The effect of foreign institutional investors on corporate governance: evidence from Chinese publicly listed firms

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ABSTRACT

Compared to the astonishing growth of the Chinese economy in the last 40 years, the development of its capital markets has been lagging behind. Now that the economic system is transforming from an export-based and investment-driven model to a consumption-based and innovation-driven one, an efficient stock market has never been more relevant. To promote the development of the Shanghai Stock Exchange (SSE) and the Shenzhen Stock Exchange (SZSE), the China Securities Regulatory Commission (CSRC) has implemented a range of new policies in the last decade. One of these policies aims at increasing the presence of foreign institutional investors. The objective of this thesis is therefore to analyse if the new influx of foreign investors have performed a monitoring role and improved firm-level corporate governance structures. More specifically, we hypothesise that larger and long-term foreign institutional investments drive corporate governance improvements. We have collected an extensive foreign ownership database and used multiple metrics to measure firm-level corporate governance. Namely, we use a corporate governance index, a transparency disclosure rating, and individual corporate governance attributes. In order to alleviate endogeneity concerns, we performed a variety of empirical tests, such as analysing the effect of lagged, significant changes in foreign ownership on the level of corporate governance. We indeed found that foreign institutional investors have enhanced the development of corporate governance mechanisms in Chinese publicly listed firms. Therefore, our results indicate that further relaxations in foreign ownership restrictions will hasten the development of the Chinese capital markets.

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Matteo Cecchi

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1. Introduction

Many authors have argued that sound corporate governance structures are beneficial for individual firms, financial markets, and countries as a whole (Jesover and Kirkpatrick 2005; Claessens and Yurtoglu 2012; Wurgler 2000). Claessens (2006) states that good corporate governance can lead to lower costs of capital, higher returns on equity, higher efficiency, and better treatment of all involved stakeholders. An inefficient stock market, characterized by low levels of corporate governance, might hinder economic growth (Maher and Andersson 2000). In the case of China, past economic growth depended to a large extent on state-owned banks financing state-owned enterprises (SOEs), which was made possible by China's large base of domestic deposits (ASIFMA 2017). However, China's economic development is entering a new stage where export and investments are being replaced by consumption and innovation (Allen, Qian and Gu 2017). In order to support this transition, China's financial model will need to evolve (ASIFMA 2017). Well-developed capital markets can play an important role here by optimising resource allocation, expanding financial channels for enterprises, and providing investment opportunities for the Chinese population (Cheng and Li 2015). Moreover, the effects of Chinese capital markets' progress span further than just the Chinese economy. Since 2007, China has been the greatest contributor to the growth of the world economy (World Bank (a) 2019). The development of the Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE) will consequently be an important factor in the future development of the world economy (Carpenter, Lu and Whitelaw 2015).

Unlike the tremendous economic growth that China has reached in the last four decades, its stock markets have not kept pace. One factor that has slowed down their development is corporate governance related issues. There is a significant amount of academic research covering the high levels of corporate fraud (Jia, Ding, Li, and Wu 2009; Chen, Gao, Firth, and Rui 2005), earnings management (Qiao, Bin and Qian 2006; Liu and Lu 2007), and expropriation of minority shareholders (Cheung, Jiang, Limpaphayom and Lu 2008 ; Gao and Kling 2008). In order to alleviate these issues, and to promote sound development of the capital markets, the China Securities Regulatory Commission (CSRC) has implemented a wide array of new regulations in the last decade. First, significant changes have been made to the securities law, company law, and accounting standards (Keay and Zhao 2018). Second, a Corporate Governance Code, which

follows the principles established by the Organisation for Economic Co-operation and Development (OECD), was implemented in 2001 (OECD 2011). Third, the CSRC has stepped up oversight of publicly listed-firms and has amplified the potential enforcement actions available to punish non-compliant firms (Feinerman 2007). Nonetheless, there are still issues related to weak corporate governance, limited transparency, soft law enforcement, and weak auditing and accounting standards (ASIFMA 2017). As a consequence, many leading Chinese firms, such as Tencent, Xiaomi, Alibaba, and Meituan, have decided to list on foreign stock exchanges (The Economist 2019).

Researchers have often put foreign investors forward as a means of improving the level of corporate governance, and the overall development of capital markets (Gillan and Starks 2003). In line with its WTO entrance conditions, China opened up its financial markets to foreign investors in 2006 through the Qualified Foreign Institutional Investor (QFII) program (China Securities Regulatory Commission, Notice of China Securities Regulatory Commission on the Relevant Issues Concerning the Measures for the Administration of Securities Investment within the Territory of China by Qualified Foreign Institutional Investors 2006). In the last decade, the CSRC has reduced the limitations of the QFII program, and has put new methods in place to increase the level of foreign ownership. There are currently three ways for foreign investors to invest directly into the SSE and the SZSE. The first option is through the QFII and Renminbi Qualified Foreign Institutional Investor (RQFII) programs, which differ only slightly. The QFII program allows foreign investors to invest in China with USD and other foreign currencies, while the RQFII program allows foreign investors to utilise offshore RMB funds (Shanghai Stock Exchange, Comparing Stock Connect with QFII/RQFII 2015). The second option is a strategic investment, which is more appropriate for foreign public and private companies. The final options is through one of the Connect programs. The first links both the SZSE and SSE to the Hong Kong Exchange (HKEX). The second links the SSE to the London Stock Exchange (LSE). The Connect program with HKEX has been up and running since November 2014 and is showing great potential (Yiu 2017). The Connect program with LSE has only started recently and is still quite limited in scope.

By allowing more foreign investments into the capital markets, the CSRC aims to strengthen the corporate governance mechanisms of Chinese firms (CSRC 2016). Foreign institutional investors might be able to improve firm-level corporate governance through both public and

private channels, by respectively initiating shareholder activism cases or entering into private dialogues with the firm. The objective of this paper is therefore to see if the new influx of foreign institutional investors, mostly through the QFII/RQFII and Connect programs, has improved the level of corporate governance of Chinese publicly listed firms. A subsequent improvement in corporate governance could be beneficial for firm-level performance, the overall development of the Chinese capital markets, and the growth level of the real economy.

In order to demonstrate this, we collect an extensive database on foreign ownership between 2005 and 2017 by manually collecting ownership data from the FactSet database. Next, we use different metrics to capture the level of corporate governance. Firstly, we use a corporate governance index consisting out of 19 individual attributes. Secondly, we use a Transparency Disclosure Index, compiled by the SZSE. Thirdly, we use certain important individual corporate governance attributes as dependent variables as well. We then use a variety of empirical methodologies to alleviate concerns, such as endogeneity, as best as possible. Firstly, we measure the effect of lagged and significant changes in foreign ownership on the current level of corporate governance. Secondly, we perform multiple logistic regressions to analyse the effect of lagged ownership levels on corporate governance outcomes. Thirdly, we include several robustness tests to support our findings. Finally, we perform a qualitative study by collecting activism shareholder and engagement cases to prove that institutional investors are able to effectively influence Chinese companies in practice. Our results indeed show that foreign institutional investors have strengthened firm-level corporate governance.

Apart from Tan (2009), who performs a qualitative study by interviewing nine QFIIs, and Zhu and Huang (2015), who specifically looks at the effect of QFIIs on the split-share structure reform process, our study is, to the best of our knowledge, the first to prove that foreign investors have enhanced the corporate governance structures of Chinese public firms. Our results thus contribute to the stream of research that promotes an important monitoring role for foreign investors. In terms of proposed policy changes, our findings suggest that a reduction in the current limitations to foreign investors will lead to more sound corporate governance mechanisms and a faster development of the Chinese capital markets. Better functioning capital markets can play an important role in supporting economic growth, productivity increases, and innovation, which in turn will lead to increases in the standard of living of the Chinese population.

The paper proceeds as follows. Section 2 consists of an extensive literature review where we cover four topics: the Chinese financial markets, the evolution of Chinese corporate governance, Chinese foreign investments and its regulation, and the effect of foreign investors on corporate governance. Section 3 presents our hypothesis in more detail. Section 4 describes the foreign ownership variables, corporate governance metrics, and other control variables in more depth. Sections 5 and 6 cover our methodologies and results. Section 7 provides our conclusions.

2. Literature Review

2.1.Chinese Market overview

The creation of the stock exchanges was an important part of the economic reforms of the People's Republic of China (PRC). The original objective of the SSE and SZSE, founded respectively in 1990 and 1991, was to privatize large SOEs. SOEs play a dominant role in the Chinese economy in areas such as energy, transportation, telecommunications, and industrial and technical equipment. However, economic reforms were necessary as, in the 1990s, one third of the SOEs were losing money and struggling under high levels of debt (Huang and Yeung 2014). In addition, a high proportion of the loans issued to the SOEs were considered non-performing, which was putting a heavy strain on the Chinese banking system. The share of non-performing loans issued to SOEs was equal to 25% in 1991 (Bartel and Huang 2000). In sum, according to Huang and Yeung (2014), the privatization had four important functions. Firstly, to let the financial markets lower the financing burdens of the state financial departments and banks. Secondly, to lower the government presence in the management of enterprises. Thirdly, to allow self-determination for companies. Finally, to channel more savings into the accumulation of social capital.

2.1.1. Early stage development

The development of the Chinese financial markets has been lagging behind compared to its real economic growth (Allen et al. 2017). The average ratio of market capitalization to Gross Domestic Product (GDP) between 2007 and 2017 was equal to 58.57%, compared to respectively 125.05% and 110.39% for the United States and the United Kingdom (World Bank(b) 2019). In January 2016, the CRSC's chairman, Xiao Gang, characterized the Chinese market as an "immature market with inexperienced investors, an imperfect trading system, and an inappropriate supervisory system" (2016). Indeed, Bayraktar's research (2014) on the development of global

stock markets showed that there was still a big discrepancy between the current level of the Chinese stock market and its potential capacity. The importance of a well-functioning stock market cannot be underestimated. Financial markets promote modern enterprise systems, more optimal resource allocation, and facilitate economic growth. In addition, an efficient stock market could play an important role in alleviating the burden of the current high levels of Chinese corporate and state debt by providing alternative financing channels (China Power Team 2019).

There are several reasons why the Chinese capital markets have not yet reached their full potential. A first reason is the Chinese political context. When the stock exchanges were created, there was a certain level of skepticism within the central government of the PRC. This skepticism was well put by Deng Xiaoping, one of China's most famous leaders, in 1992: "Securities, stock markets, are they good or evil? Are they dangerous or safe? Are they unique to capitalism or also applicable to socialism? Let us try and see. If it goes well, we can relax control; if it goes badly, we can correct or close it." (Huang and Yeung 2014). Due to this sentiment of doubt, the Chinese government opted to implement the privatization process gradually, and to maintain controlling rights in important SOEs. Consequently, a large portion of the shares of publicly listed companies was retained by the state or other legal persons in the form of non-tradable shares.

The valuation of non-tradable shares is based on Net Asset Value (NAV) mechanisms, which often leads to a distorted value compared to the stock price of the tradable shares. The subsequent lack of alignment between the shareholders of tradable and non-tradable shares was often the cause of poor corporate governance structures, and bad corporate performance (Yang, Hou and Qian 2015). By 2005, the portion of tradable shares was only 41.66% (Jiang and Kim 2015). According to Cheng and Li (2015), the non-tradable shares slowed down the development of the financial markets and had a hindering effect on the management reform of state-owned companies. After multiple attempts by the Chinese government to decrease the level of non-tradable shares, the split-share-structure reform was finally put in place in 2005. It is considered the second wave of privatization and the most important reform of the Chinese financial markets since its foundation (Zhu and Huang 2015).

A second reason why the Chinese financial markets have struggled to develop is the central role of the banking industry within the financial system. Five banks, which are all majority-owned by the government, dominate the banking industry, and account for almost half of the total loan

market (Elliott and Yan 2013). Between 1992 and 2003, the average ratio of domestically raised capital to the amount of bank loans was equal to 5.77% (Wong 2006). In addition, the Chinese financial system is characterized by a sizeable shadow-banking sector. As shadow-banks operate under a reduced level of regulatory oversight, they are able to compete in capital markets by providing cheap and more widely available financial services (Elliott, Kroeber and Qiao 2015). Thirdly, individual investors, who lack the expertise of institutional investors in pricing efficiency, dominate the Chinese capital markets. In fact, China has the largest number of individual investors in the world, with over 90 million people investing actively in shares and bonds (CSRC 2014). Finally, the IPO process is based on an approval system where the Government plays a dominant role in identifying sectors of interest, establishing a quota system and even determining the offer price. Consequently, SOEs are often favoured over private companies (Jiang and Kim 2015).

2.1.2. More recent developments

Many changes have been implemented in the last decade in an attempt to modernize and further develop the capital markets. Firstly, the split-share-structure reform has reduced agency problems between non-tradable and tradable shareholders, and improved the price discovery process and liquidity of shares (Jiang and Kim 2015). Secondly, CSRC has been promoting the development of a variety of institutional investors, including, but not limited to, pensions funds (China Daily 2017), insurance companies (ASIFMA 2017), venture capital (Yue 2016), and private equity (Yang 2018). In addition, under the Qualified Domestic Institutional Investor (QDII) program, domestic institutional investors are able to invest abroad and further develop their expertise. Thirdly, the offer of investment tools has increased significantly by including futures, and allowing margin trading, and short selling. Finally, the IPO process is getting more streamlined with the objective of ultimately transforming into a registration-based system (Zhang 2019). Carpenter et al. (2015) find evidence that these policy changes have yielded results. Their results show that the Chinese stock markets have become as informative about future corporate profits as American stock markets.

Currently, there are 1,479 companies listed on the SSE and 2,170 companies on SZSE[1]. The SSE consists mainly of large, and often state-owned, enterprises in industries such as Real Estate,

[1] As of July 12th, 2019. Found on the respective websites of the Shenzhen Stock Exchange and the Shanghai Stock Exchange.

Finance, Resources, and Energy, while the SZSE consists more out of small-and-medium sized, innovative, and technology companies. To adhere to the specific needs of different sized companies, the SZSE has transformed into a multi-tier market system consisting out of three different components: Main Board, SME Board and ChiNext. The SME Board and ChiNext are important financing channels for respectively companies in a transitional phase, and innovative or emerging companies (Shenzhen Stock Exchange 2011). In addition, the CSRC founded the National Equities Exchange and Quotations (NEEQ) in 2012. The NEEQ, an over-the-counter market, has the objective of making financing more accessible to smaller companies, which often have difficulties obtaining favourable bank loans and have limited access to capital markets (F&Y Capital 2015).

In sum, the Chinese capital markets still have significant steps to take if they want to reach their full potential and have a stature on the world stage similar to the real Chinese economy. Nonetheless, the fact that they will play an important role in the future of capital raising is indisputable. This view is shared by a survey of the Economist Intelligence Unit (2018) predicting that China will be the country with the most issuers by 2030. In addition, the announcement of MSCI in 2017 to further the integration of the Chinese stock exchanges into its MSCI Emerging Market Index sends a signal that China is well on its way (He and Ka-Sing 2017).

2.2.Chinese Corporate Governance

The quality of the corporate governance level of a country`s stock market and its constituents have important consequences for the growth of the real economy, the allocation of resources, and the level of affordable foreign and domestic capital. Corporate governance can help companies operate more efficiently, gain access to capital, and prevent mismanagement and corruption (Hartzler 2011). The development of corporate governance in Chinese publicly listed firms has been well covered academically since the inception of the financial markets (Clarke 2003; Liu 2006; Yang, Chi and Young 2011; Jiang & Kim 2015; Mutlu, Van Essen, Peng, Saleh, Durane 2018). Bearing in mind the age of the two stock exchanges, Chinese corporate governance has made significant strides over the last three decades. Nonetheless, there is still room for improvement in a series of matters. This section covers the development of the internal and external corporate governance mechanisms, some of the most pressing corporate governance issues, and the development of the regulatory framework in the Chinese financial markets.

2.2.1. Internal Corporate Governance

Corporate governance issues in the early stages of the stock market were mostly related to the disproportionate presence of SOEs and concentrated government ownership. A 2003 Corporate Governance report by the SSE showed that in 40.9% of the SOEs, the government owned more than 50% of total shares (Tan and Wang 2007). The first issue concerning high levels of state ownership is that their primary objective is not maximising shareholder value. Other aims such as maintaining employment and social stability, keeping control over important strategic sectors, and politically motivated job placement might outweigh the objectives of shareholders (Liu 2006). Next, the government is the institution that oversees market regulation and corporate governance guidelines on one hand, and a major shareholder in many listed companies on the other hand. Stulz (2005) defines this issue as a "twin-agency" problem. Thirdly, Clarke (2003) posits that government ownership leads to an absence of an effective ultimate principal. Since the population, the ultimate beneficiary of all government ownership, has no incentive or means to monitor, there is a lack of a principal agent controlling the management. Next, the non-tradable shares owned by both the government and other legal persons do not share in the profits of stock price increases. This can cause serious incentive alignment issues. Finally, even in non-SOEs, the state might still be able to influence companies through politically-connected board members and executives. In line with this, Fan, Wong and Zhang (2007) find that board structures of firms with politically connected CEOs have fewer directors with an academic background, more current or ex-government members, and older directors. Next, Schweizer, Walker and Zhang (2017) find that politically-connected private enterprises are able to obtain corporate bonds more easily and at lower financing rates. In addition, the results of Schweizer, Walker and Zhang (2019) show that the presence of politically-connected managers increases the likelihood of completing a cross-border merger or acquisition.

