investment and provincial state-owned enterprise [social capital] contributions accounted for 80.52%. Private enterprises [民营企业] and enterprises outside the province have a low degree of participation. Luxin New and Old Dynamic Energy Conversion[182] Venture Capital Fund [鲁信新旧动能转换创投基金] and Land Development and Rural Revitalization Fund [土地发展乡村振兴基金] [have raised] 1 billion RMB (150 million USD) and 5 billion RMB (745 million USD) respectively, [and] are entirely [funded] by the provincial financial guidance fund and provincial state-owned enterprises."

-From the Shandong provincial government's 2018 audit report.[183]

"[Guidance funds] have not attracted much social capital. Take the National Integrated Circuit Industry Investment Fund Co. [国家集成电路产业投资基金股份有限公司], as an example: In addition to the Ministry of Finance (25.95%) and China Development Bank Capital Corporation (CDB Capital) (23.07%), state-owned enterprises such as China National Tobacco Corporation (14.42%), Beijing E-Town International Investment and Development Co., Ltd. (7.21%) and China Mobile Communications Corporation (7.21%) all own shares. No private capital [民营资本] participated [in the fund's first place] at all."

-Jiang Liang, "Government Guidance Funds: A 12 Trillion RMB Predicament and Contradiction", *Sina News*, December 15, 2018.[184]

"Since the government set up guidance funds, especially state-owned guidance funds [国字头引导基金], market-oriented private equity firms are at a competitive disadvantage when raising capital . . . when [state-owned financial institutions] encounter both government-guided and market-based competitive fundraising, they tend to invest in government guidance funds. This is the politically safer way to do it. Even if government guidance funds make bad investments and lose money, these [guidance] funds don't carry a lot of risk and political responsibility, because they are responding to government policy requirements. However, if they give money to market-oriented investment institutions and investment goes wrong, causing losses, they have to assume a lot of responsibility. So for them, the choice to fund government guidance funds aligns with China's current market and political climate. However, this is not good for market-oriented investment institutions, because they are in an unfavorable competitive position. With government guidance funds, the so-called competitive neutrality of state-owned institutions that we are talking about cannot be achieved, and private [investment funds] have difficulty in [fundraising] for the very same reason."

-Xu Lin, chairman of a joint U.S.-China sustainable investment fund and former high-ranking Chinese development official, in a 2018 opinion piece in *Caixin Media*.[185]

“In provinces with mature venture capital development, the establishment of government guidance funds has a significant negative impact on the [overall] supply of venture capital . . . This indicates that in provinces with mature venture capital development, not only can the establishment of government guidance funds fail to guide social funding into the venture capital field, it also materially crowds out social capital.”

-Yang Minli et al., “Study on the Guiding Effects of the Government Venture Capital Guiding Funds,” [35] Science Research Management, a state-sponsored journal [11:13] (2014).[186]

“Social capital financing [i.e., financing from private investors] is hard to come by right now, but getting the guidance funds' money is easier. A good fund manager in this situation would be in an awkward position [in dealing with guidance funds] they should not take money from a government guidance fund [i.e., serve as a sub-fund] because it would erode business returns. Balancing commercial returns with policy requirements [i.e., to invest in less profitable but strategic ventures] makes it hard for funds to excel. However, as other institutions take increasingly larger sums from government guidance funds, they are under a lot of pressure.”

-Li Jianliang, expert advisor to the National Venture Capital Fund and independent director of the National IC Industry Fund, in a 2017 interview.[187]

Trends and Assessment

“In the early stage, the venture capital companies represented by Shenzhen Venture Capital and Fortune Venture Capital [达晨] benefited from Shenzhen's market environment and found a path of relative success in a market-oriented way. . . . According to relevant regulations and requirements, Fortune Venture Capital won the appraisal and became the fund manager of Shenzhen Guidance Fund [深圳引导基金]. . . . In March of 2013, Fortune Capital Chuangfeng [达晨创丰] [sub-fund] was established, and Shenzhen Guidance Fund invested 100 million RMB (16.2 million

USD), accounting for 4.89%. In 2016 and 2018, Fortune Capital Chuanglian [达晨创联] [sub-fund] and Fortune Capital Chuangtong [达晨创通] [sub-fund] were established respectively. Shenzhen Guidance Fund with 400 million RMB (60.3 million USD) and 600 million RMB (90.5 million USD) investment increased its [investment in the sub-funds] to 13.33% and 11.89%."

