Clear progress in SOE reform

Debt risk level at central State-owned enterprises seen controllable in sustained drive to improve financials

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The 19th National Congress of the Communist Party of China, held last month, learned that since the last congress in 2012, as many as 34 central State-owned enterprises (SOEs) have been restructured, with their overall number falling to 98 from 117.

An outstanding feature of the ongoing SOE reform has been the sustained drive to improve the companies' financials, mainly through sophisticated debt management.

The reform, which went beyond mergers, acquisitions and rationalization, helped improve central SOEs' efficiency and competitiveness, thus bolstering China's long-term march toward emerging as the world's largest economy, overtaking the United States.

Central SOEs posted a record high net profit of 1.11 trillion yuan ($167.4 billion) from January to September, due to supply-side reforms, which helped bring down the asset-liability ratio requirement and curbed capital outflows.

As a result of the reform, financials of 2,041 "zombie companies", all subsidiaries of 81 major central SOEs, also improved, with their losses shrinking by 88.5 billion yuan compared with the same period two years earlier. (Zombie companies are economically unviable businesses, usually in industries with severe overcapacity, kept alive only with aid from the government and banks.)

China will accelerate its efforts to prevent systemic financial risks from arising and infecting the broader economy, said senior government officials during the 19th CPC National Congress.

The ongoing supply-side structural reform — cuts to overcapacity in certain sectors such as steel and coal — and more flexible financial policies, will be sustained, they said.

From January to August this year, debt risk at central SOEs was under control as these companies maintained a steady debt-to-asset ratio over the past five years, according to the State-owned Assets Supervision and Administration Commission (SASAC).

By end-August, the average debt-to-asset ratio of central SOEs dropped to 66.5 percent, 0.2 percentage points lower than the level at the beginning of this year.

"The debt risk level at central SOEs is reasonable and controllable," said Huang Danhua, vice-chairwoman of SASAC.

"Apart from asset restructuring, central SOEs can also direct their resources toward competitive companies or industries through equity cooperation, asset swaps, strategic alliances and joint ventures," she said.

MA XUEJING AND SU JINGBO / CHINA DAILY
Source: The International Federation of Robotics, and the Chinese Institute of Electronics

Under the government plan, debt-to-equity swaps will be pushed forward, with State investment funds encouraged to participate in the process. Central SOEs will speed up the pace of mergers and acquisitions, or M&As.

Already, the SOE sector has seen a merger of two of China's top high-speed train makers and another of two major steel producers.

To cut the leverage ratio, SASAC has also encouraged SOE behemoths to optimize capital structure via initial public offerings, and supported efforts toward asset securitization.

Huang said central SOEs have made headway in cutting outdated capacity, reining in debt risks and improving competitiveness.

Given the favorable conditions, more effort is needed to cut the debt level of SOEs and a guideline will be formulated, she said.

As the debt-to-equity program is considered a significant and efficient method to tackle debt woes, China Shipbuilding Industry Corp (CSIC), one of the Chinese Navy's biggest contractors, converted debt into equity by offering eight investors stakes in two of its unlisted subsidiaries for an estimated 22 billion yuan ($3.32 billion) in August.

This is the country's first defense-related enterprise supervised by the central government to restructure its finances via such swaps.

China Cinda Asset Management and China Orient Asset Management, two of the eight investors, will contribute around 5 billion yuan and 2 billion yuan, respectively, toward servicing debt of CSIC's Dalian Shipbuilding Industry Co and Wuchang Shipbuilding Industry Group Co. In return, they pick up equity in the two CSIC subsidiaries.

In the first nine months of this year, the government reached its goal of cutting 5.95 million metric tons of capacity of central SOEs in the iron and steel sector ahead of schedule. It also succeeded in cutting 23.88 million tons of coal overcapacity.

Zhou Xiaochuan, governor of the People's Bank of China, the central bank, said M&As remain an important way to rein in SOE debt, and should go hand in hand with efforts to cut outdated capacity.

"While opening up, China's financial sector must always stick to risk-management standards and shall not tolerate highly leveraged, low-capital and nonperforming loans," said Zhou.

Yin Zhongli, a researcher at the Institute of Finance and Banking at the Chinese Academy of Social Sciences, said technological breakthroughs should continue to be made in sectors riddled with overcapacity, and innovation should play a role in deleveraging as it helps improve corporate strength.

"The reform should be further expanded to more heavily indebted industries and real economy sectors with competitive products and good market prospects," said Dong Ximiao, a senior researcher with the Chongyang Institute for Financial Studies at Renmin University of China.

The mixed-ownership reform, which seeks to diversify the ownership structure of SOEs, has started

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