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A Brief Analysis of the Reasons and Preventive Measures for the Loss of Assets in China's Mixed-Ownership Reform: The Case of the CITIC Guoan Group in China

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Abstract

To establish a perfect socialist market economy system with Chinese characteristics, the reform of mixed ownership of state-owned enterprises has been the general trend. The original intention of the mixed-ownership reform of state-owned enterprises is to reform the disadvantages of the full ownership of state-owned capital, absorb the advantages of private enterprises, realize the purpose of improving the operating conditions of enterprises and improving the efficiency of enterprises, and better serve the Chinese economy. However, in the process of practical operation, the mixed-ownership reform of state-owned enterprises has sometimes become a tool to enrich the pockets of a few people, resulting in serious losses of state-owned assets. It is urgent to establish an effective and feasible reform system to prevent the loss of state-owned assets.

Keywords: State-Owned Enterprises, Reform of Mixed Ownership, Loss of State Assets

Background

Since the establishment of the socialist market economy system with Chinese characteristics at the 14th national congress of the communist party of China (CPC) in 1992, the scale of the mixed-ownership reform of state-owned enterprises has been expanding day by day. On November 12, 2013, the third plenary session of the 18th CPC central committee adopted the decision of the CPC central committee on some major issues concerning comprehensively deepening the reform, which takes the development of the mixed-ownership economy as one of the priorities of the reform in the new era, thus kicking off a new round of mixed-ownership reform of state-owned enterprises. On August 24, 2015, the guiding opinions on deepening the reform of state-owned enterprises (hereinafter referred to as the "opinions") issued by the CPC central committee and the state council also showed the determination of the central government to further deepen the reform of state-owned enterprises. Jia (2020) considered that while enjoying the benefits brought by the mixed-ownership reform of state-owned enterprises, we cannot ignore one of the major risks -- the loss of state-owned assets. The guideline also said the supervision system of state-owned enterprises should be further improved to prevent the loss of state-owned assets and ensure their value is maintained and increased. This paper will specifically analyze the risk of the loss

of state-owned assets in the process of the mixed-ownership reform of state-owned enterprises and put forward some preventive measures.

1. Case analysis of the mixed-ownership reform process of CITIC Guoan Group

The following author will take the concrete process of the mixed-ownership reform of CITIC Guoan Group as an example to discuss the real cause of the loss of state-owned assets. Before the mixed-ownership reform, CITIC Guoan Group was fully controlled by CITIC Guoan Group, a subsidiary of the ministry of finance, and was wholly state-owned.

At the beginning of 2014, CITIC Guoan Group held a general meeting of shareholders and voted to transform the company from a sole proprietorship to a joint-stock liability company. Then in August 2014, CITIC Guoan Group group released information that the group would complete the mixed-ownership reform, this reform will introduce five private capital, after the reform CITIC Guoan Group's shareholding ratio will be changed from 100% full control to 20.945%. The base date of the reorganization of CITIC Guoan Group is December 31, 2012. On that day, the combined net assets of CITIC Guoan Group are 15.5 billion yuan, and the net assets belonging to CITIC Guoan Group are 1.06 billion yuan. Based on the evaluation value, in October 2013, CITIC Guoan Group and five private investors jointly signed the agreement on the capital increase and share expansion of CITIC Guoan Group co., LTD. The five investors added 8 billion yuan in cash to CITIC Guoan Group, occupying nearly 80% of the shares. After the mixed-ownership reform, the ownership structure of private capital is shown in the following figure.