-Jiang Yucai, fund manager of Shenzhen Guidance Fund, as quoted in a 2020 online post by Fortune Venture Capital, one of China's earliest state-backed venture capital firms.[188]

"[Quoting the founding partner of a Suzhou investment firm:] 'The main incentive mechanism that attracted us to cooperate with SME venture capital guidance funds is the government's 4–6 year exit mechanism. Generally, the rate of return on projects [funded by these guidance funds] is 20% to 40%. . . . Suzhou Industrial Park has built up more than 1,000 science and technology projects, so there are ample projects to choose from.' According to [this partner], no banks or other financial institutions are involved in the LP composition of this fund, and all funds come from the private sector [民间]."

-Liu Biao, founding partner of an investment firm in Suzhou city, Jiangsu province, as quoted in 2016 in *China Economic Times*.[189]

"At present, government guidance funds are gradually weakening government intervention [in management and investment decision-making], mainly through rigorous fund management selection procedures, focusing on investment research and the selection of other core competencies, giving more authority to the market management teams, etc. This is to improve management efficiency and professional ability and to streamline redundant procedures."

-From a 2020 online post by two investment consultants.[190]

"Since last year, we have established long-term cooperative relations with professional investment institutions such as CITIC Securities [中信证券], China Jianyin Investment [建银投资] and

Hongtai Capital Holdings [洪泰资本] by setting up new and old dynamic conversion funds [新旧动能转换基金]. These specialized investment firms are known as 'investors who find other investors,' and who, with a large amount of high-quality resource information and projects in hand, connect the guidance funds established by the government with other [investors]. After the introduction of investment institutions as important investment objects, many project institutions will offer to make a visit. The traditional way of attracting investment can't compare with this."

-Wang Jinxiang, director of Weifang city's Finance Bureau, in a 2019 interview with the *Economic Observer*.[191]

"On September 17 [a regulatory notice from the Shenzhen city government] officially announced [a] list of 25 purged sub-funds and 12 downsized sub-funds. . . . Prior to this, Shenzhen Capital Group had been purging the sub-funds that did not comply with regulations, in accordance with the relevant provisions of guidance funds. Now, the regulatory side wants to be more transparent and requires the results of the fund purge to be disclosed on the official website. This is the first time Shenzhen Capital Group publicly disclosed which funds were purged. . . . Speaking of the impact of the publicity, [a financier] said bluntly: 'this is the first time in the country's history that a large-scale purge and downsizing of participating sub-funds was made public. Its greater impact will manifest in its deterrent effect—the brakes are on.'"

-From 2019 coverage in PE Daily, a leading privately owned financial news website.[192]

"Guo Libo, director of ChinaVenture Research Institute, said, 'Recently, I sorted through information on more than 60 typical local guidance funds in China. Many funds still require 50 percent of their money to be invested locally, although some have fallen to 40 percent. However, that's a bit less than the 70 percent that was generally required a few years ago. . .' It is worth noting that many of the guidance funds established in 2016 have appropriately relaxed geographical restrictions in their management measures, which aids sub-fund management institutions in screening high-quality projects.”

-From a 2017 online post by ChinaVenture Research Institute, a private Chinese finance and investment consulting company.[193]

“Second, the highest proportion of funds and all kinds of venture capital funds in the fields of modern efficient agriculture and modern marine industries jointly invested by provinces, cities, and districts (cities) shall be raised from 40% to 50%. Third, reduce the [minimum required] proportion of investment returns from funds invested by the fund of funds (or sub-fund) fund in firms located in Qingdao City. The proportion shall be reduced to 1.1 times from the original 2 times the guidance fund's capital contribution.”