In short, the early corporate governance system in China could be defined as control-based, where the controlling shareholder, often the state, has a tight grip over the governance of the firm, instead of a market-based system (Liu 2006). The non-tradable share reform of 2005 ushered in a new period for the development of corporate governance. The control-based corporate governance system has been transforming into a hybrid model characterized by both economic and administrative measures (Keay and Zhao 2018). Nonetheless, frictions between controlling shareholders, both private and state, and minority shareholders remain. Although some authors,

such as Jensen and Meckling (1976) and Vishny and Schleifer (1986), argue that controlling shareholders can be a valuable tool in reducing agency problems; this often is not the case in emerging markets. Indeed, Chen, Li and Shapiro (2011) put controlling-shareholder expropriation forward as the most pressing issue in China and other emerging economies. Jiang, Lee and Yue (2010) find an excessive use of corporate loans by controlling shareholders so as to expropriate wealth from the firm and minority shareholders. The empirical results of Liu and Lu (2007) show that a large share of earnings management is caused by the agency conflicts between controlling and minority shareholders. Much additional research has been given to the analysis of tunneling and earnings management issues (Lo, Wong and Firth 2010; Berkman, Cole, Cole and Fu 2009; Jiang, Zhu and Huang 2013; Shan 2013).

Other issues include the ineffectiveness of supervisory boards and the limited power of independent directors. Laura Cha, the previous vice-chairman of the CSRC stated that "supervisory boards may give the illusion of certain checks and balances in the listed companies, when none existed" (2001). Xi (2006) supports this claim by stating that supervisory boards suffer from a lack of information, legal support, and expertise. Their inability to vote on board of directors' decisions and to elect board members was considered the most pressing issue. The 2006 amendements to the Company law tackled many of the aforementioned issues and thus improved the monitoring effectiveness of the supervisory boards (Ding, Jia, Li and Wu 2010). Consistent with this, recent research has brought forward more positive results on supervisory boards (Ding, Jia, Li and Wu 2009; Firth, Fung and Rui 2007; Haß, Johan and Schweizer 2016).

In any case, according to a source within the CSRC, the idea of independent directors was pushed forward as supervisory boards were deemed useless at the time (Andrews and Tomasic 2006). The *Guidelines for introducing independent directors to the board of directors of listed companies* state that, starting in 2003, at least one third of the board of directors needs to be independent. Research on the effectiveness of independent directors has shown mixed results. Three reasons have been presented to explain the potential ineffectiveness of independent directors (Tan and Wang 2007). Firstly, most boards of directors still only have a minority of independent directors, which might impede their monitoring function. Secondly, a large number of independent directors are directly chosen by the controlling shareholder, which undermines their independence.

Thirdly, the authors claim that the reputational motivation mechanism[2] for independent directors has yet to take off in China. Nonetheless, more recent research by Khanna and Ma (2016) and Jiang, Wan and Zhao (2016) found more promising results on the effectiveness of independent directors.

2.2.2. External Corporate Governance

Analogous to the situation of internal corporate governance, the external corporate governance systems have improved significantly over time, but certain issues still remain. Firstly, the legal environment is still quite weak compared to more developed economies. Allen, Qian and Qian (2005) extended the study of La Porta, Lopez-de-Silanes and Shleifer (1998) by calculating the respective corporate governance metrics for China. They find that China scores significantly lower than most countries in areas such as law enforcement, corruption, and shareholder protection. The authors mention the lack of sufficient legal professionals as an important issue as well. Jiang and Kim (2015) supplement this point of view by not only stating that law enforcement is below average, but that fines are often too low to make an impact. For example, Danhua Chemical Technology was found guilty of hiding related-party transactions worth 1.5 billion RMB (210 million USD), and of making up false bank deposits and capital worth 700 million RMB (99.28 million USD) between 2003 and 2006. The firm got off with a warning and a fine of 300,000 RMB (42,548 USD). In short, the legal cost of committing fraud is low.

Secondly, due to their relatively low levels of shareholding and short-term horizons, Chinese institutional investors are not considered effective monitors (Jiang and Kim, 2015). Aggarwal, Hu and Yang (2015) find mixed results when analysing the monitoring effect of domestic institutional investors in preventing fraud between 2001 and 2011. They find that institutions that are more likely to have business ties with firms (e.g. insurance companies, pensions funds, trusts, etc.) play no significant monitoring role, while they do find a positive monitoring effect from domestic mutual funds. Firth, Gao, Shen and Zhang (2016) further support this conclusion by finding a significant effect of mutual fund ownership on the level of dividend pay-outs. They do not find any significant either for other institutional investors.

[2] In more developed markets, an independent director is incentivized to properly fulfill its monitoring role as companies are looking for effective independent directors. The value of "good" independent directors will therefore increase, which in turn will lead to more and better paid independent director positions.

Thirdly, the corporate control market is underdeveloped. An active corporate control market can be an effective corporate governance tool. Managers of firms with weak corporate governance mechanisms are likely to lose their jobs, once the firm is taken over. Jiang and Kim (2015) suggest three reasons why there is no active corporate control market in China. First, the government will not easily sell off SOEs. Second, for non-SOEs, ownership is often too concentrated to permit a hostile take-over. Third, directors of target firms are often unwilling to sell the firm. Li and Qian (2012) find proof that a hostile take-over is less likely for firms where the controlling shareholder holds large shares of the ownership. They find as well that politically-connected CEOs have a positive effect on hostile take-overs. The authors argue that these CEOs are more interested in advancing on the political scale than in representing the interests of the controlling shareholder. Finally, debt is not considered an effective control mechanism as, even though bankruptcy laws exist, the Government will often intervene for SOEs and large firms, in order to keep employment and social stability secure. However, more recently several SOEs have been declared bankrupt by Chinese courts, such as Guangxi Nonferrous metals Group in 2016 (Durden 2016).

2.2.3. Corporate Governance regulation

Finally, we take look at the most important regulatory changes in the last three decades. Figure 1 gives an overview of the most important regulatory changes since the inception of the stock exchanges. Overall, the Chinese government and the CSRC have proven that they are capable of changing and implementing new regulations if necessary. In the last few years, the CSRC has made significant adjustments to the Company Law, Securities Law, and Accounting Standards, in order to improve the regulatory framework. For example, cumulative voting, mandatory disclosure of internal control reports, and stricter minority shareholder protection were implemented in the last decade. The most significant regulatory change regarding corporate governance was the implementation of the Corporate Governance Code in 2001. The Corporate Governance Code was enacted by the State Economic and Trade Commission (SETC) (abolished in 2003) and the CSRC. Since both agencies were ministerial-level agencies, the Code is a "ministerial rule" and thus a formal part of Chinese law.

However, according to Xi and Chen (2014), there is still a certain level of ambiguity on the enforceability of the Corporate Governance Code, both from a public and private perspective. Originally, the CSRC only had the authority to request changes in the articles of association or

corporate governance by-laws. No warnings, monetary fines, or industry bans were available to the CSRC to reprimand non-compliers. The potential repercussions of ignoring the CSRC's request to improve corporate governance structures were not clear either. In short, the legal framework and enforcement mechanisms around the Corporate Governance Code were rather soft in nature. In 2007, a campaign was started to increase the enforceability of the Corporate Governance Code. Firstly, the CSRC's toolbox to intervene was significantly increased. The new measures included private conversations with the company's chairman and top executives, formal warnings, formal criticisms, and notifications to the local government or sector regulator. Secondly, the CSRC's review of certain corporate actions such as seasoned equity offerings, mergers and acquisitions, etc. could become more stringent if a firm was non-compliant with the Corporate Governance Code. On the other hand, private enforcement of the Corporate Governance Code is uncommon as well. A specific clause that clarifies the possible enforcement actions for private parties against non-compliance does not exist.

In conclusion, the most pressing corporate governance issues in Chinese publicly listed firms are agency problems between controlling shareholders, private or state, and minority shareholders; a lack of monitoring by supervisory boards, institutional investors, and independent directors; a weak legal environment and enforcement; and no active corporate control market. Nonetheless, more recently, the Chinese stock exchanges and CSRC have taken an active stance in improving the regulatory framework and corporate governance mechanisms (Figure 1).

2.3.Foreign investments

Since 1978, China has been gradually opening up its economy to foreign investors. The main reason for this moderate approach has been the synchronisation of opening up, with the overall development of the economy and its institutional capacities (World Bank 2010). Over time, China has introduced many initiatives to modernise the economic institutions and to stimulate investments. Special Economic Zones, with favourable trade and tax policies, have been launched in multiple provinces and cities (Ye 2009). In addition, investment guides and "negative lists" have been introduced in order to guide and restrict foreign investments into certain industries (Huang 2003). Especially since 2015, China's foreign investment policy has become significantly more lenient due to low foreign exchange reserves. Its policy can currently be characterized as "control the capital flight and encourage capital inflows"[3]. In this light, in August 2017, the State council promulgated the *Notice of state council on several measures to promote foreign investment*

[3] According to the person responsible for foreign investments in Sichuan province (personal interview).

growth (guofa nr.39) in order to reduce restrictions on foreign investments significantly[4]. All these measurements have made China one of the most popular FDI destinations in the world (Central Intelligence Agency 2017). On the other hand, foreign investors' access to the Chinese capital markets has been more regulated and limited. As China's WTO accession required it to open up its capital markets by 2006, new programs and regulations were accordingly put in place (Li, Tam, Yu and Zhang 2010).

2.3.1. Foreign access at the early stages

Since the inception of the Chinese stock exchanges, foreign investors have been able to invest in selected Chinese companies through certain types of shares. B-shares are shares issued on the SSE or SZSE, and are denominated in respectively USD and HKD. There are currently around 48 B-share listings on the SZSE and 50 on the SSE of which the last ones were listed in 2000[5]. Originally, B-shares were only available to foreign investors. As there were severe liquidity issues, high information asymmetry, and large price discounts compared to their respective A-shares, domestic investors were also allowed to buy B-shares as of 2001 (Chan, Menkveld and Yang 2008). Other than B-shares, there are more types of shares for Chinese companies outside Mainland China. H-shares, P-Chips, and Red-Chips are shares of Chinese companies that are listed on the HKEX. The main differences among them is that H-share companies are incorporated in Mainland China, while Red Chips and P-Chips companies are incorporated outside China. Red-Chips have a government ownership level of at least 35% while this is not the case for P-Chips (FTSE Russel 2019). There are approximately 270 H-shares and 170 P-chips and Red-Chips combined in the Hong Kong market (Hong Kong Stock Exchange 2019). Additionally, Chinese companies are able to issue S-shares (Singapore), N-shares (New York), L-shares (London), F-shares (Frankfurt) and Depositary Receipts on other markets.

Even though these shares enable investors to get exposure to certain Chinese companies and industries, it does not allow them access to the Chinese stock market. Currently there are three different methods for foreign investors to invest directly in Chinese financial markets: the QFII and RQFII programs, strategic investments, and the Connect programs with the London and Hong Kong Exchanges (Shao, Feng and Niu 2018). Depending on the type of investment and investor, one of the three investment methods is the most fitting. The QFII and RQFII programs are more

[4] Ibid.
[5] According to the Shanghai and Shenzhen websites. As data is often outdated on the English version of these websites, the amount of B-shares might deviate slightly from this number.

appropriate for larger investment firms who want to include Chinese publicly listed firms in their portfolio. Strategic investments are mainly for public and private companies which want to obtain a significant share for a long-term horizon. The Connect programs are financial institutions needing more liquidity and flexibility than larger financial funds. Nonetheless, a survey by the Asian Corporate Governance Association (2017) showed that 46% of foreign institutional investors use both the QFII/RQFII programs and the Stock Connect programs to invest in China. All investments are still limited to the *Catalogue of industries for guiding foreign investments* and *Special administrative measures for foreign investment access (negative list)* which set out for investors the encouraged, restricted, and forbidden industries.

2.3.2. QFII and RQFII program

The QFII program was brought forward in 2002 and was officially implemented in 2006. Tam et al. (2010) argue that the Chinese government and CSRC aim to use the experience of large foreign investors to raise standards and stabilize the Chinese financial markets. The *Measures for the Administration of Securities Investment in China by Qualified Foreign Institutional Investors* outlines the regulations and requirements for QFII members. The first version was adopted on the 1st of September 2006 and was later relaxed in 2012. Table 1 gives an overview of the criteria, in terms of size and experience, which the applicant needs to meet in order to apply for the QFII license. In addition, the CSRC must have signed a Memorandum of Understanding with the securities regulatory institution of the respective foreign investor's country[6]. Figure 2 shows that the 2012 relaxations had a significant effect on the investments made under the QFII program. Between 2003 and 2011, the total quota grew from 1.7 Billion USD to 37.44 Billion USD, while, between 2012 and 2017, the quota more than doubled to 93.07 Billion USD. By September 2018, the total approved quota reached 100 Billion USD (Shen 2019).

Once a foreign investor obtains a QFII license, certain limitations still apply. Firstly, an individual QFII can only own a maximum of 20% of a single stock, while the sum of total QFII ownership cannot be larger than 30%. Secondly, the original lock-up period of one year was changed to three months in 2016 and was completely lifted in June 2018. For repatriation of profits, a monthly limit of 20% of the previous year's total onshore assets was also abolished in June 2018

[6] Table 2 gives an overview of all countries that signed the Memorandum of Understanding with the CSRC.

(Man 2018). These two modifications were important for foreign investors as this has given them more liquidity and flexibility. Restrictions on asset allocation and hedging foreign currencies have been lifted as well. Before 2016, financial institutions needed to allocate at least 50% into equity products and no more than 20% into money market products (China Securities Regulatory Commission 2016). In addition, foreign investors are able to hedge their currency risk onshore as well since June 2018 (Man 2018). This is a significant step as previously they were only able to do this with RMB outside of mainland China. Overall, most restrictions of the QFII program are being relaxed or abolished in order to stay competitive with the Connect programs.

The RQFII program was initiated in 2013. The main difference between the QFII and RQFII programs is the currency that financial institutions use for their investments in the Chinese market. QFIIs use USD or other foreign currencies, while RQFIIs use overseas RMB funds. The RQFII program therefore helps for the internationalization of the RMB currency. The eligibility criteria for RQFII applicants are less strict but are limited to certain countries. In order to apply for an RQFII license, the applicant must be the subsidiary of a mainland Chinese company in Hong Kong (or another pilot area) or be a financial institution whose headquarters are located in Hong Kong (or another pilot area). At present, the CSRC has selected 19 countries to participate in the RQFII program[7]. Unlike QFIIs, RQFIIs have no individual investment quotas. Instead, the quota is given to the respective country as a whole. Currently, Hong Kong, the United States and Japan have the highest quotas with respectively 500, 250 and 200 million RMB (70.8, 35.4 and 28.32 million USD). The regulations and limits of RQFII are similar to the QFII program.

2.3.3. Strategic investments and the Connect programs

Strategic investments differ from the QFII and RQFII program in terms of investor type, investment size, and horizon. The *Administrative measures on the strategic investments in listed companies by foreign investors* dictates that investments, depending on the industry, need to be larger than 10% of the total outstanding shares and need to be for a minimum of three years (*Art.5 2/3*). Nonetheless, in practice the rules often are not strictly implemented[8]. Strategic investors are most often private or public companies, or venture capital and private equity firms. The original

[7] Hong Kong, Singapore, South Korea, UK, Australia, United States, France, Luxembourg, Germany, Canada, Switzerland, Malaysia, Thailand, Ireland, Japan, Qatar, United Arab Emirates, Hungary and Chile.
[8] Ibid 3.

criteria for a strategic investor were 100 Million USD in real assets or 500 Million USD in assets under management. As of August 2018, these criteria apply only when the investor becomes the controlling shareholder. If this is not the case, the real assets or assets under management need to be at least respectively 50 Million USD or 300 Million USD (Guo and Boitout 2018). For strategic investments, approval of both the Ministry of Commerce (MOC) and the CSRC are necessary.

There are currently two Connect programs through which foreign investors have a limited access to the SSE and SZSE. The most significant ones are the SSE-HKEX and SZSE-HKEX Connect programs, which were initiated in November 2014 (Hong Kong Stock Exchange 2019). The CSRC (2014) defines the Stock Connect program with Hong Kong as "A mutual market access mechanism between the Shanghai/Shenzhen and Hong Kong stock exchanges which enable investors in mainland and Hong Kong to trade shares listed on the other exchange's market within scope". This scope is limited to the constituents of the SSE 180 Index and the SSE 380 Index for the SSE, and the constituents of the SZSE Component Index and the SZSE Small/Mid Innovation index for the SZSE. Since there are no criteria to use the connect program, it has gained a lot of popularity compared to the QFII and RQFII programs (Yiu 2016).The SSE-LSE Connect program is less developed and more recent. Only a certain number of eligible stocks, mostly of reputable companies, will be listed on each other's exchanges to allow their investors to get more exposure to the respective markets.

2.4.Foreign institutional investors and corporate governance

Khan and Banerji (2016) argue that foreign investments can be both the cause and the effect of corporate governance improvements. Previous academic research has analysed two facets of the relationship between corporate governance and foreign institutional investors. On one hand, researchers have investigated if foreign investors use the level of corporate governance as an investment criterion. Since foreign investors are at an informational disadvantage, they might prefer firms with strong corporate governance to reduce their investment risk (Ahearne, Griever and Warnock 2004). On the other hand, researchers have investigated if foreign investors actively monitor and attempt to increase the level of corporate governance, once they have invested in the company. In short, the first and second stream of research look respectively at the ex-ante (Bowman and Min 2015; Luo, Chung and Sobczak 2009; Byun, Eppler-Kim, Kim and Kim 2010; Leuz, Lins and Warnock 2009) and ex-post (Aggarwal, Erel, Ferreira and Matos 2011; Khan and

Banerji 2016; McCahery, Sautner and Starks 2016) relationship between corporate governance and foreign institutional investors.