Table 1: CITIC Guoan Group after the reform of the non-public part of the shareholding structure

Stockholders	Shareholding ratio (%)	Capital contributions (billion yuan)
Heilongjiang Dingshang decoration engineering co. LTD	19.76	20.00
Trust King Group	17.79	18.00
Senyuan Group	15.81	16.00
Beijing Qianrong investment (group) co. LTD	15.81	16.00
Tianjin Wanshun property co. LTD	9.88	10.00
Total	79.06	80.00

Of the 8 billion yuan invested by the five private companies, 5.662 billion yuan was recorded as paid-in capital, and the remaining 2.338 billion yuan was recorded as capital reserve. The registered capital of the CITIC Guoan Group increased from 1.5 billion yuan to 7.617.7 billion yuan, and the capital reserve increased from 0.35 billion yuan to 2.7323 billion yuan. After the mixed-ownership reform, the net assets of CITIC Guoan Group increased from 15.5 billion yuan to 23.8 billion yuan, of which the original parent company CITIC Guoan Group holds 20.945% shares, totaling 5 billion yuan, and the five private capitals hold 79.055% shares, totaling 18.8 billion yuan.¹

Since the mixed-ownership reform only conducted a transaction but has not yet entered the real operation stage, we can conclude that five private capital by buying the shares of CITIC Guoan Group will increase the assets of more than 10 billion yuan. Thus it can be seen that in the process of the mixed-ownership reform, CITIC Guoan Group has a huge gap in its value estimation, resulting in a huge amount of state-owned assets being sold at a low price, which has caused a serious loss of state-owned assets. Under CSRC rules, there is a 12-month lock-up

¹Data from the official website of CITIC Guoan Group

period for the shares.²But as soon as the lock-up period ended, four of the five investment firms cashed out of their holdings in CITIC Guoan Group, making huge profits in a series of share changes that eventually led to their exit.

Looking back at the case of the mixed-ownership reform that caused the serious loss of state-owned assets, we can find that the role of China United Assets Appraisal Group as the fair value appraiser of assets and the role of SASAC and the ministry of finance as the auditor of the reform is virtually empty. And CITIC Guoan Group has not fully disclosed all the necessary information, for information disclosure obligations prescribed by the CSRC provisions promulgated by the state council and the "proposed by capital and share the implementation of the restructuring of enterprises, should be through the property rights trading market, the media, or network public enterprise restructuring information on situation, investors, merit-based investors" rules.ⁱⁱⁱHere we have too much discussion on whether there is any fraud in the management, but the lack of information disclosure and wrong judgment on asset valuation are the important reasons for the major loss of state-owned assets. Besides, we should also see that after the loss of state-owned assets, no individual is responsible for it.(Mai,2016)

According to a large number of cases of mixed-ownership reform, much private capital, especially investment companies, choose to cash out in a short time after passing the lock-up period, which also reflects the motivation of much private capital to participate in the mixed-ownership reform. Since the stock market is a zero-sum game mechanism, and the opposite of an investment company is state-owned assets and the majority of small and medium-sized investors, this way of arbitrage is bound to harm the interests of the state and the masses of the people.(Tang,2015) We can even further deduce that for investment companies, the motivation for them to enter the mixed-ownership reform market is the profit, the low price of entry and the high price of exit, which is a monopoly rent-seeking opportunity. If shares in state-owned enterprises are only allowed to be bought by private companies at fair value, there is no speculation. To sum up, in the implementation process of mixed-ownership reform, some private capital does try to fish in troubled waters and make profits by earning price difference in a short time, and this kind of profit-seeking behavior will put forward a huge challenge to the original intention of mixed-ownership reform to maintain and increase the value of state-owned assets.

2.Reasons for the loss of state-owned assets

2.1 Theoretical reason based on the case of CITIC Guoan Group

According to the profit equalization theory of Marxist political economy, in the market of free capital flow, no matter which production sector, will comply with the average profit margin of a society. Therefore, we can infer that in the process of the mixed-ownership reform of some state-owned enterprises, the non-open non-market transaction is the reason why individuals or enterprises grab huge profits and cause the loss of state-owned assets. Taking the case of mixed-ownership reform of CITIC Guoan Group as a typical analysis, there are two main ways to drain state-owned assets:

