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Analysis for Enterprise Financial Distress in Southern Hunan Province and Its Countermeasures

---Case Study on Jingui Silver Industry and Hunan Chendian International

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Abstract. Since the outbreak of global financial crisis caused by the sub-prime crisis in the United States, the world economy is still at the recovery phase. China has also been deeply influenced. In recent years, China's GDP is growing up slowly, while the general economy is falling down. Under such big market environment, many listed companies are facing with the ST circumstances in terms of finance. Of course, the financial distress of a company may not only be influenced by external environment, but also many other internal reasons. Therefore, in order to help companies get out of the distress, it is extremely important to analyze the financial distress. Taking Jingui Silver Industry and Hunan Chendian International as objects, this paper analyzes the enterprise financial distress in Southern Hunan Province and its countermeasures through extracting the financial statement data analysis in 2015-2016.

Introduction

From Beaver's[1] first use of single variable financial distress prediction model in the 1960s to Altman's[2] multivariable financial distress prediction model, and from Martin's[3] establishment of Logistic model for the first time to frequent application of artificial neural nets and genetic algorithm, people's effectiveness and accuracy for analyzing financial distress has been continuously improved. However, there is no model that can perfectly deduce financial distress, and each model has its own strengths and weaknesses. Through conducting sample tests on several companies in the United States, Martin and Ohlson[4] got the conclusion that Logistic features higher accuracy as financial distress prediction model. Likely, in China, by contrasting single variable analysis and multivariate linear decision for the same sample company, Chen Jing[5] (1999) concluded as follows: in single variable analysis, the misjudgment rate of liquidity ratio and debt ratio is lower than others. While multivariate linear decision indicates that six indicators, including debt ratio, rate of return on common stockholders' equity, liquidity ratio, working capital/ total assets, and turnover of total capital, may predict ST company in the first three years of suffering financial distress. Through establishing models and testing by multivariate discriminant analysis, Gao Peiye and Zhang Daokui[6] (2000) found out that the functional model constructed by retained earnings/ total assets, profit before interest and tax/ total assets, sales revenue/ total assets, asset-liability ratio, and working capital/total assets can achieve good prediction effect. By making use of profile analysis, single variable analysis, linear probability model, and Logistic model, Wu Shinong[7] (2003) studied on the corporate financial distress of 140 A stock ST companies in 1998-2000, reaching a conclusion that Logistic model's accuracy rate for predicting the data in previous year is as high as 93.53%. In a word, numerous studies and researches have proved the accuracy and reliability for the prediction of Logistic model.

Literature Review

Study on countermeasures of enterprise financial distress

According to the research ideas of Sudarsanam and Lai (2001), it concludes and summarizes the countermeasures for enterprise financial distress from four dimensions, which are corporate governance reorganization, strategy, operation, and reorganization, assets reorganization, as well as financial restructuring.

Corporate governance reorganization. The core issue of corporate governance reorganization is the alteration of management layer. According to organizational change theory, Daily and Dalton (1994) found out that distressed companies would usually make reformation, and most common reformation is the change of management layer. Gilson (1990a) found out that after reorganization, large numbers of previous board members of financially distressed companies would quit their jobs, and more talents with professional skills will enter into the board of directors, such as investment bankers and reorganization experts. Gilson (1990b) found out that 52% sample companies with financial distress had suffered the change of management layer. Meanwhile, Zhu Hongjun (2002) found out that A stock listed companies with decreasing business performance would change their senior executives or directors more easily.

Strategy, Operation and Reorganization. The main purpose of strategy, operation, and reorganization is to obtain cash flow within short term, gradually improve the corporate performance, and enhance enterprise value. Kang and Shivdasani(1997) viewed that cost control is only effective for the companies with ill management. Dai Deming and Deng Fan (2007) found out that A stock listed companies with deficit might improve their corporate performance by changing operation strategies, and adjusting operation strategies has positive influence on enhancing corporate performance.

Assets Reorganization. Assets reorganization consists of stripping off business segments/ subsidiaries or increasing new investment. Liao Li and Zhu Zhengqin (2004) found out that assets reorganization is a common way for companies to improve their business performance. Through analyzing six enterprises applying for bankruptcy, He Xuqiang and Zhou Ye'an (2006) concluded that assets replacement and changing owners are major means for enterprise reorganization. Meanwhile, the good performance after reorganization can last for a long time. Fan et al.(2013) came to a conclusion that the listed companies with default on bank loans would usually deal with financial distress through selling assets.

Financial Restructuring. Financial restructuring includes debt-to-equity swap, settlement, or debt restructuring. Gilson et. al. (1990) concluded that the companies with more intangible assets, more bank loans, and fewer creditors are more likely to restructure their debt. What's more, securities market can recognize those companies with successful reorganization. Xie De'ren and Zhang Gaoju (2007) reported that financial restructuring has become a significant reorganization method for A stock listed companies with financial distress.

Case Introduction

Jingui Silver Industry. Chenzhou Jingui Silver Industry Co., Ltd. ("Company" for short) is a high-tech enterprise that mainly produces high purity silver and further processes silver products. It is also one of the important bases for silver production and export in China, boasting leading smelting and deep processing technology in China, with annual silver output ranking top list among similar enterprises in China. Besides, it is a business with large output value, profit, tax, and foreign exchange earnings, as well as one of the top 100 industrial enterprises in Hunan Province, and among top 30 private enterprises in Hunan Province.