2.4.1. Importance of Corporate Governance for foreign investors

Bowman and Min (2015) argue that the more complex and different the foreign environment is from the investor's home country, in terms of language, culture, and political and regulatory framework, the higher the cost linked to foreign investments. Therefore, foreign investors should place a lot of importance on the level of corporate governance, as this lowers the level of information asymmetry. To test their hypothesis, the authors analyse the effect of independent director appoinments on foreign ownership in South-Korean publicly-listed firms. They indeed find a positive increase of foreign ownership when outside directors are appointed. They conclude by stating that their results propose an effective method to further the process of financial globalisation. Byun et al. (2010) conduct the same analysis on the Korean financial markets and find similar results. In addition, they find that domestic institutional investors are less sensitive to corporate governance issues, which supports the idea that they are less hindered by information asymmetry issues.

As foreign investors often have only a minority stake in foreign firms, they depend more on corporate governance as it decreases the costs of monitoring controlling shareholders. This is especially the case in China where there are ownership limits for foreign investors. Leuz et al. (2008) analyse a sample of more than 4,000 firms from 29 countries, and found indeed that foreign investors were less likely to invest in firms with high insider and/or controlling ownership. Mishra and Ratti (2011) analysed the importance of corporate governance and ownership structures for Chinese companies and found similar results. Their results show that the share of foreign ownership is negatively associated with large holdings by legal persons. In addition, they found that foreign ownership is positively related to large foreign institutional holdings as well, which implies a monitoring function by the latter. In support of this, the results of Tan (2009), who performs a qualitative overview by surveying QFIIs, show that foreign QFIIs take into account the corporate governance structures of Chinese firms as well.

2.4.2. Monitoring effect of foreign institutional investors

There are several ways through which the presence of foreign investors can increase the level of corporate governance of both an individual firm and the overall market. At a firm level,

institutional investors can either directly communicate with the management to force a change ("voice" or direct intervention) or they can voice their discontent by selling shares ("exit" or "voting with their feet") (McCahery et al. 2016). On a broader level, Richard Ward, the CEO of one of the largest Chinese QFII, UBS Warburg, stated that as Chinese companies are now competing for capital against their international peers, they will be required to increase their corporate governance standards[9]. Outside China, Aggarwal et al. (2011) take a closer look at the behavior of institutional investors in 23 countries between 2003-2008. They find that changes in foreign institutional ownership are not only positively associated with firm-level governance changes, but as well with the likelihood that poorly performing CEOs are terminated. Mezzanotte and Fung (2018) analyse the voting behavior of institutional behavior on connected transaction proposals of Hong Kong-listed firms. They find a significant positive relationship between the level of institutional ownership and the level of dissent voting.

Bena, Ferreira, Matos and Pires (2017) state that, once a foreign investor becomes a shareholder, it can either choose to leverage its management and business experience, and improve the corporate governance and long-term valuation of the firm, or it can choose to prioritize short-term profit by selling off assets, increasing dividends, underinvesting in innovation and R&D, and/or implementing lay-offs. The latter form of foreign institutional investor has been given the label "locust". Franz Müntefering, formerly a German Social Democratic Party Chairman, first coined the term locust. He accused certain foreign private equity companies and activist hedge funds of prioritizing short-term profits over the long-term development of a company. However Bena et al. (2017), analyzed a large sample of publicly listed firms in over 30 countries, and found a positive relationship between foreign ownership, and long-term investments in tangible, intangible and human capital. In addition, they found that foreign institutional ownership increases the level of innovation output significantly.

Zhu and Huang (2015) test the influence of QFIIs in China by examinating the split-share structure reform process. In order to come to an agreement, non-tradable shareholders need to offer a compensation package to tradable shareholders for the dilution of their share value. As two-thirds of tradable shareholders need to agree to the proposal, the process often takes a long time. The authors find that the presence of foreign investors shortens the negotiation process and increases

[9] UBS Warburg, see "Foreign Investors Embrace QFII", 26 Nov. 2002 at <http://www.en.chinabroadcast.cn>

the compensation for minority shareholders. Aggarwal et al. (2015) research the effect of both domestic and foreign institutional investors on the probability of corporate fraud in Chinese firms. They find a significant positive monitoring effect of domestic mutual funds. However, they find no significant results for both foreign and "grey" institutional investors. Chen, Harford and Li (2007) define grey institutional investors as those which are more likely to have business ties with the firm, such as insurance companies, pension funds, banks, and trusts. Wu, Johan and Rui (2012) also found that domestic mutual funds decrease the likelihood of corporate fraud and thus perform a monitoring function, while foreign investors have no effect.

3. Hypothesis section

The CSRC stated in 2016 that the QFII and RQFII programs "were bringing in long-term foreign capital and improving corporate governance" (China Securities Regulatory Commission 2019). However, whether or not foreign investors perform a monitoring role and actively pursue improvements to corporate governance is still an open question (Bae 2012). The most convincing evidence up until now is provided by Aggarwal et al. (2011), who found a positive monitoring effect of foreign investors in 23 different countries. However, they mostly consider developed economies, which generally already have more sound corporate governance mechanisms. For emerging economies, there is overall little evidence that foreign investors perform a monitoring role. Shubita and Shubita (2019) found some proof that foreign investors take on monitoring role in Jordanian publicly-listed firms, as their presence leads to higher growth and better performance. Douma, George and Kabir (2006) found similar results for Indian firms. However, their analyses do not take into account that foreign investors might be able to select outperforming firms. On the other hand, Phung and Vy (2013) and Ananchotikul (2007) found no monitoring role of foreign investors in, respectively, Vietnamese and Thai publicly listed-firms.

Nonetheless, research from other emerging and developed countries cannot just be extrapolated to China. The combination of historically strict rules for foreign investors, and the oftentimes weak corporate governance structures in China does not make it evident that foreign investors are able to improve corporate governance (Allen and Rui 2018). Foreign investors definitely have enough incentive to attempt to improve corporate governance. Firstly, it lowers the likelihood of expropriation by controlling shareholders, and fraud (Chen, Firth, Gao and Rui 2006; Ding, Jia, et al. 2009; Huyghebaert and Wang 2012). Secondly, more sound corporate governance

can lead to better operating performance. Haß et al. (2016) indeed found that firms with higher levels of corporate governance have higher performance persistence. They find as well that evidence that this increased performance persistence leads to a lower cost of borrowing. Evidence that foreign investors are in fact willing to actively engage with Chinese companies is given by Allen and Rui (2018). Their survey of 155 institutional investors with experience in China and other countries in Asia, shows that 46% of investors actively try to engage with Chinese A-share firms.

Foreign institutional investors have several channels to influence the governance of Chinese firms (Ding 2018). Firstly, investors holding at least 3%, individually or as a group, can put forward an interim proposal which includes discussion points and matters to be voted on. Secondly, investors holding at least 1%, individually or as group, have the right to initiate legal action against directors who have breached their fiduciary duty towards the shareholders. Thirdly, investors holding at least 10%, individually or as group, can request an interim shareholder meeting. If the Board of Directors and Board of Supervisors are unable or unwilling to preside the meeting, the shareholders can preside the meeting themselves. Fourthly, investors holding at least 10%, individually or as a group, have the right to initiate a motion to dissolve the company if the firm is undergoing serious and unrepairable difficulties which will lead to significant shareholder value losses. Finally, firms are required to implement cumulative voting if the controlling shareholder holds more than 30%. Besides these active tactics, foreign investors always have the option to discuss matters through private negotiations. In the past, both domestic and foreign institutional investors have used several of the aforementioned strategies to impact the behavior of Chinese firms. Even knowing that foreign investors might use these strategies, can give enough leverage over Chinese firms.

The willingness to actively monitor and promote good governance alone might not lead to actual improvements. In the case of China, 68% of the investors rate the difficulty of communicating with management and the Board of Directors of Chinese companies as “very difficult” (Allen and Rui 2018). A variety of reasons are given to support why foreign investors have difficulties in engaging with Chinese firms. Firstly, not only the substantial differences in language, but also cultural differences make it hard to communicate effectively. Secondly, getting access to key-level executives is often considered a challenge. Thirdly, there is a lack of corporate

governance knowledge by both Investor Relations (IR) personnel and management. Finally, and maybe most importantly, the high number of firms with significant controller shareholder ownership make it difficult to have an influence, especially considering that foreign investors often only own a limited portion of the shares.

We therefore predict that foreign investors will in fact have a significant monitoring effect on corporate governance, but that substantial changes will only occur under certain conditions. We firstly propose that foreign investors need to own a large enough share to have an effective influence. The size of the ownership level will be an important factor in the success rate of both shareholder activism cases and private dialogues with the firm. We go more in depth in the methodology section on what we define as a large enough share. This view is supported by Phung and Vy (2013) who found that non-concentrated foreign ownership has no monitoring effect on Vietnamese publicly-listed firms. Secondly, it is imperative that foreign investors stay invested in the firms for more than one year. There are two reasons for this. One, in order to implement significant changes to the corporate governance structures, time is necessary. Two, Chinese firms will be more willing to engage in meaningful conversations if they know that their interests are aligned with those of the foreign investors. Supporting this idea, David Smith, the head of Corporate Governance at Aberdeen Standard Investments, a large QFII in China, states that the interest of Chinese companies in Aberdeen's proposals increases, once they see a longer-term investment horizon of the QFII (Allen and Rui 2018).

4. Data collection

4.1. Foreign and institutional ownership

We collected all end-of-the-year foreign ownership data manually from the FactSet database for the years 2005 - 2017. We define foreign ownership as the sum of the end-of-year holdings of all foreign investors divided by the firm's total market capitalization. FactSet gathers the institutional ownership data from National Regulatory Authorities, the company websites, annual reports, daily transactional amounts, and mutual fund associations. Since we are interested in foreign institutional investors, we make two adjustments to the foreign ownership data. Firstly, we exclude all data for fiscal paradises, including British Virgin Islands, U.S. Virgin Islands, Cayman Islands, Barbados and Bermuda, as these are mostly used for fiscal purposes. Secondly, we exclude all data for foreign individuals. As mentioned earlier, there are different types of foreign

investments: strategic investments, QFII/RQFII and the Connect programs. Since strategic investments are characterized by larger ownership shares and by a more long-term horizon, we differentiate between strategic investments and institutional investors. We define strategic investments as all foreign investments by foreign private and public companies.

We collected domestic institutional ownership from the China Stock Market & Accounting Research (CSMAR) database. CSMAR gathers the institutional ownership data from both interim and annual reports of China's listed enterprises. CSMAR distinguishes seven types of institutional investors: funds, securities brokerages, insurance companies, social security funds, trusts, finance companies and banks. We define total Domestic Institutional Ownership as the sum of the holdings of the seven types of institutional investors divided by the firms total market capitalization.

Figure 3 gives an overview of the foreign ownership data by country. Investors from 42 countries have entered the Chinese capital markets in the last 12 years. We can see that the share of foreign investors has increased almost every year between 2005 and 2017, except for the years 2014 and 2015. On average, the share of foreign ownership has increased from 0.35% to 1.32% in the last 12 years. The most prominent foreign country by far is Hong Kong, which claims on average 52.09% of the total foreign ownership share. Other noteworthy countries are Taiwan, United States, Japan and United Kingdom. The summary statistics in Table 5 show that domestic institutional ownership is significantly higher than foreign ownership, with an average value of 5.39%.

4.2.Firm-level corporate governance

We use two different metrics in order to capture the level of corporate governance as best as possible: a Corporate Governance Index (CGI) consisting of 19 constituents and a Transparency Disclosure Rating (TDR) compiled by the Shenzhen Stock Exchange. We collected all elements for the CGI and the TDR from CSMAR. The CGI can be broadly divided into three different categories: board characteristics (seven attributes), ownership characteristics (six attributes), and conduct characteristics (six attributes). The board characteristics include the chairman's age, board size, board independence, board meetings, supervisory board size, CEO duality and qualifications of independent directors. The ownership characteristics include ownership concentration, state shares, insider ownership, separation between ownership and control, presence

of blockholders and non-negotiable shares. The conduct characteristics include numbers of commissions established, internal control disclosure, enforcement actions, foreign auditor and two measurements of related-party transactions. Table 3 gives an overview of the exact definition and the sources of the individual corporate governance attributes. Table 4 gives the correlation matrix between the different corporate governance attributes. Table 5 shows that the average CGI score is equal to 10.032 out of 19 (52.8%).

The Transparency Disclosure Rating, compiled by the Shenzhen Stock Exchange, takes into account the quality of listed firm's public announcements, and the firm's overall conduct in respect of protecting the rights of investors (MondoVisione 2019). The rating considers the conduct of the firm, the controlling shareholders, directors, supervisors, senior management, and information disclosure staff. A quantitative scoring method is used to score each criterion and subsequently to rank each firm according to four grades: A, B, C, and D, where A and D are respectively the highest and the lowest score. In 2018, 17.96% of firms received a rating C and D, while 82.04% received a rating of A and B. For practical purposes, we modified the letter grades into numbers. A, B, C, and D become respectively 1, 2, 3, and 4. Table 5 gives the summary statistics for the corporate governance metrics. The average rating during our sample period is 2.970.

4.3.Firm Characteristics

We obtained firm-level characteristics and other control variables from the CSMAR database. We used the following control variables in our regressions: log of total assets in (Size), the percentage change in revenue from year T-1 to T (Growth), the ratio of total cash and cash equivalents over total assets (Cash), the ratio of total liabilities over total assets (Leverage), the ratio of operating profit to total assets (ROA), the ratio of the sum of total liabilities and end-of-year market capitalization to total assets (MBratio), the ratio of the difference between total assets and total current assets to total assets (PPE), and whether a firm is cross-listed on any stock exchange outside China (Foreign Listing). Growth and ROA are winsorized at the lower 1% levels, while MBratio is winsorized at the upper 1% level. The remaining control variables are not winsorized as there are no significant outliers. Table 5 gives an overview of the summary statistics of all firm-specific control variables. The summary statistics show that the median firm has respectively a ratio of cash and cash receivables and PPE to total assets of 14.7% and 42.4%. In addition, we find that the median firm has a significant amount of leverage (45% of total assets).

In terms of ROA and revenue growth, we find median values of respectively 4% and 12%. Finally, we find that the median market-to-book ratio is equal to 2.00 and that 10% of Chinese firms have at least one foreign listing. Table 6 gives the exact definitions of the control variables. Table 7 gives the correlation table between the different control variables, corporate governance metrics, and foreign ownership.

5. Methodology

The biggest hurdle in analysing the relationship between corporate governance and foreign ownership is endogeneity concerns. A positive association between the current levels of foreign ownership and firm-level corporate governance might not imply causality or monitoring. It is possible that foreign investors avoid firms with corporate governance issues and only invest in those firms who already have sound corporate governance mechanisms in place. Leuz, et al. (2009) indeed found evidence that American institutional investors avoid foreign firms with low levels of corporate governance. An increase in corporate governance might therefore be attributable to the firm itself, and not due to the monitoring role of foreign or domestic institutional investors. To alleviate these concerns, we include several different methodologies.

Previous researchers most often use two different methods to get around this issue: they either include lagged variables or look at the effect of changes in institutional ownership (Aggarwal et al., 2011; Min and Bowman, 2015; Boone and White, 2015). First, lagged variables allow us to examine the relation between the earlier foreign ownership and future levels of corporate governance. We can therefore more easily analyze causality by looking at values over time, instead of contemporary changes. Secondly, by looking at changes instead of level values, we can measure the effect of an increase in foreign ownership on corporate governance. With the purpose of reducing endogeneity concerns as much as possible, we combine both methods. In other words, we look at the effect of lagged, significant changes of foreign ownership on the current level of corporate governance.

In order to determine a "significant" change, we need to take into account that the level of foreign ownership in China is still quite limited (See summary statistics Figure 3). We consequently use three different values to define a significant increase: 4, 7 and 10 percentage points. (i.e. the level of foreign ownership is equal to at least 4%, 7%, and 10% after the increase.) We choose these cut-off values for two reasons. On one hand, investors holding these levels of

ownership are able to have a significant effect on the election of board of directors and supervisory board members, which could subsequently protect their and other minority shareholder interests. One could argue that this is not the case when there is a significant controlling shareholder. However, cumulative voting is mandatory for firms where the controlling shareholder holds more than 30% (Xi and Chen 2014). On the other hand, the selling of the respective share levels would send out a strong signal to the market on possible issues at the firm. Investors therefore hold a significant amount of leverage over the firm. We do not include higher values than 10%, since the number of firms with changes of 10% in foreign ownership is limited. Next, we include two different lags. We include both the change from year T-2 to T-1 and the change from year T-1 to T.

Another concern, which might lead to non-significant results, is the investment horizon of the foreign investor. On one hand, foreign investors, who are mostly interested in short-term profits, might not perform a monitoring role. On the other hand, Chinese firms might be less willing to engage with short-term investors (Allen and Rui 2018). In addition, time is needed in order to implement changes in the corporate governance framework of a firm. We therefore require that foreign ownership stay above a certain threshold ("lead level") in the year after the change. To determine the value of a significant "lead level", we need to consider that the Chinese market has a reputation of being volatile and turnover is quite high (Cheng and Li, 2015). We therefore define "require" that the "lead level" be at least 4%, or half of the original minimum change value. This means that the significant "lead levels" are 4%, 4%, and 5% (for respectively changes of 4, 7, and 10 percentage points. In sum, the variable of interests are interaction dummy variables that take on the value of 1 if, firstly, there is a significant change of 4 , 7 or 10 percentage points, and, secondly, the level of foreign ownership at the end of the next year is equal or larger than respectively 4%, 4% and 5%.