One is that state assets are undervalued. And this kind of undervaluation of asset value often comes from the information asymmetry in the reform. Before the implementation of mixed-ownership reform, state-owned enterprises were fully controlled by the state, and there may be incomplete risks in terms of information disclosure. Based on the situation that the ownership agents and operators of state-owned enterprises are often the same part of people, the internal business information of enterprises, such as the true price of assets, the true benefits of enterprises, etc., are often in the hands of this part of people. (Zhang,2014)Therefore, when entering the market transaction stage, a foundation of information asymmetry is created. In the process of the reform in the national security group, for state-owned assets valuation problem has not been a clear measure, after fulfilling the reform only roughly by the publication of five private capital investment and asset values, and in addition to financial data released parts subsidiary, the national security group also does not release its full asset information. However, compared with the financial statements of CITIC Guoan Group in previous years, the actual amount of state-owned assets after the reform is far from the amount of state-owned assets. As a result of

information asymmetry, SASAC and other departments as regulators and other transaction participants in the market may not have a clear understanding of this part of real information, and cannot carry out good political supervision and market competition, thus creating loopholes for the loss of state-owned assets. In essence, this kind of loss means that a few people grasp the information advantages that others do not have, and use these advantages to seek benefits unknown to others, resulting in the loss of state-owned assets.

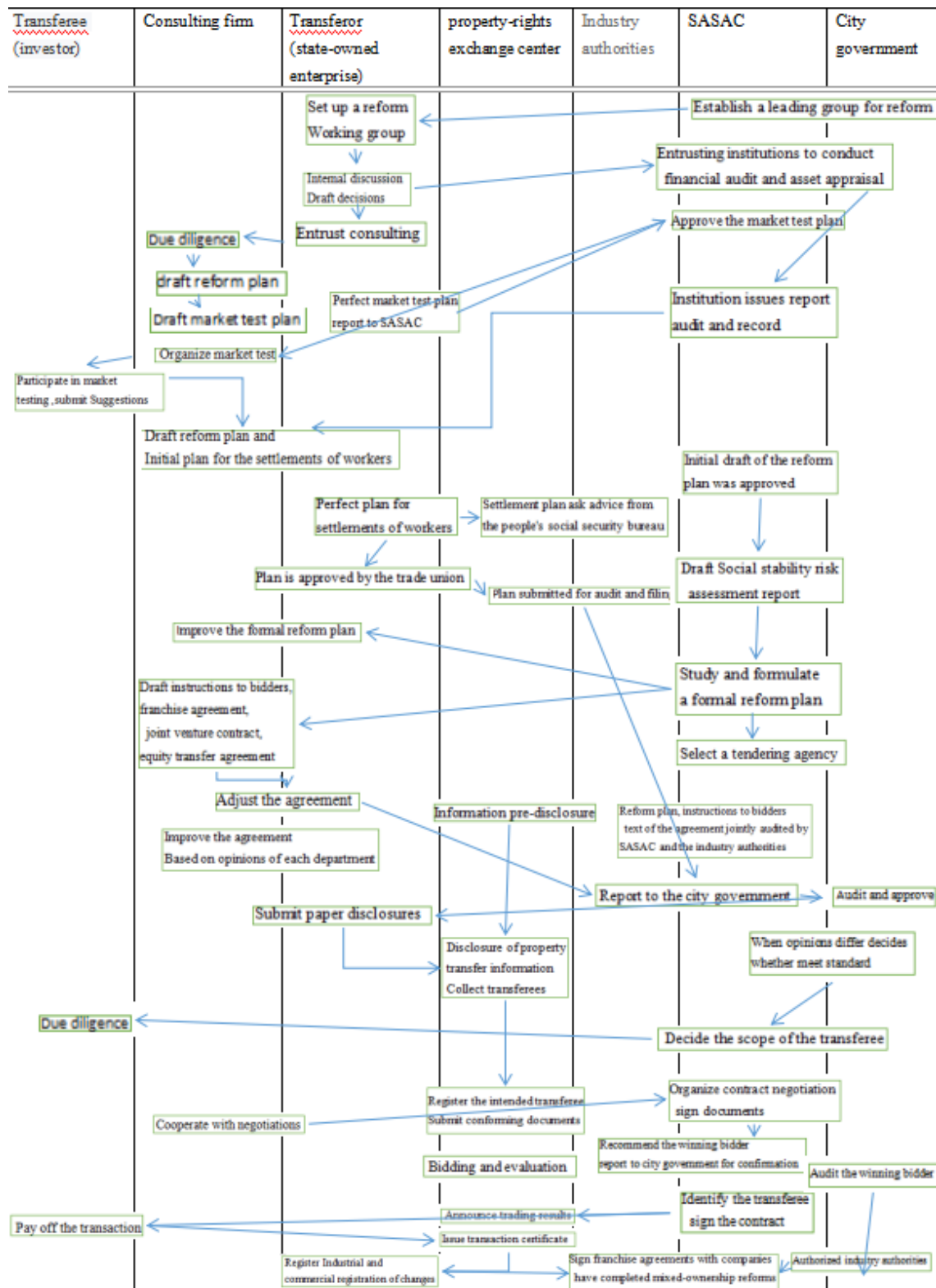
The second is that there are non-market backroom deals. In an open market with full flow of resources, if there is a transaction in one market with a profit margin much higher than that in other markets, then the flow of resources in the market will flood into the transaction, and the profit margin will be reduced to the normal level through the influence of supply and demand. In this case, the asset loss behavior in the reform of state-owned enterprises will attract a large number of private resources to flood in(Huang,2014), and the price of state-owned assets will be pushed up again through market adjustment, thus blocking the trend of state-owned assets loss. However, in the case of CITIC Guoan Group, the introduction process of the five private capital was not disclosed. It was not until August 2014, when the reform was almost completed, that the two listed subsidiaries of CITIC Guoan Group disclosed the information of the five private capital involved in the reform, which led to the suspicion of whether there was a behind-the-scenes transaction. In behind-the-scenes trading, the actual controllers of some state-owned assets have the power to decide the trading object, trading mode and trading price. Through non-market behind-the-scenes trading, private capital can acquire a large number of state-owned assets at the cost of market law. This loss of state assets is due to the excessive government power in the transaction stage of reform, but the reason for this monopoly is not the government itself, but the improper use of government power by a few people.(Zhang,2009)