-From a 2020 new regulation on Qingdao city's guidance funds.[194]

“In the future, the selection of government guidance funds will be further tightened [i.e., funds will become more selective], and the GPs that have an unwarranted reputation and fall short of expectations will be eliminated. Yancheng Venture Capital put it bluntly: ‘Funds in the later period will set more specific quantitative indicators in accordance with the requirements of the notice. Funds that fail to achieve the expected performance or that are slow to invest, etc., will terminate their contributions or withdraw funds according to regulations. Government guidance funds prefer institutions with strong overall marks in familiarity with the local industrial structure and local enterprises' projects and with [investment strategies] that are [widely] recognized.’”

-From a 2020 online post by Chinese Venture, an investment consulting company.[195]

“Guidance funds shall not participate in daily operation and management, but shall have the right to supervise investment in small- and medium-sized tech companies in the initial stage . . . If a venture capital institution fails to invest in a small- or medium-sized tech company in the initial stage as agreed in the [applicable] 'Investor Agreement and Articles of Association,' the guidance fund shall have the right to withdraw."

-From a 2007 Ministry of Finance regulation.[196]

"In the course of operation, the government investment fund shall not engage in the following businesses: 1. Engage in the business of guarantees, mortgages, entrusted loans, and businesses other than financing guarantees; 2. Invest in secondary market stocks, futures, real estate, securities investment funds, corporate bonds rated below AAA, trust products, non-guaranteed financial products, insurance plans and other financial derivatives; 3. Provide subsidies or donations to any third party (except approved charitable donations); 4. Absorb or take deposits in disguise, or provide loans and funds to third parties; 5. Undertake overseas investment with unlimited joint and several liabilities; 6. Issue trusts or collect financial products to raise funds; 7. Other businesses prohibited by the laws and regulations of other countries."

-Provisions of a 2015 Ministry of Finance regulation widely interpreted as targeting then-widespread guidance fund practices.[197]

"If the performance of the fund fails to have the expected effect, or if investment progress is slow or the fund is idle for a long time, the [government's] financial contribution shall be withdrawn according to the articles of association (agreement). If the fund fails to set up or carry out business according to the agreed timeline, or the social capital raised is lower than the agreed minimum limit, the financial contribution may be withdrawn ahead of time."

-From a 2020 Ministry of Finance regulatory notice.[198]

"The point of government intervention is to complement the gains or share the risks with social capital by making them willing to invest in early-stage companies. In the past, the government used subsidies and direct investment to improve the quality of social capital investment objects. But after all, the government is not a business, it lacks the people and mechanisms to screen projects, and it is not good at making business judgments. Therefore, the government began to introduce teams and entrust professional institutions to manage the funds while attracting social capital. At the same time, professional institutions can also provide entrepreneurial management experience, upstream and downstream business resources and other assistance as early-stage companies grow."

-Li Jianliang, expert advisor to the National Venture Capital Fund and independent director of the National IC Industry Fund, in a 2017 interview.[199]

"'In the past, government budget funding used to support enterprises was mostly in the form of project subsidies. The government department has the final say on whom to give to give to and whom not to give to, which is prone to result in phenomena such as money not being spent or even rent-seeking.' Liu Shangxi believes that the establishment of a government investment fund, in which the government generally does not participate in the day-to-day management of the fund, is beneficial to the establishment of a more equitable and effective new mechanism. Given an effective incentive and constraint mechanism, government funding can guide the investment orientation of the fund by forgoing a reasonable amount of [potential] profits [合理让利] to promote the realization of policy objectives."