Next, consistent with the literature, we include different control variables that might affect the level of corporate governance. First, we include domestic institutional ownership. In line with our foreign ownership variable, we create a dummy variable that takes on the value of 1 if there is a significant change in domestic institutional ownership. We determine the cut-off value as the 90th percentile of domestic institutional ownership changes, which is equal to a change of 4.80 percentage points. Research on the monitoring role in China and other emerging markets has

shown mixed results. Stulz (2005) finds that domestic institutional investors do not have any significant impact on corporate governance in emerging markets. However, Wu, Johan and Rui (2012) and Aggarwal, Hu and Yang (2015) found that domestic institutional investors decrease the likelihood of fraud in Chinese publicly listed firms.

Second, following Doidge, Karolyi and Stulz (2007), we include the size of the respective company (Size). Previous research has indicated that larger firms might have better corporate governance due to economies of scale. Third, we include the level of leverage of the respective firm (Leverage). Banks and other financial institutions might monitor firms with higher levels of debt more strictly. This increased level of monitoring might lead to improvements in corporate governance. However, Qian and Yeung (2015) state that Chinese financial institutions are not considered tough monitors. Thirdly, we include foreign listings (foreign listings), which is a dummy variable if the firm has issued B-shares or H-shares, or is listed on a foreign exchange. If Chinese firm issues B- or H-shares, it needs to follow international accounting standards (Liu 2006). In addition, firms that are listed in other countries often adhere to stricter corporate governance regulations. Supporting this idea, Lin, Hutchinson and Percy (2015) found that audit committees of cross-listed Chinese firms are more effective in reducing management earnings. In addition, we include the growth in revenue (Growth), operating performance (ROA), market performance (Market-to-Book ratio), the level of liquid assets (Cash), and the ratio of fixed assets to total assets (PPE ratio). Since the purpose of our model is to explain future levels of corporate governance, all control variables are included as differences. Finally, in order to control for differences over time and industries, we include industry and time-fixed effects. A definition of all the control variables can be found in the data section and in table 6 (appendix).

The equations of our main regressions can be represented as follows:

$$CG_t = \alpha + \beta_1 . FOR\_IO\_DUMMY_{t-1} + \beta_2 . FOR\_IO\_DUMMY_{t-2} + \sum_j \gamma_j . Controls_{j,t} + \emptyset_t + \xi_t + \varepsilon_t$$

CG_t is the dependent variable of interest and represents the current level of corporate governance. As mentioned above, this value is either the Corporate Governance Index, or the Transparency Disclosure Rating. $FOR\_IO\_DUMMY_{t-1}$ and $FOR\_IO\_DUMMY_{t-2}$ are the two dummy variables of interest. The former represents the change from T-1 to T, while the latter represents the change from T-2 to T-1. $Controls_{j,t}$ are the control variables that are mentioned in

the section above. $\emptyset_t$ and ξ_t are respectively the industry-fixed effects and time-fixed effects. ε_t represents the error-term. For clarity, we omit firm-level notations.

In a second stage, we try to find more support for our hypothesis that corporate governance changes are driven by significant and long-term foreign ownership shares. Firstly, we include only changes of foreign ownership between 0.30 and 4.00 percentage points. We use 0.30 as threshold since it represents the 90th percentile of foreign ownership changes. We do not expect that changes under 0.30 could have an effect on corporate governance. Secondly, we take out the "long-term" criteria. More specifically, we no longer require that the level of foreign ownership be equal to the threshold values of 4%, 4%, and 5% in the year after the change. As in the main regressions, we still include the same control variables and fixed effects.

Thirdly, we perform two different robustness tests to address remaining concerns. First, we make sure that corporate governance changes are driven by institutional investors, and not by strategic investors. We therefore look at the effect of changes in strategic investments instead of changes in overall foreign ownership. Second, we take into account the criticism of Bhagat, Bolton and Romano (2008) on the use of corporate governance indices. Their criticism is based on the fact that they do not find any positive association between several well-known corporate governance indices, such as the G-Index (Gompers et al., 2003), E-index (Bebchuk, Cohen and Ferrell 2009), and Gov-score index (Brown and Caylor 2006), and corporate performance. We therefore perform logit regressions on six individual corporate governance elements. Namely, we use the likelihood of fraud as dependent variable and five constituents of our corporate governance index: related party transactions (items 16 and 17), foreign auditor (item 7), board size (item 2), and board meeting (item 4).

Finally, we provide evidence of both investor activism cases in which foreign investors played an important role, and private dialogues between Chinese firms and foreign investors. The objective is to ensure that foreign investors actively engage with Chinese firms in order to improve the corporate governance structures of the firm. An increase in the level of corporate governance might only be symbolic, i.e. to please or attract more foreign investors, if there is no active intervention strategy of the part of the foreign investor.

6. Results section

6.1.Effect of significant and long-term foreign ownership change

Table 7, 8, and 9 show the coefficients of the effect lagged significant changes of respectively 4, 7, and 10 percentage points, on the current level of corporate governance. FOR_IO_Dummy T-1 and FOR_IO_Dummy T-2 are the two variables of interest, which take on the value if two conditions are met. Firstly, there needs to be a significant change in foreign ownership from year T-1 to T and year T-2 to T-1. More precisely, the change must be equal to at least 4, 7, and 10 percentage points in respectively Tables 7, 8, and 9. Secondly, we require a significant threshold level of foreign ownership at the end of the year after the change. This threshold is equal to 4%, 4%, and 5% in respectively Tables 7, 8, and 9. Refer to the hypothesis and data part on a more in-depth rationale of the two variables of interest.

Columns (1), (2), and (3) of Tables 7, 8, and 9 use the Corporate Governance Index as the dependent variable. The results of table 7 show a positive and significant effect of a significant change in foreign ownership from year T-2 to T-1. A change of at least 4 percentage points in foreign ownership from year T-2 to T-1 leads to an increase in the Corporate Governance Index of 0.53 by the end of year T. The coefficient for FOR_IO_Dummy T-2 is economically meaningful as well. A change of at least 4 percentage points in foreign ownership leads to an improvement of 2.5% in Corporate Governance (0.53/19). We divide by 19 since our Corporate Governance Index consists of 19 individual attributes. We find no significant effect of a change in foreign ownership from year T-1 to year T. This supports our hypothesis that it takes time before the monitoring role of foreign investors is turned into corporate governance improvements. The coefficients for domestic institutional ownership are not significant and even slightly negative (DOM_IO_Dummy T-1 and DOM_IO_Dummy T-2). This suggests that foreign institutional investors are more rigorous monitors than domestic institutional investors. For the control variables, we find a positive and significant effect of foreign listings and the size variable. The former result is straightforward since Chinese firms that issue B- or H-shares are subject to more stringent legal rules. In addition, foreign exchanges often have more sound corporate governance criteria. The latter indicates that the larger firms are more prone to have better future corporate governance. This is consistent with Doidge, et al. (2007), who find that larger firms have better corporate governance due to economies of scale.

Columns (1), (2), and (3) of Tables 8 and 9 support the results of table 7 and our hypothesis even more. The coefficient for a minimum of 7 and 10 percentage points are significant respectively at the 5% and 1% level. In economic terms, the effects become more significant. A change of respectively 7 and 10 percentage points from year T-2 to T-1 leads to an increase 5.0% (0.92/19) and 8.5% (1.56/19) in the firm-level corporate governance by the end year T. Since the coefficients for Tables 8 and 9 are higher than Table 7, it shows that the effect is driven by changes of at least 7 and 10 percentage points. The effect of FOR_IO_Dummy T-1 becomes stronger for 7% and even significant for 10% changes. This implies that when the ownership level is high enough, it takes less time to implement corporate governance changes. It therefore supports our hypothesis that corporate governance improvements are driven by large foreign ownership shares. Next, the overall model seems to be capable of predicting the level of corporate governance, considering that the R2 value is equivalent to 0.40. Finally, the Variance Inflation Factors (VIFs) show that there is no multicollinearity.

Columns (4), (5), and (6) of Tables 7, 8, and 9 use the Transparency Disclosure Rating as the dependent variable. The results are consistent with the previous findings in columns (1), (2), and (3). Namely, lagged significant changes have a positive effect on future changes in the corporate governance. However, now we notice that the effect of T-1 changes (FOR_IO_Dummy T-1) contribute more than T-2 changes (FOR_IO_Dummy T-2). An explanation for this "faster" effect might be due to the difference between the two corporate governance metrics. The corporate governance index takes into account the broader corporate governance framework of a firm, while the Transparency Disclosure Rating focuses more on disclosure aspects of corporate governance. It goes without saying that it takes less time to improve the quality of public announcements and the general disclosure quality of the firm, than the overall corporate governance structures. Columns (6) of Tables 7, 8, and 9 show that, in economic terms, an increase between 4 and 10 percentage points leads to an increase of approximately 12.5% (0.50/4) of the Transparency Disclosure Rating by the end of the following year. Finally, we still find no significant effect of domestic institutional investors on the transparency quality. For the remaining control variables, the foreign listings variable is still positive and significant, while the size is still significant but has turned negative.

Overall, our main results show that lagged significant changes in foreign ownership have a statistically and economically significant impact on corporate governance. Following our hypothesis, the results in columns (1), (2), and (3) of Tables 7, 8, and 9 indicate that the effect of T-2 changes (FOR_IO_Dummy T-2) are more significant than T-1 changes (FOR_IO_Dummy T-1). On one hand, this shows that it takes time to implement corporate governance changes. On the other hand, it suggests as well that Chinese firms might be more willing to change corporate governance structures if foreign institutional investors have a long-term horizon and align their interests with those of the firm. However, to improve the disclosure quality, less time is needed. This can be seen by the larger effect of FOR_IO_Dummy T-1 over FOR_IO_Dummy T-2 on the Transparency Disclosure Rating in columns (4), (5), and (6) of Tables 7, 8, and 9. We find no significant effect of domestic institutional investors for either the corporate governance index or the Transparency disclosure rating (DOM_IO_Dummy T-1 and DOM_IO_Dummy T-2).

6.2.Effect of smaller changes and short-term foreign ownership

In order to support our hypothesis that corporate governance changes are driven by significant and longer-term foreign investors, we show the results for both smaller changes and shorter-term investments. For the former case, we consider only foreign ownership changes between 0.30 and 4 percentage points. We choose 0.30 as a threshold value for two reasons. Firstly, we do not expect that changes under 0.30 percentage points could have any significant effect on corporate governance. The foreign institutional investors would have neither enough voting power to elect members of the board of directors or supervisory board nor have enough leverage to threaten the management with the selling of their shares. Secondly, we take 0.30 since it is the 90^{th} percentile of foreign ownership changes in our sample. We still require the "lead" condition. More precisely, we require that foreign ownership is at least 0.30% at the end of the year after the change. To measure the importance of the long-term horizon, we take out the "lead" condition for the foreign ownership dummy. FOR_IO_Dummy T-1 and FOR_IO_Dummy T-2 thus take on the value of 1 if there is a change of 4, 7, or 10 percentage points. Overall, if we find a lesser effect of the FOR_IO_Dummy T-1 and FOR_IO_Dummy T-2 on corporate governance in Table 10 and 11 compared to Tables 7, 8, and 9, it would imply that corporate governance changes are driven by larger and longer-term foreign investor shares. The results in Table 10 and 11 are indeed consistent with this hypothesis.

Table 10 shows the results of the lagged ownership changes, between 0.30 and 4.00 percentage points, on the current level of corporate governance. Columns (1), (2), and (3) use the corporate governance index as the dependent variable, while columns (4), (5), and (6) use the Transparency Disclosure rating. In both cases, we still find a significant effect. However, the effect is smaller, both in statistical and economical terms. A change in ownership between 0.30% and 4.0% from year T-2 to T-1 leads to an increase in firm-level corporate governance of approximately 1.7% (0.3235/19). This is a decrease of 0.8, 3.3, and 6.8 percentage points compared to changes of at least 4, 7, and 10 percentage points. For the Transparency Disclosure rating, an increase between 0.30 to 4.0 percentage points from year T-1 to T leads to an increase of 7.0% (0.2812/4) by the end of the year. This is a decrease of around 5 percentage points on average compared to changes of at least 4, 7, and 10 percentage points.

Table 11 shows the results without the long-term criteria. Again, we still find significant results, but there is a substantial reduction compared to the results of Tables 7, 8, and 9. Columns (1), (2), and (3) use the Corporate Governance Index as the dependent variable. Column (1) shows that the effect of 4 percentage point changes becomes insignificant once we take out the "lead" criteria. The coefficients for FOR_IO_DUMMY T-2 of columns (2) and (3) show a reduction of 27.48% ((0.9286-0.6740)/0.6740) and 38.30% ((1.5633-0.9645)/0.9645) on the effect of corporate governance compared to the foreign ownership variable with the long-term criteria. Columns (4), (5), and (6) use the Transparency Disclosure Rating as a dependent variable. The magnitude of the coefficients of FOR_IO_DUMMY T-1 is decreased by 44.47% ((0.4879-0.2709)/0.2709), 33.40% ((0.5751-0.3830)/0.3830), and 14.88% ((0.4999-0.4255)/0.4255) for respectively 4, 7, and 10 percentage points compared to the foreign ownership variable with the long-term criteria. For both the Corporate Governance Index and Transparency Disclosure rating, we see that the decreasing effect of taking out the long-term criteria becomes less severe for higher ownership variables. These results therefore indicate that corporate governance changes are driven by larger foreign ownership shares. In addition, the reduction in the effect of the foreign ownership variable without the lead criteria, shows that the long-term criteria is an important aspect as well.

6.3.Robustness testing

In the first robustness tests, we make sure that foreign institutional investors are driving corporate governance changes, and not strategic investors. Since they hold larger shares of the

company, they might be more incentivised to monitor the firm more thoroughly. Table 12 shows the results of the effect of changes in strategic investments on future corporate governance. Strategic Investment ΔDummy T-1 and Strategic Investment ΔDummy T-2 are dummy variables that take on the value of 1 if there is a positive change in strategic investments from respectively year T-1 to T or T-2 to T-1. Columns (1), (2), and (3) show no positive or significant effect of strategic investors on corporate governance. In other tables that are not published, we include only larger changes in strategic investors and include the long-term investment criteria as well. We find similar results as in table 11 in both cases. These results support our hypothesis that foreign institutional investors are driving corporate governance changes, and not strategic investors. It therefore implies that foreign institutional investors have more experience in engaging with the management of firms, monitoring conduct, and ultimately improving corporate governance.

Secondly, we take into account the criticism of some authors on corporate governance indices. (Bhagat et al., 2008) state that indices are not proper metrics to measure the level of corporate governance. (Refer to the methodology part for more information on their comments concerning corporate governance indices.) To address these issues, we perform logit regressions with six individual corporate governance attributes. We choose these corporate governance attributes based on their importance for corporate governance structures. (Refer to the methodology part and the appendix (Table 3) for a more in-depth explanation of the different governance attributes.) In contrast to the other regressions, we use lagged levels of foreign ownership instead of changes. We use lagged values since we do not want predict future changes in corporate governance. Rather, we want to see if the lagged presence of foreign investors has a positive effect on corporate governance mechanisms. In line with this, we include the lagged level of domestic institutional investors instead of changes as well. Table 13 shows the coefficients. According to our hypotheses, we find a positive effect on four out of six corporate governance measures. In line with our expectations, we find that the significant effect is derived from T-1 lagged changes and not T-2. The results show that lagged foreign ownership decreases the likelihood of related-party transactions (column 3), increases the likelihood of having a foreign auditor (column 4), and has a positive effect on board structures and conduct (column 5 and 6). We find no significant effects for the likelihood of fraud (column 1) and the second related-party transactions measure (column 2). Again, we find no significant effect for domestic institutional investors (Domestic Ownership T-

1 and Domestic Ownership T-2). In addition, we find that foreign listings have a positive and significant effect for all corporate governance attributes, except for board size (column 5).

Finally, we discuss some noteworthy comments. First, there is some robustness testing that we do not consider in our research. Firstly, we do not include a 2SLS model due to a lack of proper instrumental variable. Aggarwal et al. (2011) use two different instrumental variables to account for foreign ownership: dividends and inclusion in the MSCI world index. First, dividends would not be a good measurement for foreign ownership in China. Indeed, regulation on issuing new shares dictates that firms need to pay-out dividends for three years straight (Jiang and Kim, 2015). Dividends might therefore not be a monitoring sign of institutional investors. Second, MSCI only recently started including Chinese A-shares in the emerging MSCI index. The sample period would therefore be too short to use this as an effective instrumental variable. However, future research should be able to include this as an instrumental variable. Second, we state that our hypotheses and results are not just evidence that foreign institutional investors use corporate governance as an investment criteria. If only this was the case, and there was no monitoring effect, we would just see a positive association between the current levels of foreign ownership and the current level of corporate governance. Even if the corporate governance structures of these firms might already be more sound than other firms, the fact that lagged and significant changes in foreign ownership lead to future corporate governance improvements strongly suggests that there indeed is a monitoring effect.

6.4. Shareholder activism and engagement cases

Finally, we analyze the frequency of shareholder activism and engagement cases to ensure that foreign institutional investors are able to actively influence Chinese firms from a practical point of view. Ding (2018) does an extensive research on shareholder activism in China and identifies 26 shareholder activism cases between 1994 and 2014 (Table 15). Institutional investors, both domestic and foreign, have used several strategies to actively influence Chinese companies such as shareholder proposals (13), proxy voting (10), private meetings (2), call for shareholder meeting (2), legal action (2), and press conferences (2)[10]. There are a variety of topics including voting against new share issuances, electing and/or removing new directors, proposing

[10] The sum of the types of activism is larger than 26 since multiple strategies were used in several activism cases.

amendments to the articles of association, and improving corporate governance structures. In 16 out of the 26 cases, the institutional investors achieved their objective.