In addition to the above two reasons, many other reasons cause the loss of state-owned assets, such as the personal corruption of managers and the deadweight loss caused by the poor efficiency of reform, etc., but these are not the behaviors in the transaction process, nor are they the main reasons that cause the loss of state-owned assets. This paper will not make further analysis.

To sum up, the above two reasons for the loss of state-owned assets are, in the final analysis, non-public and non-market behaviors in the process of reform. This article will further analyze the more general process of mixed-ownership reform, find the reasons that are applicable to explain most cases of state-owned assets loss and develop a universal solution.

2.2.Reasons based on Specific process of reform

At present, there are three specific ways to carry out the mixed-ownership reform in the market: state-owned enterprises transfer equity to private capital, state-owned enterprises purchase the equity of private enterprises through private placement, the state capital and employees' equity in state-owned enterprises.Tang(2020)concluded that in these three specific ways, there are more or fewer loopholes that lead to the loss of state-owned assets. The most common form of reform is the transfer of equity from state-owned enterprises to private capital. By analyzing the specific process of state-owned enterprises transferring equity to investors, we can observe how the risk of specific loss of state-owned assets is generated. The following chart is a flow chart of the basic mixed-ownership reform of municipal state-owned enterprises.



As can be seen from the figure, the process from proposing the reform plan to the completion of the reform can be mainly divided into two steps: one is the steps of government behavior, and the other is the steps of market behavior. The three parties leading the reform are SASAC, state-owned enterprises, and investors. Through the comparative analysis of these three parties, it can be found that the internal personnel of state-owned enterprises, as the managers and operators of state-owned assets, have natural advantages in information, while the private capital in SASAC and the general market participating in the transaction, as the regulator, have limited access to information. The reason is that SASAC is not personally involved in the daily operation and supervision of enterprises, and its access to information is often through the reporting of enterprise operators. Private capital in the market can only understand the assets of state-owned enterprises through their information disclosure, which

is often incomplete from the perspective of the reform process of the CITIC Guoan Group. This information asymmetry, in turn, provides the basis for potential back-room deals.