-From a 2015 *People's Daily* report on new guidance fund regulations. Liu Shangxi is director of the Chinese Academy of Fiscal Sciences.[200]

"Tang Xuefeng explained: In the past, development zones mainly attracted investment through land concessions and tax subsidies. However, when development zones across the country do this, it creates a vicious competition. In the end, enterprises may indeed enjoy preferential policies, but the places they go to may not be suitable for them, which is not good for the long-term development of enterprises. 'Our approach now is to not compete with development zones across the country on preferential policies, but to attract investment through guidance funds. After becoming a shareholder, we also have more opportunities and discourse power [话语权] [i.e., the ability to speak and influence] to have in-depth exchanges with enterprises,' he said."

-Tang Xuefeng, general manager of a major state-owned investment fund, in a 2017 interview.[201]

"It is more and more difficult and unsustainable to rely on preferential policies related to land and taxation to achieve leapfrog development [跨越发展] . . . Because capital is the best 'selector,' 'amplifier' and 'accelerator' of the project, not only can it fulfill urgent requirements for funding, technology and talent, it also completely accords with current regulatory requirements, and has become the preferred way to attract investment. . . . The traditional way of attracting investment cannot compare with this."

-Wang Jinxiang, director of Weifang city's Finance Bureau, in a 2019 interview with the *Economic Observer*.[202]

Appendix 2: Categorization of Chinese sources based on their authoritativeness

The table below provides further details on the Chinese-language sources cited in this paper, categorized based on their authoritativeness.

Category[203]	Notes	Source	Description
Authoritative sources	Include official documents and statements by the government of the People's Republic of China, the CCP, and central media. Authoritative sources help clarify the CCP's policies and priorities, but often lack depth and concrete details, and may present a sanitized view of the facts on the ground. Nonetheless, in some cases, bureaucrats at the provincial level interpret the CCP Central Committees' guidelines and implement their own version. These sources inform our understanding of the Chinese authorities' priorities and intentions with	The National Audit Office [审计署]	A ministry under the State Council that is responsible for auditing final accounts of public finance and state projects.
		Ministry of Science and Technology of the People's Republic of China [中华人民共和国科学技术部]	A ministry under the State Council that implements guidelines and policies concerning scientific and technological innovation.
		Ministry of Finance of the People's Republic of China [中华人民共和国财政部]	A ministry under the State Council that administers macroeconomic policies and the national annual budget.
		People's Daily [人民网]	The official newspaper of the CCP.
		Guangming Online [光明网]	The website of Guangming Daily, the CCP Central Committee's daily newspaper for intellectuals, which is managed by the CPC

	respect to government guidance funds.		Central Propaganda Department. Covered topics include science, technology, and education.
Quasi-authoritative sources	Include commentaries by media and academic institutions, listed here in the order of authority of their sponsoring institutions. Quasi-authoritative sources serve as messengers for their sponsoring institutions. Analyses and commentaries made by Chinese scholars and party members can help to interpret official policies on guidance funds. Despite being overseen by the Party, these media sources don't carry the same authority as the central media. But they are probably more important than articles written by authors with no institutional backing	Xinhua Finance [中国金融信息网]	A financial media supervised by Xinhua News Agency and sponsored by China Economic Information Network.
		China Economic Times [中国经济时报]	An economic newspaper published by the Development Research Center of the State Council.
		China Central Television Website [央视网]	A central news website sponsored by the China Media Group (a state media company).
		China Securities Journal [中国证券报]	A newspaper sponsored by Xinhua News Agency and designated by the China Securities Regulatory Commission to disclose information about publicly listed companies.
		Securities Times [证券时报]	A financial and securities newspaper administered by People's Daily and designated by the China Securities Regulatory Commission.

	and seen as a more prominent subset of non-authoritarian sources.	Beijing Business Today [北京商报]	An economic newspaper sponsored by the Beijing Daily Newspaper Group that is overseen by the CCP Central Propaganda Department.
		China Fund News [中国基金报]	A financial newspaper overseen by People's Daily.
		Science Research Management [科研管理]	An academic journal sponsored by the Chinese Academy of Sciences and the Research Center for Technology Innovation at Tsinghua University.
		Forum on Science and Technology in China [中国科技论坛]	An academic journal managed by the Ministry of Science and Technology and sponsored by the Chinese Academy of Science and Technology for Development.
		Tianjin Daily [天津日报]	The official newspaper of the Tianjin Municipal Committee of the CCP.
		China Times [华夏时报]	A financial and economic newspaper managed by the China Disabled Persons Federation. Shui Pi [水皮], a prominent financial analyst,