In ten out of the 26 activism cases, a foreign investor, either as a minority shareholder in a Joint Venture or as a QFII, was the main driver or active participant behind a shareholder activism case. In most instances, the activist shareholder was a sino-foreign joint venture in which the foreign investor held between 25% and 49% of the shares. Compared to domestic institutional investors, foreign investors have been significantly more effective in reaching their goal. Out of the ten cases, eight were successful, one was partly successful, and one failed. The latter case was a joint effort between China Asset Management, in which Power Corporation of Canada and MacKenzie investments limited have a combined ownership of 28%[11], China Southern Asset Management and Bosera Asset Management to amend the articles of association of Vanke in 2004. On the other hand, domestic institutional investors have a significantly lower success rate of 37.5%.

In terms of activist strategies, Table 15 shows an important pattern. In nine out of the ten cases, the foreign investor joined efforts with domestic institutional investors. There are two potential reasons for this trend. Firstly, foreign investors often do not own large enough shares to outvote controlling shareholders. They therefore need the support of domestic institutional investors to obtain enough leverage. Secondly, domestic institutional investors can offer important advice since they have more know-how in manoeuvring through the Chinese legal system. Only in the case of "Eastern Airline v Rongtong Asset Management", in which the Japanese Nikko Asset Management holds a 40% stake[12], was the activism process initiated without other domestic institutional investors. Out of all cases, "Gree Electric Appliances v Penghua Fund management and Yale Endowment Fund" stands out the most. Firstly, both investment funds have a significant foreign influence. Penghua Fund Management is a Sino-Foreign Joint Venture in which Eurizon Capital SGR S.p.A holds 49% of the shareholdings[13]. Yale Endowment Fund is a QFII member since 2006. Secondly, they succeeded in getting their candidate to the Board of Directors of Gree

[11] Ownership level of 28% is at the end of 2018. Both institutional investors have been shareholders since April 1998 (EY 2018)
[12] Ownership level of 40% is at the end of 2018. Nikko Asset Management has been a shareholder of Rongtong Fund since May 2001 (EY 2018).
[13] Ownership level of 49% is at the end of 2018. Eurizon Capital SGR S.p.A. has been a shareholder of Penghua Fund since December 1998. (EY 2018)

Electric Appliances with a limited level of shareholder ownership. More precisely, they combined their respective shareholdings of 1.6% and 1.76% to reach the required 3% ownership level to launch an interim proposal meeting and bring forward their candidate. The two investment funds succeeded in convincing other minority shareholder and, with the help of the cumulative voting system, successfully elected their candidate.

Especially in between 2015 and 2017, shareholder activism became more common in China. This increase was mostly attributable to a relaxation in the investment opportunities for insurance companies (Holthuis, Jiao and Liu 2019). A well-known insurance company case is "Vanke v Baoneng" (2016), in which Baoneng, a domestic insurance company, accused Vanke's CEO of misconduct and being overpaid with his salary of 7.5 million USD. In order to actively pursue Vanke, Baoneng increased their ownership level to become the controlling shareholder. In addition, both Baoneng and China Resources Ltd., the second largest shareholder of Vanke, used WeChat and newspaper articles to publicly oppose Vanke's management. Nonetheless, the increase in shareholder activism was short-lived, as the CSRC perceived them as troublemakers who were mostly interested in "rocking the boat and collecting the benefits". The then chairman of the CSRC even dubbed them as "demonic and evil creatures" (Holthuis, Jiao and Liu 2019). In sum, we find significant evidence that shareholder activism has been a channel for both domestic and foreign institutional investors to guide the behavior of Chinese companies.

In addition to shareholder activism, institutional investors have a more discrete option to communicate and influence Chinese enterprises. Namely, they can engage in private dialogues with the Board of Directors and key personnel to voice their concern or enquire more information about certain topics. Private dialogues might be more beneficial for institutional investors for several reasons. Firstly, legal enforcement of minority shareholder rights is still considered quite weak (Wang 2019). Secondly, there is currently no compensation mechanisms in place for the activist investor to reclaim costs incurred (Holthuis, Jiao and Liu 2019). Thirdly, in the case of State-Owned Enterprises, foreign institutional investors are wary to criticize them publicly in fear of irritating the Chinese government (Kodaira 2019). Finally, engaging with Chinese firms in good-faith can lead to mutually beneficial compromises and can foster a trust relationship, which has an important place in Chinese society. Finding evidence of private dialogues is difficult since most action happens behind closed doors. However, Yoon (2017) tries to circumvent this issue by

analyzing so-called “Broker Facilitated Private Meeting” in which foreign institutional investors communicate with Chinese firms at corporate events organised by foreign brokers. His results show that Chinese firms have significantly increased the frequency of dialogues with foreign investors. More precisely, he finds that the amount of facilitated meetings with Shanghai-listed firms has quadrupled since the inception of the Shanghai-Hong Kong connect program in 2014. In addition, he finds that every meeting leads to an average increase of 30% in foreign ownership. Finally, both Investec Asset Management (2018) and Aberdeen Investments (2018), stated recently that Chinese firms have shown more interest to discuss corporate governance related and other topics.

7. Conclusion

The objective of this thesis was to determine if foreign institutional investors have had a positive impact on the corporate governance mechanisms of Chinese publicly listed firms. To test this, we manually collected an extensive foreign ownership database from FactSet, differentiating among the countries of origin. In order to measure corporate governance as well as possible, we used different metrics. Firstly, we compiled a corporate governance index, taking into account 19 different individual governance attributes. Secondly, we used a Transparency Disclosure Rating provided by the Shenzhen Stock Exchange. Finally, we used individual corporate governance attributes. Next, in order to alleviate endogeneity concerns, we used several methodologies. First, we looked at the effect of lagged, significant changes in foreign ownership on future levels of corporate governance. Second, we performed logistic regressions with the lagged level of foreign ownership as the independent variable of interest. In addition, we implemented a variety of robustness tests to further support our main results.

Overall, our results show that the presence of foreign institutional investors has significantly improved the firm-level corporate governance of Chinese publicly listed firms. More precisely, we found that corporate governance changes are driven by long-term and large foreign investments. A long-term change in foreign ownership of at least 4, 7, and 10 percentage points in year T-2 leads to an average increase of respectively 2.5%, 5.0% and 8.5%. For the Transparency Disclosure Rating, long-term changes of at least 4 percentage points in year T-1 led to an average increase of 12.5%. We showed as well that the effect becomes less significant when looking at smaller changes and taking out the long-term criteria. In additon, we found that lagged levels of

foreign ownership decrease the likelihood of related-party transactions, increase the likelihood of having a foreign auditor, and have a positive impact on the board structure and conduct.

Our research has important implications for Chinese policy towards foreign institutional investors. The Chinese economy is entering a new stage of development, one where consumption and innovation will replace export and masnufacturing. Wang Yiming, deputy director of the development research center of the state council, states that China is transitioning from the world factory to the world market (XinhuaNet 2019). Ambitous plans such as Made in China 2025 further support this hypothesis. However, to support this transitional stage, efficient capital markets might be essential. On one hand, developed capital markets can provide new financing channels for enterprises. On the other hand, developed markets enable firms to share their profitsand risks with other investors and offer valuable investments opportunities to the Chinese population and investors. Our research indicates that the Chinese government and the CSRC can further promote sound development of the Chinese capital markets by relaxing the current restrictions for foreign investors. Especially in terms of owership limits, namely that the sum of foreign ownership may not be higher than 30%, there is still room for improvement.

8. List of Tables and Figures

Figure 1: Most significant regulatory developments
The figure below gives an overview of the most important regulatory changes implemented by the China Securities Regulatory Commission (CSRC), Shanghai Stock Exchange (SSE), Shenzhen Stock Exchange (SZSE), and other regulatory bodies. Source: CSRC website and (Allen and Rui 2018).

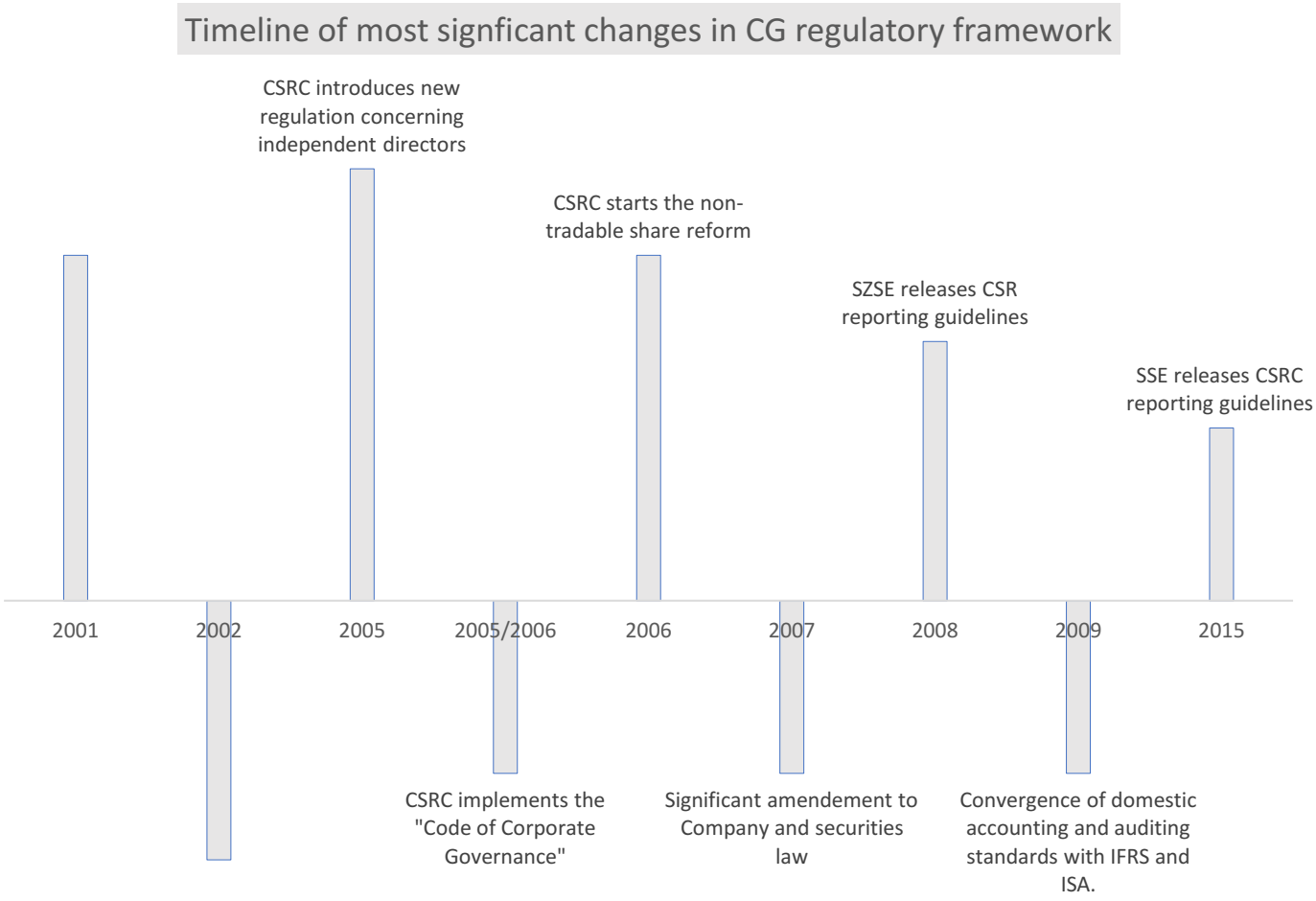

Table 1: Qualified Foreign Institutional Investor (QFII) Criteria
This table shows the criteria used in applying for the Qualified Foreign Institutional Investor (QFII) program before and after 2012. A distinction is made among four different types of investors. Source: http://english.sse.com.cn/laws/qfii/

Financial institution	***2006-2012***	***>2012***
Asset Management Institution	▪ 5 years experience ▪ 5 Billion USD AUM	▪ 2 years of experience ▪ 500 Million USD AUM
Securities Company	▪ 30 years experience ▪ 1 Billion USD paid-in capital ▪ 10 Billion USD AUM	▪ 5 years experience ▪ 500 Million USD Net Assets ▪ 5 Billion USD AUM
Insurance Company	▪ 15 years experience ▪ 5 Billion USD AUM	▪ 2 years experience ▪ 500 Million USD AUM
Commercial Bank	▪ 10 Billion USD AUM ▪ Top 100 worldwide in total assets	▪ 10 years experience ▪ 300 Million USD tier 1 capital ▪ 5 Billion USD AUM
Other Institutional Investors	▪ 5 years experience ▪ 5 Billion USD AUM	▪ 2 years experience ▪ 500 Million USD AUM

Figure 2: QFII and RQFII Quotas
This graph shows the quotas allocated by the State Administration of Foreign Exchange (SAFE) to the Qualified Foreign Institutional Investors (QFIIs) and Renminbi Qualified Foreign Institutional Investors (RQFII) since the inception of both programs. Source: CSRC website

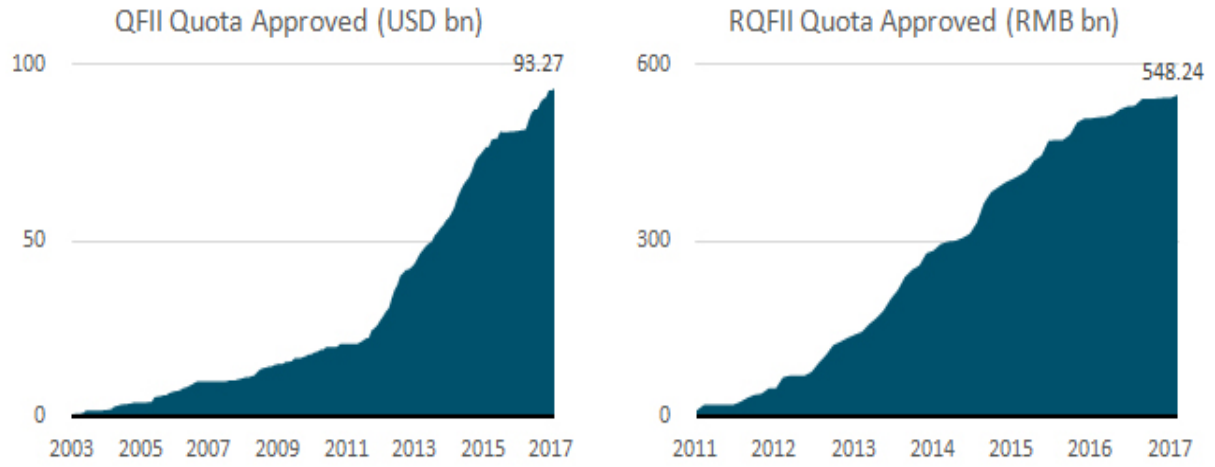

Table 2: Countries that signed Memorandum of Understanding (MoU) with the CSRC.
This table shows all the countries whose securities regulatory institutions signed a MoU with the CSRC. This is an important criterion for a foreign institutional investor which wants to apply for the Qualified Foreign Institutional Investors (QFII) license. Source: CSRC website.

Country	*Year*	*Country*	*Year*
Hong Kong	1993	United States	1994
Singapore	1995	Australia	1996
United Kingdom	1996	Japan	1997
Malaysia	1997	Brazil	1997
Ukraine	1997	France	1998
Luxemburg	1998	Germany	1998
Italy	1999	Egypt	2000
South Korea	2001	Romania	2002
South Africa	2002	Netherlands	2002
Belgium	2002	Canada	2003
Switzerland	2003	Indonesia	2004
Portugal	2004	Nigeria	2005
Vietnam	2005	India	2005
Argentina	2006	Jordan	2006
Norway	2006	Turkey	2006
United Arab Emirates	2006	Thailand	2007
Liechtenstein	2008	Mongolia	2008
Russia	2008	Dubai	2008
Ireland	2008	Austria	2008
Spain	2009	Taipei	2009
Malta	2010	Kuwait	2010
Pakistan	2010	Israel	2011
Qatar	2011	Lao PDR	2011
Sweden	2012	Belarus	2014
Brunei	2014	Jersey	2014
Kazakhstan	2018	Iran	2018
Cayman Islands	2018	Poland	2015
Chile	2017	Greece	2017
Abu Dhabi	2016	Isle of Man	2014

Table 3: Corporate Governance Index
This table gives the summary statistics (N, Mean, Median, Standard Deviation, Q1, and Q3) for the individual corporate governance attributes, the Corporate Governance Index, the Transparency Disclosure Rating, foreign ownership, and the remaining control variables. Growth and ROA are winsorized at the lower 1% level. MBratio is winsorized at the upper 1% level.