Here the loss of state-owned assets can be divided into active loss and passive loss. The loss of initiative refers to that the insiders of state-owned enterprises seek profits by taking advantage of their information advantages and potential power to carry out behind-the-scenes transactions(Guo et al,2019). When the enterprise operators have a moral hazard, it is difficult for SASAC to deeply identify the authenticity of the information they provide, and it is also difficult to supervise whether they carry out behind-the-scenes transactions. Once the enterprise operators collude with individual investors, or further collude with third-party evaluation institutions, the state-owned assets will face the risk of serious loss. Passive loss refers to the failure of some local departments or enterprises to make a detailed assessment of state-owned assets to quickly complete the task of mixed-ownership reform, and the wrong prediction of the value of state-owned assets, resulting in the sale of state-owned assets at a low price. In either case, there is a lack of information that is not fully available to all parties. Most cases of the loss of state assets can be attributed to the fact that the assets were not accurately valued and disclosed, and that the few people holding the power of the government decided the detailed process of the transaction, such as the price and the object, under incomplete conditions.

We can split the whole process into two parts: the government and the market. At the government level, on the one hand, the government fails to fulfill its duty of breaking down information barriers and maintaining a free competitive market, which is the traditional work of "night watchman". On the other hand, the government's power is excessively expanded. It crosses the boundary of "night watchman", and some people use the government's power to gain a dominant position in market transactions, such as pricing power. This dominant position is supposed to be a seller's monopoly market of state-owned assets, and the government can use this dominant position to maximize the national interests(Wang,2019).However, the reality is that a few people with such power only realize the maximization of their interests, and it is a loss for the country to sell off state-owned assets for personal interests. From the perspective of the market, the market should have determined the equilibrium price of the transaction in the process of the transaction, to realize the reasonable allocation of resources, but in the process of the mixed-ownership reform, the market's role of such decision is deprived by the government's power. Mixed ownership reform is an important stage to realize the marketization of the economy, but the process of implementation is so non-marketization.

To sum up, in the process of implementing mixed-ownership reform, the government, on the one hand, controls too little, resulting in information barriers, on the other hand, controls too much, depriving the market of the function of resource allocation, resulting in the loss of state-owned assets.

3.Ways to improve the system of preventing the loss of state-owned assets

To solve the problem of the loss of state-owned assets, we must solve two key points: "who will manage" and "how to manage". To sum up, the reason for the loss of most state-owned assets lies in the information asymmetry and non-market transaction. To avoid the loss of state-owned assets to the greatest extent, we should focus on these two points.

At present, most of the Suggestions of the mainstream public opinion on this issue are that the state should strengthen the control, establish more detailed management methods, refine the asset accounting, and implement more strong supervision measures on state-owned enterprises. Specific measures might include: perfecting the relevant laws and regulations of the legislative work, standardization of enterprise assets evaluation criteria, in the enterprise internal-external build more regulators or is it strengthens the audit of circulation of state-owned assets, such as setting up a state-owned asset valuation and price difference of the legal scope, responsibility, and penalties for violators. These measures are of course beneficial, and to some extent they can indeed alleviate the problem of the loss of state-owned assets.

In fact, for a long time, the legislative supervision of such issues has been gradually promoted. The law on state-owned assets of enterprises clearly defines the above issues, such as information disclosure, asset accounting,

equity transfer method, and operator supervision.ⁱⁱⁱIn the following ten years, various supplementary provisions based on the spirit of the law on state-owned assets of enterprises have been successively introduced. Facts have proved that the establishment of these provisions does not fundamentally prevent the loss of state-owned assets.