Table 1 Related Financial Statement Data of Jingui Silver Industry in 2014-2016 (unit: yuan)

Year	2014	2015	2016
Sales revenue	4121422340.32	5116061912.67	6662082092.71
Net margin	121916061.88	119750426.87	143859622.72
Earnings per share	0.53	0.24	0.29
Net asset per share	8.16	3.92	4.19
Return on equity	11.20%	11.80%	14.82%
Asset-liability ratio	67.13%	68.24%	72.20%
General assets	5676461114.31	6216961853.31	7577883354.88
Long-term liabilities	1017235467.92	993798591.59	2087422979.52
Total liabilities	3810708988.10	4242924580.02	5471454354.67
Shareholders' equity	1865752126.21	1974037273.29	2106429000.21
Equity to debt ratio	48.96%	46.53%	38.50%
Rate of return on common stockholders' equity	6.53%	6.07%	6.83%
Turnover of total capital	72.61%	82.29%	87.91%

Data resource: publicly announced financial reports from Jingui Silver Industry for past three years

Table 1 illustrates that for the past three years, the sales revenue, return on equity, asset-liability ratio, general assets, long-term liabilities, total assets, shareholders' equity, and turnover of total capital have increased year by year. Nevertheless, earnings per share, net assets per share, and equity to debt ratio have continuously decreased. Meanwhile, net profit and rate of return on common stockholders' equity have presented wave shape.

Hunan Chendian International. Hunan Chendian International Development Co., Ltd. ("Chendian International" for short) was mainly sponsored by original Chenzhou Electric Power Company in December 2000. It is a joint stock limited company by associating four local power enterprises, such as Yizhang County Electric Power Co., Ltd., Linwu County Water Conservancy and Electric Power Co., Ltd., Rucheng County Water Conservancy and Electric Power Co., Ltd., and Yongxing County Water Conservancy and Electric Power Co., Ltd, together with the United Nations international center for small hydropower. It is also a large local independent distribution enterprise and A stock listed company. With electric power supply as its major business, the company also engages in power development, industrial gas manufacturing, and power equipment manufacturing. With registered capital of 210.27million yuan, this company boasts 5 branch companies, 6 subsidiaries, and joint ventures.

Table 2 Related Financial Statement Data of Chendian International in 2014-2016 (unit: yuan)

Year	2014	2015	2016
Sales revenue	1,870,479,871.96	1,863,588,801.70	1,989,245,414.53
Net margin	76,993,613.15	53,375,191.43	124,616,242.82
Earnings per share	0.29	0.20	0.47
Net asset per share	8.62	10.63	11.29
Return on equity	4.10%	1.95%	3.53%
Asset-liability ratio	61.17%	63.98%	68.79%
General assets	5,867,957,158.17	7,797,517,469.61	9,559,781,675.54
Long-term liabilities	2,289,718,471.01	3,713,350,347.92	4,744,753,785.35
Total liabilities	3,589,556,243.57	4,988,502,808.34	6,576,360,186.42
Shareholders' equity	2,278,400,914.60	2,809,014,661.27	2,983,421,489.12
Equity to debt ratio	63.47%	56.31%	45.37%
Rate of return on common stockholders' equity	3.38%	1.90%	4.18%
Turnover of total capital	31.88%	23.90%	20.81%

Data resource: publicly announced financial reports from Chendian International for past three years

Table 2 indicates that for the past three years, the earnings per share, net assets per share, asset-liability ratio, general assets, long-term liabilities, and total liabilities have increased year by year. On the contrary, net margin, equity to debt ratio, and turnover of total capital have reduced year by year. Meanwhile, sales revenue has basically remained unchanged, while return on equity and rate of return on common stockholders' equity have presented the state of wave shape.

Countermeasures and Suggestions

Chendian International and Jingui Silver Industry are the only two listed companies in Chenzhou. Therefore, sample analysis for the data of these two companies in past three years is representative for enterprises in Southern Hunan Province.

Financial distress is a dynamic process. Although financial distress and bankruptcy do not have inevitable causal connection, once enterprises fall into financial distress, it still deserves our concern. Only viewing from these two companies, the growth of assets is mainly achieved along with the increasing liabilities, and long-term liability is the major motivation of increasing liabilities. At the same time, Long-term liability's influence on enterprises mainly reflects on high interest charges.

From the perspective of favorable development of enterprises, it is necessary to put forward the following suggestions:

Government policies provide superior financing channels for enterprises. As Southern Hunan Province is staying at the key period of economic transition, local government should fully understand the actual operation of enterprises, conduct in-depth investigation and analysis for the development of the whole industry, as well as the enterprise positions, and also master the financing environment of enterprises. Meanwhile, through financing policies, the government should help enterprises get through the difficulties, actively introduce some experience and enlightenments from developed countries to support enterprises, and expand financial channels for enterprises to the largest extent.

Create favorable social credit guarantee system. Under the background of continuously consummating market economy, it has raised higher demand for the social credit of enterprises. However, solid credit guarantee system is one of the major routes to enhance enterprise credit, and it is the key content to realize sustainable and stable development of enterprises, which can effectively solve some difficult financing problems of small and medium-sized enterprises during the actual development process. Related practices state that credit guarantee has always been the enterprises with high risk coefficient. Therefore, during the actual guarantee process, we must prevent and control risks through scientific, reasonable, and standard financial management. In order to ensure the integrity and science of credit guarantee system, we must take the market access principle with high standards and strict requirements.

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