	N	**Mean**	**Median**	**Std. Dev.**	**Q1**	**Q3**
Chairman's Age	27,844	51.818	52.000	7.166	47.000	56.000
Board Size	29,028	8.903	9.000	1.929	8.000	9.000
Board Independence	29,026	0.369	0.333	0.054	0.333	0.400
Board Meeting	29,166	9.456	9.000	4.022	7.000	11.000
Supervisory Board Size	29,186	3.757	3.000	1.295	3.000	5.000

Ownership Concentration	29,183	35.650	33.470	15.549	23.470	46.390
Auditor	28,774	0.080	0.000	0.271	0.000	0.000
State Shares	29,174	0.097	0.000	0.190	0.000	0.068
CEO Duality	28,236	0.238	0.000	0.426	0.000	0.000
Ownership and Control Separation	27,846	5.100	0.000	7.910	0.000	9.022
Insider Ownership	27,985	0.111	0.000	0.196	0.000	0.138
Presence of Blockholders	29,109	22.762	21.330	13.887	11.260	32.470
Commissions	28,287	3.863	4.000	0.728	4.00	4.00
Internal Control	26,042	0.560	1.000	0.496	0.000	1.000
Enforcement Actions	29,115	0.824	1.000	0.511	1.000	1.000
Related Party Transactions (1)	27,910	0.036	0.008	1.415	0.004	0.022
Related Party Transactions (2)	27,936	0.368	0.055	16.477	0.000	0.216
Independent Director Qualification	29,111	0.555	0.333	0.699	0.000	1.000
Non-Negotiable Shares	29,102	0.324	0.306	0.283	0.003	0.571
Corporate Governance Index	22,969	10.032	10.000	2.149	9.000	12.000
Foreign Ownership	28,156	1.078	0.000	5.741	0.000	1.130
Strategic Investments	28,158	0.442	0.000	4.153	0.000	0.000
Institutional Ownership	13,141	5.388	3.670	5.973	1.389	7.558
Size	29,183	19.978	19,790	1.516	18,989	20,722
Leverage	29,183	0.550	0.454	0.546	0.281	0.623
Cash	29,150	0.191	0.147	0.152	0.086	0.250
Market-to-Book ratio	28,630	2.821	2.047	2.591	1.402	3.257
Growth	25,327	0.097	0.119	0.327	-0.015	0.244
ROA	29,187	0.039	0.039	0.075	0.011	0.073
PPE	28,894	0.440	0.424	0.222	0.269	0.596
Foreign Listing	29,187	0.100	0.000	0.300	0.000	0.000
Disclosure Rating	16,213	2.970	3.000	0.642	3.000	3.000

Figure 3: Foreign ownership summary

The bar chart below gives a summary of the average level of foreign ownership per year and per country. Foreign ownership includes the Qualified Foreign Institutional Investors (QFII) and Renminbi Qualified Foreign Institutional Investors (RQFII) programs, the Shanghai-Hong Kong and Shenzhen-Hong Kong connect programs, and strategic investments.

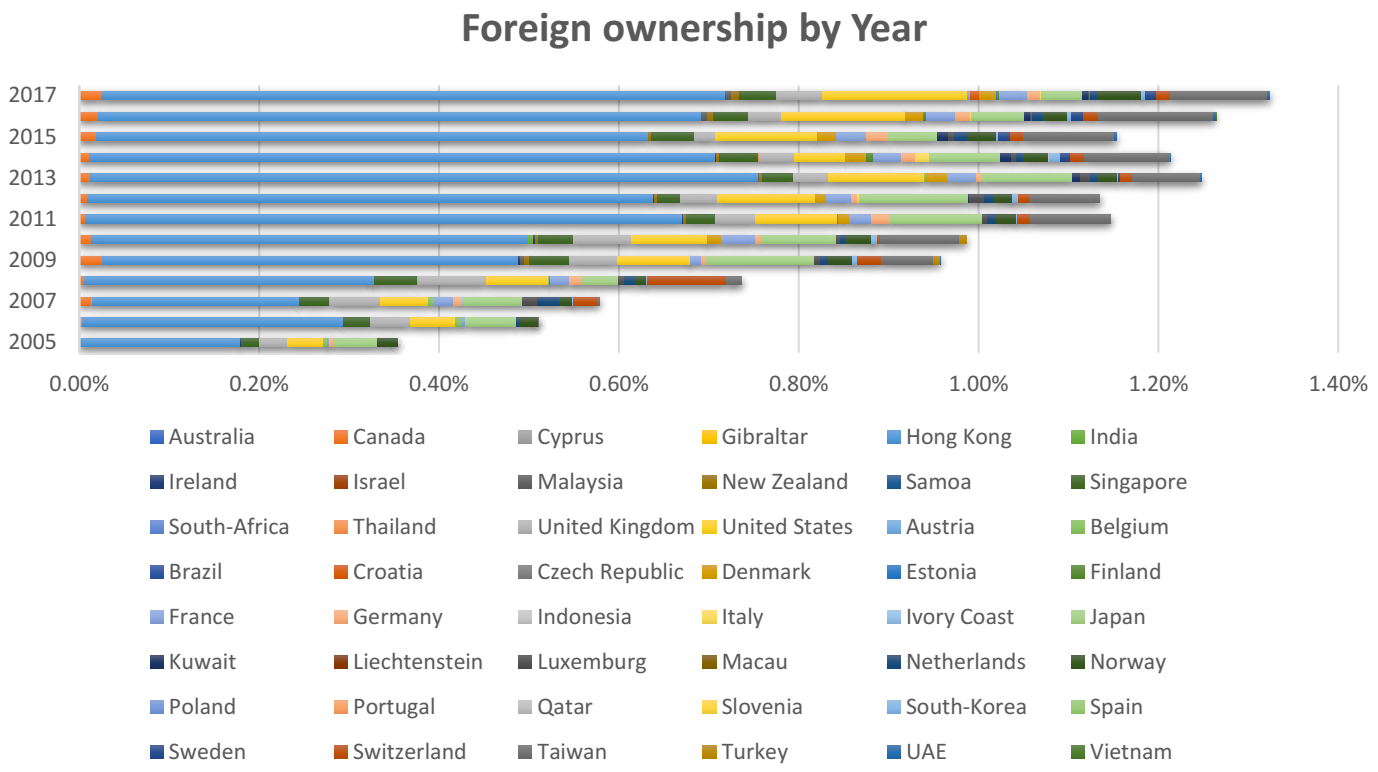

Table 4: Corporate Governance Index constituents, definitions, measurements, and supporting literature.

Governance Index$_{i,t}$=$\sum_{j=1}^{19}$ Governance mechanisms$_j$

Governance Mechanism	Definition	Measurement and supporting literature*
1. *Chairman's Age*	Age of the company's chairman	Equals 1 if the age of the chairman of firm i in fiscal year t is less than the mean value of the sample in fiscal year t, and 0 otherwise. (Schweizer, Walker and Zhang 2017); (Waelchli and Zeller 2013)
2. *Board Size*	Number of directors on the board of directors	Equals 1 if the size of the board of firm i in year t is greater than the median value in year t, and 0 otherwise. (Schweizer, Walker and Zhang 2017); (Chen, Firth, et al. 2006); (Qian and Yeung 2015)
3. *Board Independence*	Ratio of number of independent directors to	Equals 1 if the board independence of firm i is higher than 0.33, and 0 otherwise. (Gao and Kling 2012);

		total directors on the board of directors	(Jiang, Wan and Zhao 2016); (Rezaee, et al. 2018); (Chen and Zhang 2014)
4.	*Board Meeting*	Number of annual meetings of the board of directors	Equals 1 if the number of annual board meetings for firm i in year t is less than the mean value of year t, and 0 otherwise. (Chen, Firth, et al. 2006); (Schweizer, Walker and Zhang 2017); (Xing, Tinghua and Hou 2019)
5.	*Supervisory Board Size*	Number of members on the Supervisory Board	Equals 1 if the supervisory board size for firm i in year t is greater than the median value of year t, and 0 otherwise. (Ding, Jia, et al. 2009); (Y. G. Shan, Value relevance, earnings management and corporate governance in China 2015); (Firth, Fung and Rui 2007)
6.	*Ownership Concentration*	Percentage of shares held by the largest shareholder	Equals 1 if the ownership of the largest shareholder of firm i in year t is in between Q1 and Q3, and otherwise 0. (Liu, Miletkov, Wei and Yang 2015); (Beatson and Chen 2018); (Lo, Wong and Firth 2010); (Cheung, et al. 2008)
7.	*Auditor*	Hiring a Big 4 or other foreign auditor	Equals 1 if the auditor is foreign or a member if the domestic big 4, and otherwise 0. (Schweizer, Walker and Zhang 2017); (Y. G. Shan, Value relevance, earnings management and corporate governance in China 2015); (Shan and McIver 2011)
8.	*State Shares*	Percentage of shares held by the Chinese government	Equals 1 if the state holds more than 5% of the shares of firm i in year t, and otherwise 0. (Qian and Yeung 2015); (Chen and Zhang 2014); (Cheung, et al. 2008); (Liu, et al. 2015)
9.	*CEO Duality*	If the positions of CEO and Chairman of the board of directors are occupied by the same person	Equals 1 if the Chairman of the board position and CEO position are not occupied by the same person for firm i in year t, and 0 otherwise. (Beatson and Chen 2018); (Gao and Kling 2012); (Lo, Wong and Firth 2010); (Rezaee, et al. 2018); (Haß, Johan and Schweizer 2016)
10.	*Separation between ownership and Control rights*	Difference between the actual controller's control and ownership of the company	Equals 1 if there is no divergence between ownership and control for firm i in year t, and 0 otherwise. (Qian and Yeung 2015); (Rezaee, et al. 2018); (Beatson and Chen 2018)
11.	*Insider ownership*	Number of shares held by the members of the Management, Board of Directors and Supervisory Board	Equals 1 if the insider ownership for firm i in year t is greater than 1%, and 0 otherwise. (Sami, Wang and Zhou 2011); (Zou, et al. 2008); (Qian and Yeung 2015)

12. *Presence of Blockholders*	Number of shares held by the 2nd to 10th largest shareholders	Equals 1 if the ownership of blockholders, for firm i in year t is higher than the mean, and 0 otherwise. (Chen and Zhang 2014); (Beatson and Chen 2018); (Jiang, Wan and Zhao 2016)
13. *Commissions*	Number of commissions established	Equals 1 if 4 or more commissions have been established by firm i in year t, and 0 otherwise. (Rezaee, et al. 2018); (Cheung, et al. 2008); (Gao and Kling 2012); (Lo, Wong and Firth 2010)
14. *Internal Control*	Disclosure of Internal Control Audit report	Equals 1 if the audit report of internal control was disclosed by firm i in year t, and o otherwise. (Rezaee, et al. 2018)
15. *Enforcement Actions*	Enforcement actions carried out by the CSRC, Stock exchanges or other institutions	Equals 1 if there were no enforcement actions in year i, 0 if there was an enforcement action in year i handled by the Stock exchanges and -1 if there was an enforcement action in year i handled by the CSRC. (Beatson and Chen 2018); (Cheung, et al. 2008); (Rezaee, et al. 2018)
16. *Related Party Transactions (1)*	Ratio of Other receivables over total Assets	Equal 1 if the ORECTA (Net other receivables over total assets) of firm i in year t is smaller than the mean, and 0 otherwise. (Qian and Yeung 2015); (Zou, et al. 2008);
17. *Related Party Transactions (2)*	Ratio of guarantees issued to related parties over Total Assets	Equal 1 if Guarantees over total assets for firm i in year t is smaller than the median, and 0 otherwise. (Jiang, Wan and Zhao 2016)
18. *Qualification of independent directors*	Ratio of concurrent positions of independent directors to the total number of independent directors	Equals 1 if the ratio of concurrent positions to number of independent directors for firm i in year t is greater than the median value for year t, and 0 otherwise. (Rezaee, et al. 2018); (Jiang, Wan and Zhao 2016)
19. *Non-Negotiable shares*	Percentage of Shares that are non-tradable.	Equals 1 if the share of non-negotiable ownership for firm i in year t is smaller than the mean, and 0 otherwise. (Jiang and Kim 2015)

Table 5: Corporate Governance Attributes Correlation Matrix

The following table gives the correlation among the 19 different corporate governance attributes of our Corporate Governance Index (CGI). The following variables are included in the table: Age (Chairman's Age), Bsize (Board Size), BIndep (Board Independence), BMeet (Board Meeting), SSize (Supervisory Board Size), Own (Ownership Concentration), Audit (Auditor), State (State Shares), CEOD (CEO Duality), Sep (Separation Between Ownership and Control Rights), Ins (Insider Ownership), Block (Presence of Blockholders), Comm (Commissions), Intern (Internal Control), Enforc (Enforcement Actions), RTP (1) (Related Party Transactions 1), RTP (2) (Related Party Transactions 2), INDQ (Qualification of Independent Directors) and NNEG (Non-Negotiable Shares). Refer to Table 3 and the data part for more information on the different attributes and how they are calculated.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15	(16)	(17)	(18)	(20)
(1) Age	1.000																		
(2) BSize	**-0.059**	1.000																	
(3) BIndep	**0.026**	**0.252**	1.000																
(4) BMeet	**-0.058**	0.003	**-0.017**	1.000															
(5) SSize	**-0.052**	**0.299**	**-0.040**	0.006	1.000														
(6) Own	0.010	**-0.039**	**-0.031**	0.005	**-0.019**	1.000													
(7) Audit	**-0.069**	**0.193**	**0.041**	**-0.033**	**0.148**	**-0.035**	1.000												
(8) State	**0.040**	**-0.193**	**0.055**	**0.020**	**-0.251**	**0.014**	**-0.071**	1.000											
(9) CEOD	**-0.128**	**0.141**	**-0.064**	-0.011	**0.181**	**-0.025**	**0.077**	**-0.163**	1.000										
(10) Sep	**0.015**	**0.022**	**0.055**	-0.005	0.009	**-0.039**	**-0.014**	**-0.080**	**-0.031**	1.000									
(11) Ins	-0.001	**-0.070**	**-0.020**	**-0.014**	**-0.102**	**0.032**	**-0.064**	**0.090**	**-0.120**	**0.099**	1.000								
(12) Block	**0.033**	0.011	**0.016**	-0.005	**-0.102**	**0.123**	**0.058**	**0.061**	**-0.114**	**0.049**	**0.113**	1.000							
(13) Comm	0.005	**-0.044**	**0.023**	-0.007	-0.048	**0.021**	**-0.090**	**0.146**	**-0.043**	**0.026**	0.007	**0.047**	1.000						
(14) Intern	**-0.014**	**-0.020**	**0.057**	**-0.015**	**-0.014**	-0.004	**0.037**	**0.229**	**-0.027**	**0.035**	**-0.069**	**0.032**	**0.159**	1.000					
(15) Enforc	**-0.032**	**0.029**	**-0.014**	**0.068**	**0.030**	0.007	**0.042**	**-0.073**	**0.019**	-0.004	0.010	0.007	**-0.057**	**-0.075**	1.000				
(16) RTP (1)	**-0.042**	-0.002	-0.004	**0.080**	**-0.019**	0.015	**0.026**	**0.078**	**-0.049**	**0.034**	**0.035**	**0.065**	**0.095**	**0.133**	**0.045**	1.000			
(17) RTP (2)	**-0.028**	**0.036**	0.000	**0.126**	**0.022**	**-0.038**	**0.099**	**-0.076**	**-0.014**	**0.084**	**0.012**	**0.068**	**-0.062**	**-0.021**	**0.053**	**0.053**	1.000		
(18) INDQ	0.002	**-0.049**	**0.013**	-0.014	**-0.061**	**-0.015**	**0.047**	**0.123**	**-0.050**	**0.040**	**0.023**	**0.065**	**0.082**	**0.141**	-0.007	**0.071**	-0.002	1.000	
(19) NNEG	**-0.049**	**0.031**	**0.037**	0.003	**0.096**	**-0.053**	**0.042**	**0.311**	**0.105**	**-0.069**	**-0.137**	**-0.256**	**0.108**	**0.252**	**-0.067**	0.005	**-0.078**	**0.039**	1.000

Table 6: Definition and source of Control variables, Independent Variables and Dependent Variables
The following table gives an overview of the different variables used in the regressions, and how they are calculated. Refer to the data and methodology part for a more in-depth explanation of the respective variables.