			serves as editor-in-chief.
		21st Century Business Herald [21 世纪经济报道]	A business paper affiliated with the Southern Media Group, but tightly controlled by the Party since a 2015 investigation.[204]
		China Business News [第一财经]	A financial and business newspaper owned by the Shanghai Media Group (a state-owned media company).
		Fortune Venture Capital [达晨财智]	One of China's earliest state-backed venture capital firms, located in Shenzhen.
Non-authoritative sources	Include reporting and commentary by third-party researchers, consultants, industry outlets, and independent media. Non-authoritative sources often provide insight about policy debate and implementation that pushes back on	Guotai Junan Securities [国泰君安证券]	A major private (i.e. non-state-owned) Chinese financial services company.
		Zero2IPO Research Center [情科研究中心]	A private Chinese investment services, data, research, and consulting company.
		ChinaVenture Research Institute	A private Chinese finance and investment consulting company.

	the authoritative voices. These sources can be rich in data and case studies that help to contextualize the development of guidance funds as well as the private equity and venture capital markets. They also provide policy recommendations and help map the boundaries of acceptable reforms the Chinese authorities are willing to make.	website [投中网]	
		China FOF Research Center [母基金研究中心]	An academic research, exchange and cooperation platform.
		China Industry Information [中国产业信息]	An industrial information website operated by Intelligence Research Group (a market research and consulting company).
		PE Daily [投资界]	A PRC venture capital and investing web portal run by Zero2IPO Group
		Caixin News [财新网]	An investigative news website that provides financial and economic news.
		Economic Observer [经济观察]	A business information platform managed by the Shandong Sanlian Group Co., a media investment company.
		Sina Finance [新浪财经]	The financial news channel of a popular, privately run PRC web portal.

		Sohu [搜狐]	A major privately operated Chinese web portal.
		Chinese Venture [融资中国]	An equity investment consulting company.
		Xingtai Zhaoshang Website [邢台招商网]	A website run by an investment consulting company based in Xingtai, prefecture-level city in Hebei province.
		China Modern Consulting [现代咨询]	A prominent asset management consulting company based in Jiangsu province.
		Morning Whistle Group [晨哨集团]	An equity investment consulting company, founded by a group of senior media, legal and investment bankers.
		Guangcai Investment [光彩南粤投资]	A management group that manages government and private investment in PRC state infrastructure projects.

Endnotes

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[2] Zero2IPO Report (Part 1), 19; Zhang, “Guidance Funds Become a Weathervane,” 9; Guan, “Where Will the Chinese Government Guidance Funds Go” (“Narrowly defined, government guidance funds include venture capital funds, while broadly defined government guidance funds cover government industrial investment guidance funds and government venture capital guidance funds, as well as public-private partnership (PPP) funds and other types of funds.”) In this paper, we generally follow the broader definition.

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[4] Zhang, “Guidance Funds Become a Weathervane,” 7; “Social funding” [社会资金] is a synonym.

[5] See generally Zhang, “Guidance Funds Become a Weathervane,” 1 (“The essence of domestic industrial funds is the internationally known Private Equity Fund”).

[6] Zhang, “Guidance Funds Become a Weathervane,” 9; Ma Wen [马文], “Analysis on the Operation Mode of Government Guidance Funds” [政府引导基金的运营模式分析], FoF-Research [水母研究], December 13, 2018, available at