In many market models, only one model does not have monopoly behavior, that is, the free competitive market. Although there is no condition to constitute a free competition market in reality, the closer a market is to free competition, the less likely monopoly will appear. It is also important to recognize that most monopolies arise because governments have crossed the line of "night watchmen" and intervened in the market. As in mixed-ownership reform, part of the business operators to master the power of the government is too big, they have the freedom to exercise power to determine matters such as stock issue price, the information disclosed object, although this is not the power of the government's original intention, but essentially, they represent the government determines which private capital have the right to participate in, the resulting nonmarket transactions.

By comparing the state intervention and the free market can have more effect on the trading behavior of mixed-ownership reform, we can see that the country's legislation and controls are always asked for a universal, if specific to an industry, a company, the assessment of the value of state-owned assets and the current price differences within the scope of what is feasible? Is this standard applicable to another industry or company? Zheng(2014) reckoned that the real economic situation is always complex and changeable, while state control is fixed and cannot be changed in a short time. When it comes to every micro-economic decision, the market naturally has more flexible advantages than the government. The market of information flow can price every specific state-owned asset more accurately than the government so that every transaction is in an equilibrium state. All the government needs to do is to ensure that the market takes full advantage of this(Duckett.,2001).The loss of state-owned assets is essentially caused by the government. Relying on the government to further control cannot fundamentally solve the problem. Meanwhile, the cost of supervision is gradually increased. On the contrary, if the force of the market can be used at this time, it can often return to the market equilibrium.

Imagine such a situation: when a when facing mixed-ownership reform of state-owned enterprises and all potential participants of the market, access to all information provided by the government, the market access system and be relaxed at the same time, so when the possibility of a state-owned asset sale, all the capital market will flock to the unbalance of supply and demand relations will push the state-owned assets back to the real price level.

To sum up, it is inevitable to establish an open and free market system to solve the problem of loss of state-owned assets in the reform of mixed ownership. Mixed ownership reform is essentially the process of marketization of non-market enterprises. In this case, it is more necessary to adopt the marketization approach. Hayek(1984) argued that the more imperfectly competitive the market, the greater the benefits of competition. There is inevitably no perfect competition, but it cannot be regarded as the reason for not implementing the competition system. Market allocation of resources is often more efficient in the subtle and subtle areas that are hard to reach directly. The specific approach is that the country only needs to do a full disclosure of information and relax the market access system, pricing and trading rights back to the market. The transaction of state-owned assets, each item should be fully complete message to the society of private capital, and make the selection of appropriate response to the market price and computation, can also set up a standard auction of state-owned assets of the trading system, by private capital rising price is to avoid unreasonable price for holes on state-owned assets. Such market-determined transactions can largely push the value of state assets to a market-recognized equilibrium price.

This measure can be compared to the stock market IPO pricing system from fixed price to inquiry. First, to set up the system of the stock market in China, the issue of new shares tend to adopt the model of a fixed price, the resulting defects is the issue of stock prices sometimes serious deviation from the real value of the company, that occurs after the listed stock value is not reasonable and unreasonable fell, serious when even appeared after value into one over ten or more than ten times. To solve this problem, the securities and futures commission promulgated the several problems about IPO trial inquiry system notice, "notice" provisions of the companies

issuing new shares for the first time, have to comply with the China Securities Regulatory Commission (hereinafter referred to as the CSRC requirements as prescribed in the securities investment fund management companies, securities companies, trust investment companies, finance companies, insurance institutional investors and qualified foreign institutional investors (QFII), and other institutional investors approved by China Securities Regulatory Commission for inquiry, with the result of the inquiry as to the stock price and decided to purchase the important basis of the object.^{iv}This is the return of pricing and trading rights to the market. From the implementation of the effect, this measure did play a stabilizing role in the stock market.

In fact, in the current mixed-ownership reform of state-owned enterprises, some enterprises do use the IPO listing procedure, but there are also defects of the complex internal structure of state-owned enterprises and insufficient information disclosure, which make this procedure fail to fully play its role. To this end, the government still needs to further improve the relevant system, should grasp, should let go, to build a more adequate competitive market, to fundamentally cut the seeds of monopoly, from the source of blocking the loss of state-owned assets.

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