Control Variables	Definition	CSMAR ID / Other source
CG Index	Corporate Governance Index (See Table 4)	Table 4
CG Rating	Transparency Disclosure Rating	Company Opacity (Transparency of Listed Company)
FOR_IO_DUMMY T-1	Dummy variable for foreign ownership change from year T-1 to T (refer to the data and methodology part for more information on this variable)	FactSet
FOR_IO_DUMMY T-2	Dummy variable for foreign ownership change from year T-2 to T-1 (refer to the data and methodology part for more information on this variable)	FactSet
DOM_IO_DUMMY T-1	Dummy variable fore domestic institutional ownership. Takes on the value of 1 if the change from year T-1 to T is higher than the 90th percentile of domestic institutional ownership changes (4.80%)	Sum of different types of domestic institutional investors on CSMAR (excluding QFII)
DOM_IO_DUMMY T-2	Dummy variable fore domestic institutional ownership. Takes on the value of 1 if the change from year T-2 to T-1 is higher than the 90th percentile of domestic institutional ownership changes (4.80%)	Sum of different types of domestic institutional investors on CSMAR (excluding QFII)
Strategic Investment ΔDummy T-1	Dummy variable equal to 1 if there is a positive change in strategic investments from year T-1 to T.	FactSet
Strategic Investment ΔDummy T-2	Dummy variable equal to 1 if there is a positive change in strategic investments from year T-1 to T.	FactSet
Foreign Ownership T-1	T-1 lagged level of foreign ownership	FactSet
Foreign Ownership T-2	T-2 lagged level of foreign ownership	FactSet
Domestic Ownership T-1	T-1 lagged level of domestic institutional ownership	Sum of different types of domestic institutional investors on CSMAR (excluding QFII)
Domestic Ownership T-2	T-2 lagged level of domestic institutional ownership	Sum of different types of domestic institutional investors on CSMAR (excluding QFII)
Size	$Log(Total\ Assets)$	A004000000 (Total assets)
Growth	$\frac{Total\ operating\ revenue_t - Total\ operating\ revenue_{t-1}}{Total\ operating\ revenue_t}$	B001100000 (Total operating revenue)

Cash	$\frac{cash\ and\ cash\ equivalents}{Total\ Assets}$	A001101000 (Cash and cash equivalents) ; A004000000 (Total assets)
Leverage	$\frac{Total\ liabilities}{Total\ Assets}$	A002000000 (Total liabilities); A004000000 (Total assets)
ROA	$\frac{Operating\ profit}{Total\ Assets}$	B001300000 (Operating profit); A004000000 (Total assets)
MBRatio	$\frac{Total\ liabilities + Market\ capitalisation}{Total\ Assets}$	A002000000 (Total liabilities); Msmvttl (Market capitalisation) ; A004000000 (Total assets)
PPE	$\frac{Total\ assets - current\ assets}{Total\ Assets}$	A004000000 (Total assets); A001100000 (Total Current Assets)
Foreign listing	Equal to 1 the firm is listed on a foreign stock exchange	ExchangeCode

Table 7: Correlation matrix of corporate governance metrics, foreign ownership and control variables

The following table gives the correlation matrix between the two corporate governance metrics, foreign ownership, and the control variables. The following variables are included: CG Index (Corporate Governance Index), TRD (Transparency Disclosure Rating), For Own (Foreign Ownership – including QFII/RQFII, Strategic Investors, and Connect program), Strategic (Foreign Strategic Ownership), Inst (Domestic Institutional Ownership), Size, Lev (Leverage), Cash, MBRatio, Growth, ROA, Listing (Foreign Listing), PPE. Refer to Table 3 and the data part for more information on the different attributes and how they are calculated.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
(1) CG Index	1.000												
(2) For Own	**0.044**	1.000											
(3) Strategic	**0.025**	**0.730**	1.000										
(4) Inst	**0.015**	-0.005	**-0.020**	1.000									
(5) Size	**0.164**	**0.124**	**0.033**	**0.073**	1.000								
(6) Lev	**-0.051**	-0.003	-0.002	0.000	**-0.063**	1.000							
(7) Cash	**0.104**	**-0.020**	-0.012	**0.030**	**-0.198**	**-0.017**	1.000						
(8) MBRatio	**0.052**	**-0.028**	-0.010	**0.041**	**-0.441**	**0.110**	**0.193**	1.000					
(9) Growth	**0.054**	**0.047**	**0.030**	**0.097**	**0.227**	**-0.022**	**-0.152**	**-0.074**	1.000				
(10) ROA	**0.125**	**0.051**	**0.023**	**0.092**	**0.085**	**-0.076**	**0.250**	**0.044**	**0.050**	1.000			
(11) Listing	**0.079**	**0.062**	**0.019**	**-0.049**	**0.252**	**0.014**	**-0.070**	**-0.071**	**0.024**	**-0.025**	1.000		
(12) PPE	0.001	**0.044**	0.009	**-0.014**	**0.185**	-0.006	**-0.487**	**-0.129**	**0.103**	**-0.149**	**0.115**	1.000	
(13) TRD	**0.210**	**0.058**	**0.022**	**0.086**	**0.246**	**-0.027**	**0.122**	**-0.064**	**0.114**	**0.346**	0.004	**-0.062**	1.000

Table 8: Effect of lagged and significant changes in foreign ownership on the current level of corporate governance (4 percentage points)

This tables shows the estimated coefficients of the effect of lagged foreign ownership changes (FOR_IO_Dummy T-1 and FOR_IO_Dummy T-2) on the present level of Corporate Governance. The first three columns use the Corporate Governance Index as dependent variables. The last three columns use the Transparency Disclosure Rating as dependent variable. Refer to the data part and the appendix for more detailed explanations on the two corporate governance metrics. FOR_IO_Dummy T-1 and FOR_IO_Dummy T-2 are dummy variables that take on the value of 1 if two conditions are met. Firstly, there needs to be a change of 4 percentage points from respectively year T-1 to T or T-2 to T-1. Secondly, we require a threshold value of 4% at the end of the year after the change. Refer to the data part for a more in-depth explanation of the foreign ownership dummy variables. DOM_IO_Dummy T-1 and DOM_IO_Dummy T-2 are dummy variables that take on the value of 1 if there is a change of at least 4.80 percentage points from respectively year T-1 to T or T-2 to T-1. Refer to the appendix for the definition of the remaining control variables. All control variables are lagged, and both Industry and Time-fixed effects are added to the regressions. *, **, *** indicate significance of respectively 10%, 5%, and 1%. The average and max Variance Inflation Factors (VIF) are given at the bottom of the table.

Pooled Ordinary Least Squares (OLS)	**CG Index (1)**	**CG Index (2)**	**CG Index (3)**	**CG Rating (4)**	**CG Rating (5)**	**CG Rating (6)**
FOR_IO_Dummy T-1	0.3496		0.1801	0.5239***		0.4879***
	(0.337)		(0.628)	(0.001)		(0.003)
FOR_IO_Dummy T-2		0.5322*	0.5416*		0.2674**	0.2794**
		(0.096)	(0.096)		(0.039)	(0.038)
DOM_IO_Dummy T-1	-0.0277	-0.0305	-0.0237	0.0027	-0.0031	-0.0005
	(0.772)	(0.749)	(0.805)	(0.945)	(0.935)	(0.990)
DOM_IO_Dummy T-2	-0.0478	-0.0466	-0.0496	-0.0290	-0.0359	-0.0331
	(0.579)	(0.588)	(0.566)	(0.407)	(0.306)	(0.347)
ΔSize	-0.2980***	-0.2960***	-0.3052***	0.1211***	0.1295***	0.1218***
	(0.004)	(0.005)	(0.004)	(0.004)	(0.002)	(0.004)
ΔGrowth	0.0517	0.0407	0.0472	0.0016	-0.0168	-0.0083
	(0.497)	(0.591)	(0.536)	(0.962)	(0.610)	(0.802)
ΔLeverage	-0.0870	-0.0851	-0.0869	-0.0004	0.0005	-0.0001
	(0.505)	(0.514)	(0.505)	(0.956)	(0.934)	(0.988)
ΔCash	-0.5459	-0.4603	-0.4812	-0.0420	-0.0850	-0.0424
	(0.167)	(0.245)	(0.224)	(0.782)	(0.576)	(0.781)
ΔROA	-0.0085	0.0242	0.0129	0.2047	0.1702	0.1770
	(0.988)	(0.966)	(0.982)	(0.355)	(0.442)	(0.424)
ΔMarket-to-Book ratio	-0.0055	-0.0066	-0.0073	0.0046	0.0033	0.0030
	(0.774)	(0.731)	(0.704)	(0.539)	(0.660)	(0.690)
ΔPPE	0.1442	0.1414	0.1625	0.1266	0.0981	0.1204
	(0.706)	(0.712)	(0.671)	(0.419)	(0.531)	(0.442)
Foreign listings	1.2297***	1.2116***	1.2216***	0.1276***	0.1238***	0.1269***
	(0.000)	(0.000)	(0.000)	(0.003)	(0.004)	(0.003)
Industry Fixed-Effects	YES	YES	YES	YES	YES	YES
Year Fixed-Effects	YES	YES	YES	YES	YES	YES
Observations	6,831	6,807	6,777	4,443	4,428	4,407
R-Squared	0.407	0.408	0.409	0.393	0.393	0.396
Min VIF	1.397	1.427	1.398	1.478	1.478	1.483
Max VIF	2.952	2.570	2.574	2.955	2.945	2.959

Table 9: Effect of lagged and significant changes in foreign ownership on the current level of corporate governance (7 percentage points)

This table shows the estimated coefficients of the effect of lagged foreign ownership changes (FOR_IO_Dummy T-1 and FOR_IO_Dummy T-2) on the present level of Corporate Governance. The first three columns use the Corporate Governance Index as dependent variables. The last three columns use the Transparency Disclosure Rating as dependent variable. Refer to the data part and the appendix for more detailed explanations on the two corporate governance metrics. FOR_IO_Dummy T-1 and FOR_IO_Dummy T-2 are dummy variables that take on the value of 1 if two conditions are met. First, there needs to be a change of 7 percentage points from respectively year T-1 to T or T-2 to T-1. Then, we require a threshold value of 4% at the end of the year after the change. Refer to the data part for a more in-depth explanation of the foreign ownership dummy variables. DOM_IO_Dummy T-1 and DOM_IO_Dummy T-2 are dummy variables that take on the value of 1 if there is a change of at least 4.80 percentage points from respectively year T-1 to T or T-2 to T-1. Refer to the appendix for the definition of the remaining control variables. All control variables are lagged, and both Industry and Time-fixed effects are added to the regressions. *, **, *** indicate significance of respectively 10%, 5%, and 1%. The min and max Variance Inflation Factors (VIF) are given at the bottom of the table.

Pooled Ordinary Least Squares (OLS)	**CG Index (1)**	**CG Index (2)**	**CG Index (3)**	**CG Rating (4)**	**CG Rating (5)**	**CG Rating (6)**
FOR_IO_Dummy T-1	0.8755		0.6475	0.5642***		0.5751***
	(0.117)		(0.266)	(0.014)		(0.014)
FOR_IO_Dummy T-2		0.9295**	0.9286**		0.2656	0.3133*
		(0.045)	(0.045)		(0.119)	(0.072)
DOM_IO_Dummy T-1	-0.0328	-0.0305	-0.0284	0.0012	-0.0004	0.0012
	(0.730)	(0.748)	(0.766)	(0.975)	(0.992)	(0.975)
DOM_IO_Dummy T-2	-0.0504	-0.0466	-0.0517	-0.0278	-0.0332	-0.0289
	(0.557)	(0.587)	(0.549)	(0.428)	(0.344)	(0.410)
ΔSize	-0.2918	-0.2974***	-0.3005***	0.1279***	0.1279***	0.1267***
	(0.005)	(0.004)	(0.004)	(0.003)	(0.003)	(0.003)
ΔGrowth	0.0450	0.0402	0.0390	-0.0067	-0.0058	-0.0056
	(0.553)	(0.595)	(0.607)	(0.837)	(0.859)	(0.864)
ΔLeverage	-0.0857	-0.0888	-0.0891	0.0002	0.0004	0.0003
	(0.511)	(0.495)	(0.494)	(0.978)	(0.949)	(0.963)
ΔCash	-0.5308	-0.4832	-0.4932	-0.0674	-0.0806	-0.0634
	(0.178)	(0.221)	(0.212)	(0.656)	(0.596)	(0.676)
ΔROA	-0.0187	0.0264	0.0066	0.1833	0.1781	0.1607
	(0.974)	(0.963)	(0.991)	(0.408)	(0.421)	(0.468)
ΔMarket-to-Book ratio	-0.0055	-0.0064	-0.0073	0.0046	0.0039	0.0037
	(0.773)	(0.736)	(0.704)	(0.538)	(0.597)	(0.627)
ΔPPE	0.1156	0.1425	0.1331	0.1103	0.1139	0.1197
	(0.762)	(0.709)	(0.728)	(0.481)	(0.467)	(0.445)
Foreign listings	1.2283***	1.2103***	1.2204***	0.1229***	0.1216***	0.1204***
	(0.000)	(0.000)	(0.000)	(0.004)	(0.004)	(0.005)
Industry Fixed-Effects	YES	YES	YES	YES	YES	YES
Year Fixed-Effects	YES	YES	YES	YES	YES	YES
observations	6,850	6,825	6,814	4,453	4,438	4,428
R-Squared	0.408	0.409	0.410	0.392	0.392	0.393
Min VIF	1.396	1.396	1.397	1.477	1.478	1.482
Max VIF	2.569	2.568	2.569	2.950	2.943	2.946

Table 10: Effect of lagged and significant changes in foreign ownership on the current level of corporate governance (10 percentage points)

This tables shows the estimated coefficients of the effect of lagged foreign ownership changes (FOR_IO_Dummy T-1 and FOR_IO_Dummy T-2) on the present level of Corporate Governance. The first three columns use the Corporate Governance Index as dependent variables. The last three columns use the Transparency Disclosure Rating as dependent variable. Refer to the data part and the appendix for more detailed explanations on the two corporate governance metrics. FOR_IO_Dummy T-1 and FOR_IO_Dummy T-2 are dummy variables that take on the value of 1 if two conditions are met. Firstly, there needs to be a change of 10 percentage points from respectively year T-1 to T or T-2 to T-1. Secondly, we require a threshold value of 5% at the end of the year after the change. Refer to the data part for a more in-depth explanation of the foreign ownership dummy variables. DOM_IO_Dummy T-1 and DOM_IO_Dummy T-2 are dummy variables that take on the value of 1 if there is a change of at least 4.80 percentage points from respectively year T-1 to T or T-2 to T-1. Refer to the appendix for the definition of the remaining control variables. All control variables are lagged, and both Industry and Time-fixed effects are added to the regressions. *, **, *** indicate significance of respectively 10%, 5%, and 1%. The minimum and maximum Variance Inflation Factors (VIF) are given at the bottom of the table.

Pooled Ordinary Least Squares (OLS)	**CG Index (1)**	**CG Index (2)**	**CG Index (3)**	**CG Rating (4)**	**CG Rating (5)**	**CG Rating (6)**
FOR_IO_Dummy T-1	1.2443*		0.9495	0.4988**		0.4999**
	(0.064)		(0.184)	(0.055)		(0.054)
FOR_IO_Dummy T-2		1.5641***	1.5633***		0.2778	0.2777
		(0.006)	(0.006)		(0.160)	(0.160)
DOM_IO_Dummy T-1	-0.0347	-0.0312	-0.0305	0.0010	-0.0007	0.0007
	(0.715)	(0.743)	(0.748)	(0.979)	(0.985)	(0.986)
DOM_IO_Dummy T-2	-0.0498	-0.0493	-0.0536	-0.0295	-0.0327	-0.0304
	(0.562)	(0.566)	(0.533)	(0.399)	(0.352)	(0.387)
ΔSize	-0.2939***	-0.2958***	-0.3010***	0.1283***	0.1278***	0.1270***
	(0.005)	(0.005)	(0.004)	(0.003)	(0.003)	(0.003)
ΔGrowth	0.0464	0.0429	0.0430	-0.0066	-0.0070	-0.0065
	(0.540)	(0.571)	(0.570)	(0.838)	(0.830)	(0.841)
ΔLeverage	-0.0874	-0.0897	-0.0919	0.0002	0.0004	0.0003
	(0.502)	(0.491)	(0.480)	(0.972)	(0.951)	(0.960)
ΔCash	-0.5013	-0.4871	-0.4696	-0.0768	-0.0821	-0.0747
	(0.204)	(0.217)	(0.234)	(0.611)	(0.588)	(0.622)
ΔROA	-0.0347	0.0142	-0.0188	0.1902	0.1901	0.1805
	(0.952)	(0.980)	(0.974)	(0.390)	(0.390)	(0.415)
ΔMarket-to-Book ratio	-0.0056	-0.0058	-0.0068	0.0047	0.0039	0.0036
	(0.769)	(0.759)	(0.722)	(0.534)	(0.606)	(0.632)
ΔPPE	0.1335	0.1455	0.1530	0.1048	0.1111	0.1105
	(0.727)	(0.703)	(0.689)	(0.503)	(0.478)	(0.480)
Foreign listings	1.2259***	1.2118***	1.2208***	0.1235***	0.1231***	0.1231***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.004)	(0.004)
Industry Fixed-Effects	YES	YES	YES	YES	YES	YES
Year Fixed-Effects	YES	YES	YES	YES	YES	YES
observations	6,855	6,829	6,823	4,459	4,443	4,439
R-Squared	0.408	0.409	0.409	0.391	0.391	0.392
Min VIF	1.396	1.396	1.397	1.473	1.4749	1.474
Max VIF	2.571	2.568	2.571	2.945	2.942	2.947

Table 11: Effect of lagged and significant changes in foreign ownership on the current level of corporate governance (0.30 to 4 percentage points)

This tables shows the estimated coefficients of the effect of lagged foreign ownership changes (FOR_IO_Dummy T-1 and FOR_IO_Dummy T-2) on the present level of Corporate Governance. The first three columns use the Corporate Governance Index as dependent variables. The last three columns use the Transparency Disclosure Rating as dependent variable. Refer to the data part and the appendix for more detailed explanations on the two corporate governance metrics. FOR_IO_Dummy T-1 and FOR_IO_Dummy T-2 are dummy variables that take on the value of 1 if two conditions are met. Firstly, there needs to be a change between 0.30 and 4 percentage points from respectively year T-1 to T or T-2 to T-1. Secondly, we require a threshold value of 0.30% at the end of the year after the change. Refer to the data part for a more in-depth explanation of the foreign ownership dummy variables. DOM_IO_Dummy T-1 and DOM_IO_Dummy T-2 are dummy variables that take on the value of 1 if there is a change of at least 4.80 percentage points from respectively year T-1 to T or T-2 to T-1. Refer to the appendix for the definition of the remaining control variables. All control variables are lagged, and both Industry and Time-fixed effects are added to the regressions. *, **, *** indicate significance of respectively 10%, 5%, and 1%. The minimum and maximum Variance Inflation Factors (VIF) are given at the bottom of the table.