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[8] Zero2IPO Report (Part 1), 12; "Report on the Development of Chinese Government Guidance Funds 2019 (Part 2)" [2019 年中国政府引导基金发展研究报告(下篇) 之运营管理研究], Zero2IPO [情科研究中心], January 22, 2020, 18, available for purchase at https://research.pedaily.cn/report/pay/202001222205.shtml (archived at https://perma.cc/89Z9-E3L5) (hereinafter "Zero2IPO Report (Part 2)); Jiang, "A 12 Trillion RMB Predicament and Contradictions"; Some funds use less social capital. See, e.g., Ma Mujie [马慕杰], "Beijing Science and Technology Innovation Fund Chairman Liu Kefeng: Focus on 'Patient Capital' to Help Hard S&T Enterprises Cross the Valley of Death" [北京科创基,董事长刘克峰：聚焦"耐心资本"，助力硬科技企业跨越死亡谷], ChinaVenture Research Institute website [投中网], October 24, 2019, https:/www.chinaventure.com.cn/news/80-20191024-349530.html (archived at https://perma.cc/WQM5-TJWW); Zhu Xiaojia [朱晓佳], "Sorting through Government Guidance Fund Policy—Beijing" [政府引导基金政策梳理—北京篇], Chinese Venture [融中财经], December 10, 2019, http://www.thecapital.com.cn/News/show/id/24351.html (archived at https://perma.cc/S8JH-VAEJ) (some funds only use at most 50% of social capital); Shen Junhan [申俊涵], "Interview with Li Jianliang, Independent Director of National Integrated Circuit Industry Fund, on 'Overstepping the Boundary' of Government Guidance Funds: How to Supervise and Evaluate and Return to the Original Intention?" [专访国家集成电路产业基金独董李建良 政府引导基金"越界"：如何监管评价、回归初衷?], *21st Century Business Herald* [21 世纪经济报道], March 18, 2017, http://m.21jingji.com/article/20170318/50698a1b9e1860c64ec1a2d8ffb8f105.html (archived at https://perma.cc/US3W-E2ZR?type=image) (others only 40%-60%).

[9] Zero2IPO Report (Part 1), 12.

[10] See, e.g., Zero2IPO Report (Part 1), 21; Du Tao [杜涛], "'Weifang Sample' of Government Guidance Fund—Fund Investment After Land and Tax Incentives" [政府引导基金的"潍坊样本"——土地、税收优惠之后的基金招商], *Economic Observer* [经济观察], March 16, 2019, http://m.eeo.com.cn/2019/0316/350578.shtml (archived at https://perma.cc/HF4T-UPDN).

[11] Zero2IPO Report (Part 1,) 7-12; "China's Government Guidance Funds in 2019, From 'Large Scale Blossom' to 'Intensive Cultivation'" [2019 年我国政府引导基金由"遍地开花"到"精耕细作"], *People's Daily* [人民网], May 6, 2020, http://money.people.com.cn/fund/n1/2020/0506/c201329-31698315.html (archived at https://perma.cc/ADL2-EZGP); Funds of Fund [基金的基金] are also known as "mother funds" [母基金]. These other funds may be "mother funds" or subsidiaries ("sub-funds" [子基金]) of the guidance fund itself, or funds established by third parties. Zhang, "Guidance Funds Become a Weathervane, 7"; "CGP Investment Jiang Mingming: There are 'Tricks' to Managing Government Guidance Funds" [盛世投资姜明明：管理政府引导基金有"套路"], *FOF Weekly* [母基金周刊], April 26, 2018, https://www.fofweekly.com/chuangtouquan/1680.html (archived at https://perma.cc/6YW8-PKET).

[12] Zero2IPO Report (Part 1), 20; Zero2IPO Report (Part 2), 51; "China's Government Guidance Funds in 2019, From 'Large Scale Blossom' to 'Intensive Cultivation'"; "New Air Vent for Investment Promotion: Government Guidance Funds Scramble for Preferential Policies, the 'Capital Investment' Era Has Risen!" [资新风口：政府引导基金拼抢优惠政策，"资本招商"时代已经崛起!], [邢台招商服务平台], *Xingtai Zhaoshang Website* [邢台招商网], October 18, 2017, http://www.kbhrd.com/xingtaidongtai/387501.html (archived at https://perma.cc/7SPS-TVE2).