Pooled Ordinary Least Squares (OLS)	**CG Index (1)**	**CG Index (2)**	**CG Index (3)**	**CG Rating (4)**	**CG Rating (5)**	**CG Rating (6)**
FOR_IO_Dummy T-1	0.0951		0.0548	0.3181***		0.2812***
	(0.409)		(0.637)	(0.000)		(0.000)
FOR_IO_Dummy T-2		0.3178***	0.3235***		0.3136***	0.2835***
		(0.003)	(0.004)		(0.000)	(0.000)
DOM_IO_Dummy T-1	-0.0018	-0.0425	-0.0064	0.0128	-0.0016	0.0084
	(0.986)	(0.664)	(0.950)	(0.744)	(0.967)	(0.834)
DOM_IO_Dummy T-2	-0.0679	-0.0156	-0.0406	-0.0138	-0.0187	-0.0002
	(0.444)	(0.861)	(0.658)	(0.700)	(0.602)	(0.996)
ΔSize	-0.2872***	-0.3367***	-0.3355***	0.1125***	0.1214***	0.1084**
	(0.008)	(0.002)	(0.002)	(0.011)	(0.005)	(0.015)
ΔGrowth	0.0355	0.0698	0.0642	0.0027	0.0010	0.0111
	(0.648)	(0.363)	(0.414)	(0.934)	(0.976)	(0.740)
ΔLeverage	-0.0910	-0.0877	-0.0977	-0.0006	-0.000	-0.0007
	(0.490)	(0.503)	(0.461)	(0.929)	(0.995)	(0.919)
ΔCash	-0.5293	-0.5209	-0.5346	-0.0426	-0.0898	-0.0427
	(0.192)	(0.195)	(0.196)	(0.782)	(0.558)	(0.785)
ΔROA	-0.2729	0.2401	-0.0708	0.0955	0.0049	-0.0042
	(0.641)	(0.680)	(0.906)	(0.671)	(0.516)	(0.985)
ΔMarket-to-Book ratio	-0.0075	-0.0053	-0.0083	0.0044	0.0049	0.0045
	(0.699)	(0.783)	(0.675)	(0.559)	(0.516)	(0.558)
ΔPPE	0.0644	0.1719	0.1315	0.1356	0.1046	0.1531
	(0.870)	(0.658)	(0.742)	(0.397)	(0.509)	(0.347)
Foreign listings	1.2334***	1.2059***	1.2208***	0.0991**	0.1095***	0.0868**
	(0.000)	(0.000)	(0.000)	(0.024)	(0.011)	(0.054)
Industry Fixed-Effects	YES	YES	YES	YES	YES	YES
Year Fixed-Effects	YES	YES	YES	YES	YES	YES
observations	6,538	6,570	6,249	4,249	4,262	4,049
R-Squared	0.414	0.4183	0.426	0.410	0.414	0.431
Min VIF	1.410	1.406	1.421	1.505	1.543	1.509
Max VIF	2.584	2.599	2.619	2.961	2.982	2.716

Table 12: Effect of lagged and significant changes in foreign ownership on the current level of corporate governance (4, 7, and 10 percentage points) without the long-term criteria.

This tables shows the estimated coefficients of the effect of lagged foreign ownership changes (FOR_IO_Dummy T-1 and FOR_IO_Dummy T-2) on the present level of Corporate Governance. The first three columns use the Corporate Governance Index as dependent variables. The last three columns use the Transparency Disclosure Rating as dependent variable. Refer to the data part and the appendix for more detailed explanations on the two corporate governance metrics. FOR_IO_Dummy T-1 and FOR_IO_Dummy T-2 are dummy variables that take on the value of 1 if two conditions are met. Firstly, there needs to be a change of at least 4 (Columns 1 and 4), 7 (Columns 2 and 5), and 10 (Columns 3 and 6) percentage points from respectively year T-1 to T or T-2 to T-1.. Refer to the data part for a more in-depth explanation of the foreign ownership dummy variables. DOM_IO_Dummy T-1 and DOM_IO_Dummy T-2 are dummy variables that take on the value of 1 if there is a change of at least 4.80 percentage points from respectively year T-1 to T or T-2 to T-1. Refer to the appendix for the definitions of the remaining control variables. All control variables are lagged, and both Industry and Time-fixed effects are added to the regressions. *, **, *** indicate significance of respectively 10%, 5%, and 1%. The minimum and maximum Variance Inflation Factors (VIF) are given at the bottom of the table.

Pooled Ordinary Least Squares (OLS)	**CG Index[1] (1)**	**CG Index[2] (2)**	**CG Index[3] (3)**	**CG Rating[1] (4)**	**CG Rating[2] (5)**	**CG Rating[3] (6)**
FOR_IO_Dummy T-1	0.1762	0.6319	0.7023	0.2709**	0.3830**	0.4255*
	(0.528)	(0.180)	(0.252)	(0.027)	(0.033)	(0.060)
FOR_IO_Dummy T-2	0.2329	0.6740*	0.9645**	0.1086	0.1815	0.2217
	(0.346)	(0.067)	(0.030)	(0.300)	(0.193)	(0.182)
DOM_IO_Dummy T-1	-0.0302	-0.0310	-0.0332	0.0041	0.0008	0.0004
	(0.751)	(0.744)	(0.727)	(0.914)	(0.984)	(0.992)
DOM_IO_Dummy T-2	-0.0527	-0.0521	-0.0532	-0.0290	-0.0313	-0.0310
	(0.540)	(0.544)	(0.535)	(0.409)	(0.372)	(0.377)
ΔSize	-0.2957***	-0.2970***	-0.2963***	0.1258***	0.1266***	0.1274***
	(0.005)	(0.004)	(0.005)	(0.003)	(0.003)	(0.003)
ΔGrowth	0.0439	0.0456	0.0459	-0.0088	-0.0078	-0.0081
	(0.562)	(0.546)	(0.544)	(0.788)	(0.809)	(0.802)
ΔLeverage	-0.0867	-0.0869	-0.0868	0.0002	0.0003	0.0003
	(0.506)	(0.504)	(0.505)	(0.971)	(0.967)	(0.958)
ΔCash	-0.4914	-0.4742	-0.4743	-0.0665	-0.0683	-0.0765
	(0.213)	(0.229)	(0.229)	(0.660)	(0.652)	(0.613)
ΔROA	0.0276	0.0310	0.0287	0.1962	0.1932	0.1981
	(0.961)	(0.957)	(0.960)	(0.375)	(0.382)	(0.370)
ΔMarket-to-Book ratio	-0.0058	-0.0057	-0.0055	0.0040	0.0040	0.0041
	(0.761)	(0.764)	(0.773)	(0.594)	(0.590)	(0.582)
ΔPPE	0.1389	0.1500	0.1461	0.1283	0.1262	0.1188
	(0.716)	(0.694)	(0.702)	(0.413)	(0.420)	(0.448)
Foreign listings	1.2099***	1.2055***	1.2016***	0.1257***	0.1257***	0.1223***
	(0.000)	(0.000)	(0.000)	(0.003)	(0.003)	(0.004)
Industry Fixed-Effects	YES	YES	YES	YES	YES	YES
Year Fixed-Effects	YES	YES	YES	YES	YES	YES
observations	6,843	6,843	6,843	4,453	4,453	4,453
R-Squared	0.409	0.409	0.409	0.392	0.392	0.392
Min VIF	1.396	1.397	1.397	1.476	1.476	1.474
Max VIF	2.571	2.567	2.568	2.941	2.942	2.492

[1] = 4% changes; [2] = 7% changes; [3] = 10% changes.

Table 13: Effect of lagged strategic investments changes on current level corporate governance

This table shows the estimated coefficients of the effect of lagged strategic investment changes (Strategic Investment ΔDummy T-1and Strategic Investment ΔDummy T-1) on the present level of Corporate Governance. We only include the results with the Corporate Governance Index variable. We find similar results if we use the Transparency Disclosure Rating as dependent variable. Refer to the data part and the appendix for more detailed explanations on the Corporate Governance Index. Strategic Investment ΔDummy T-1 and Strategic Investment ΔDummy T-2 are dummy variables that take on the value of 1 if there is a positive change in strategic investments from respectively year T-1 to T or T-2 to T-1. DOM_IO_Dummy T-1 and DOM_IO_Dummy T-2 are dummy variables that take on the value of 1 if there is a change of at least 4.80 percentage points from respectively year T-1 to T or T-2 to T-1. Refer to the appendix for the definition of the remaining control variables. All control variables are lagged, and both Industry and Time-fixed effects are added to the regressions. *, **, *** indicate significance of respectively 10%, 5%, and 1%. The min and max Variance Inflation Factors (VIF) are given at the bottom.

Pooled Ordinary Least Squares (OLS)	**CG Index**	**CG Index**	**CG Index**
Strategic Investment ΔDummy T-1	0.2971		0.2984
	(0.357)		(0.357)
Strategic Investment ΔDummy T-2		0.0284	-0.0125
		(0.926)	(0.968)
DOM_IO_Dummy T-1	-0.0352	-0.0326	-0.0329
	(0.711)	(0.731)	(0.729)
DOM_IO_Dummy T-2	-0.0476	-0.0479	-0.0499
	(0.580)	(0.577)	(0.561)
ΔSize	-0.2891***	-0.2900***	-0.2906***
	(0.006)	(0.005)	(0.005)
ΔGrowth	0.0444	0.0442	0.0426
	(0.558)	(0.559)	(0.574)
ΔLeverage	-0.0840	-0.0869	-0.0858
	(0.519)	(0.504)	(0.510)
ΔCash	-0.5241	-0.4986	-0.4974
	(0.184)	(0.206)	(0.207)
ΔROA	0.0046	0.0258	0.0268
	(0.994)	(0.964)	(0.962)
ΔMarket-to-Book ratio	-0.0047	-0.0050	-0.0050
	(0.805)	(0.794)	(0.794)
ΔPPE	0.1296	0.1382	0.1441
	(0.735)	(0.717)	(0.706)
Foreign listings	1.2221***	1.2133***	1.2155***
	(0.000)	(0.000)	(0.000)
Industry Fixed-Effects	YES	YES	YES
Year Fixed-Effects	YES	YES	YES
observations	6,860	6,850	6,848
R-Squared	0.407	0.408	0.409
MIN VIF	1.396	1.396	1.396
MAX VIF	2.569	2.566	2.566

Table 14: Logistics regression of the lag level of foreign ownership on six individual corporate governance attributes. This table shows the estimated coefficients of the effect of changes in foreign ownership on current levels of Corporate Governance. In this case, we measure Corporate Governance by utilizing six different individual attributes. The individual attributes are defined as follows. Fraud is equal to 1 if there was no case of corporate fraud for firm i in year t. RTP is equal to 1 if net other receivables over total assets is lower than the median in year t. RTP2 is equal to 1 if guarantees over total assets is lower than the median in year t. Foreign auditor is equal to 1 if the firm had a foreign auditor or domestic branch of foreign auditor in China. Board size is equal to 1 if the board size of firm i is higher than the median in year t. Board Meeting is equal to 1 if the total number of board meetings of firm I, is less than the mean value of year t. (See Corporate Governance Index for more detailed definition). The independent variables of interest are Foreign Ownership T-1 and Foreign Ownership T-2, which are respectively equal to the T-1 lagged and T-2 lagged values of foreign ownership. Refer to the appendix for the definition of the remaining control variables. All control variables are lagged, and both Industry and Time-fixed effects are added to the regressions. *, **, *** indicate significance of respectively 10%, 5%, and 1%.

Proc logistic	**Fraud (1)**	**RTP (2)**	**RTP2 (3)**	**Foreign Auditor (4)**	**Board Size (5)**	**Board Meeting (6)**
Intercept	1.1922**	2.043***	-2.1579***	-22.200***	-9.7266***	2.2456***
	(0.050)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Foreign Ownership T-1	-0.0020	-0.0016	0.0255***	0.0167**	0.0142**	0.0143**
	(0.816)	(0.874)	(0.000)	(0.027)	(0.019)	(0.012)
Foreign Ownership T-2	0.0011	-0.0012	0.0007	0.0108	0.0006	-0.0044
	(0.906)	(0.910)	(0.912)	(0.179)	(0.919)	(0.465)
Domestic Ownership	-0.0022	-0.0207**	-0.0065	-0.0134	0.0206***	-0.0128**
T-1	(0.784)	(0.011)	(0.239)	(0.269)	(0.002)	(0.018)
Domestic Ownership	0.0025	-0.0002	0.0004	-0.0052	0.0031	-0.0055
T-2	(0.759)	(0.983)	(0.939)	(0.672)	(0.648)	(0.305)
Size	0.0306	-0.0701**	0.0184	0.9183***	0.3514***	-0.133***
	(0.290)	(0.018)	(0.342)	(0.000)	(0.000)	(0.000)
Growth	-0.0192	-0.011	-0.355***	0.1638	0.0921	-0.593***
	(0.785)	(0.876)	(0.000)	(0.332)	(0.226)	(0.000)
Leverage	0.0282	-0.0090	-0.0303**	-0.6046*	0.0486***	-0.0210
	(0.572)	(0.527)	(0.031)	(0.071)	(0.001)	(0.219)
Cash	-0.0753	2.624***	3.894***	0.4227	1.0161***	0.3858**
	(0.800)	(0.000)	(0.000)	(0.376)	(0.000)	(0.045)
ROA	4.2071***	6.7115***	4.1988***	3.963***	1.2689***	2.4943***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.010)	(0.000)
Market-to-Book ratio	0.0043	-0.0378**	0.1036***	-0.0446	-0.0496***	-0.0119
	(0.785)	(0.016)	(0.000)	(0.296)	(0.010)	(0.270)
PPE	0.0168	2.3735***	1.3768***	0.7409***	1.7305***	0.3947***
	(0.921)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Foreign listings	0.2786*	0.2904*	0.5273***	2.4121***	-0.0469	0.2497***
	(0.060)	(0.0733)	(0.000)	(0.000)	(0.645)	(0.000)
Industry Fixed-Effects	YES	YES	YES	YES	YES	YES
Year Fixed-Effects	YES	YES	YES	YES	YES	YES
observations	8,737	8,705	8,537	8,737	8,708	8,732
Likelihood Ratio	79.53	393.94	825.56	2065.24	712.28	193.24

Table 15: Overview of investor activism cases between 1994-2014

*The following table gives an overview of all investor activism cases, the companies and investors involved, the type of activism, and the outcome from the year 1994 and until 2014. The cases annotated with a * are the ones with at least one foreign investors involved. F = failure, N = Unknown, S = Success.*

Year	Case	Topic	Type of activism	Outcome
1994	*China Vanke v Guotai Junan Securities*	Regrouping of board of directors	Press conference	F
2000	*Hubei Xingfu v Mingliu Investment Company*	Regrouping of board of directors	Call for shareholder meeting and proposal	S
2002	*ZTE v Da Cheng Fund Management*	Voting against the issuance of H-shares	Proxy voting (Joint effort)	S
2003	*China Merchant Bank v China Asset Management*, NSSF and Shiji Securities*	Voting against the issuance of securities	Private meeting and Proxy voting (Joint effort)	S
2004	*China Vanke v China Asset Management*, China Southern Asset Management and Bosera Asset Management*	Amending articles	Call for shareholder meeting and proposal	F
2004	*Chongqing Baihuo v Huabao Xingye Asset Management**	Voting against the issuance of new shares	Proxy voting (Joint effort)	S
2007	*Yinchuan Guangxia v Da Cheng Investment Fund*	Suing for misrepresentation	Legal action	S
2008	*Pingan China v Da Cheng Investment Fund and Lion Fund Management*	Voting against proposal to refinance	Proxy voting	F
2008	*Eastern Airline v Rongtong Asset Management**	Voting against a merger with Singapore Airlines	Proxy voting	S
2008	*Saima v Shanghai Baoyin Investment and Consulting Company*	Proposals to improve corporate governance and elect new directors	Private meeting and shareholder proposal	F
2010	*Shuanghui v Harvest Asset Management* and Bosera Asset Management*	Rejecting multiple proposals	Proxy voting	S
2011	*Xiaxin Electrical v Shenzhen Hongshan Investment*	Suing for misrepresentation	Legal action	S

2011	*Shanghai Wenhui Xinmin v Aegon Industrial Fund Management* and Orient Securities*	Promoting the enactment of certain promises	Press conference (Joint effort)	S
2011	*Dashang v Shenzhen Heying Asset Management and Penghua Asset Management**	Proposing to incentive management	Shareholder proposal (Joint effort)	S/F
2012	*Chongqing Beer v Da Cheng Investment Fund*	Proposal to remove director	Shareholder proposal	F
2012	*Gree Electric Appliance v Penghua Asset Management* and Yale Endowment Fund**	Voting against appointment of director and proposing own candidate	Proxy voting and shareholder proposal (Joint effort)	S
2012	*Beiyinmei v JVR International*	Proposing corporate operational strategy	Shareholder proposal	N
2012	*Zhejiang Huahai Pharmaceutical v Fullgoal Fund Management* and Lion Fund Management*	Voting against the proposal to remove a director	Proxy voting	S
2013	*Shanghai Jahwa v Fullgoal Fund Management*, Huitianfu Fund management and Huashang Fund Management*	Proposing amendments to the articles of association and proposal to elect director	Shareholder proposal (Joint effort)	S
2013	*Dashang v Fuguo Fund Management*	Voting against merger proposal	Proxy voting	S
2013	*China Merchant Bank v Anbang Insurance Group*	Proposing new directors	Shareholder proposal	F
2014	*Chongqing Taiji Industry v Baoying Fund Management*	Voting against several proposals	Proxy voting	S
2014	*Minsheng Bank v Anbang Insurance Group*	Proposing new directors	Shareholder proposal	S
2014	*Unknown v Zexi Investment Fund*	Proposing company operational strategies	Shareholder proposal	S
2014	*Unknown v Zexi Investment Fund*	Proposing company operational strategies	Shareholder proposal	N
2014	*Gongda Shouchuang v Zexi Investment Fund*	Proposing restructure of Board of Directors	Shareholder proposal	N

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