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[14] "Interim Measures for the Administration of Government Investment Funds" [政府投资基金暂行管理办法], Ministry of Finance of the People's Republic of China [中华人民共和国财政部], November 12, 2015, available at http://www.gov.cn/gongbao/content/2016/content_5051233.htm (archived at https://perma.cc/2PK7-PN3F); "Interim Measures for the Management of Science and Technology Small and Medium Sized Enterprise Venture Investment Guidance Funds"; Li Jianliang [李建良], "Analysis on the Characteristics,

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[17] Zero2IPO Report (Part 1), 2.

[18] See, e.g., Guan, "Where Will the Chinese Government Guidance Funds Go."

[19] Zhang, "Guidance Funds Become a Weathervane," 1; Zero2IPO Report (Part 1), 3.

[20] See e.g., Guan, "Where Will the Chinese Government Guidance Funds Go"; Zheng Delin [郑德琳], "Countermeasures and Suggestions to Improve the Operation Efficiency of Government Investment Funds" [提高政府投资基金运行效率的对策建议], *Budget Management & Accounting* [预算管理与会计], no. 2 (2018):31, http://www.cnki.com.cn/Article/CJFDTotal-YSKJ201802011.htm (archived at https://perma.cc/N5L4-KFV4).

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[23] Fan Yuan [范媛], "Other Secrets to Government Guidance Funds' 'Sleeping'" [政府引导基金 "沉睡"另有隐情], *China Economic Times* [中国经济时报], January 16, 2017, http://lib.cet.com.cn/paper/szb_con/481567.html (archived at https://perma.cc/MH7E-KY98)("Under the pressure of central policies, local government funds must change the way they use funds, and the allocation of financial support for industrial development funds has changed from 'subsidy investment' to 'equity investment'."); See also Zhang, "Guidance Funds Become a Weathervane", 9; Zero2IPO Report (Part 1), 55; Shen Junhan [申俊涵], "Government Investment Fund Whirlwind, Yizhuang [Town] Investment Level 3.0" [政府投资基狂飙亦庄国投进阶 3.0], *21st Century Business Herald* [21 世纪经济报道], February 11, 2017, http://www.21jingji.com/2017/2-11/yNMDEzNzhfMTQwMjYyNA.html (archived at https://perma.cc/UFG4-L4ZY).

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[26] "A Panoramic Report of China Funds of Fund"; Zero2IPO Report (Part 1), 13.

[27] "A Panoramic Report of China Funds of Fund"; Zhao, "'Scanning' China's Funds of Fund"; Zero2IPO Report (Part 1), 13.

[28] See, e.g., Zero2IPO Report (Part 1), 13 and 55; Shen, "Government Investment Fund Whirlwind."

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[32] Zero2IPO Report (Part 1), 23 ("The average target size of national government guidance funds reached 63.744 billion RMB (9.22 billion USD), 6.28 times the average target size of provincial government guidance funds and 15.97 times that of prefecture-level government guidance funds.").

[33] Zero2IPO Report (Part 1), 16; Guan, "Where Will the Chinese Government Guidance Funds Go" (As of 2019, there are 11 funds in the 100 billion-plus RMB range target size at the provincial and municipal levels, but on average, the target size of local guidance funds is still below that of national level guidance funds.).

[34] Zero2IPO Report (Part 1), 49.

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[47] Du, “‘Weifang Sample’ of Government Guidance Fund.”

[48] Guan, “Where Will the Chinese Government Guidance Funds Go.”

[49] Zero2IPO (Report Part 2), 19.

[50] Guan, “Where Will the Chinese Government Guidance Funds Go.”

[51] “The Role of Government Guidance Funds in Countercyclical Regulations ‘Fund Exploration’“ [融中财经：政府引导基金的逆周期调节作用「基金探秘」.（下）], Chinese Venture [融资中国], June 30, 2020, available at https://baijiahao.baidu.com/s?id=1670890212428044711&wfr=spider&for=pc (archived at https://perma.cc/FKH8-WP3A).

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