

Li Ning's financial dilemma research

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Abstract: This paper takes Li Ning as the research object, analyzes the countermeasures of financial distressed enterprises, and explains it from the perspective of property rights and government intervention. This paper finds that in order to deal with financial distress, companies need to conduct corporate governance restructuring, strategic and operational restructuring, asset restructuring and financial restructuring from a global perspective. In the reorganization, state-owned enterprises are more inclined to adopt non-marketization means such as related party transactions, while private enterprises pay more attention to the adjustment of company strategy and business strategy. The financial distress of state-owned enterprises should be significantly less costly than private enterprises. For financially distressed enterprises, government intervention is reflected in the “hand of support”. The “supporting hand” of government intervention is not only reflected in the soft budget constraints of state-owned enterprises, but also plays a role in private enterprises. However, investors' negative response to government intervention has led to the non-marketization of private companies' response to financial distress.

1. Introduction

The financial dilemma is that the company is unable to repay the debts due or the company's profitability continues to decline or even loses (Altman, 1968; Wu Shinong and Lu Xianyi, 2001). At present, the research results on financial distress mainly involve financial early warning, influencing factors and costs of financial distress (Altman, 1984; Lu Changjiang and Han Huibo, 2004). There are few studies on how to deal with financial distress. Moreover, the existing research mainly focuses on enterprises in developed countries, and the research conclusions obtained may not be suitable for enterprises in transition economies. China's transitional economy has the characteristics of weak property rights protection and serious government intervention. These problems make the financial distress of Chinese enterprises not only the commonality of Western financial distressed enterprises, but also the characteristics of enterprises in transition economies.

An important feature of China as a transitional economy is that enterprises can be divided into state-owned enterprises and private enterprises according to their property rights. These two types of enterprises have significant differences in ownership structure, agency costs, and corporate behavior decision-making. So, are there differences between the two types of companies in dealing with financial distress? Does government intervention have a significant impact on the financial distress of these two types of enterprises? The existing academic research does not answer these questions well, and this is also the concern of the practical community. Important topic. This paper hopes to explore how companies can cope with financial distress and the nature of property rights and the impact of government intervention on corporate financial distress through Li Ning's case study.

The case study selected in this paper is: Li Ning Co., Ltd. ("Li Ning Company"), which is a typical representative of private enterprises in financial distress, and has a complete research element on how to deal with financial distress, so the research on this company can be more Comprehensively demonstrate the behavioral characteristics of private enterprises in dealing with financial distress.

Through case studies we found that:

Corporate financial distress response is a systematic restructuring of the enterprise, which requires fundamental adjustments from multiple dimensions such as corporate governance restructuring, strategic and operational restructuring, asset restructuring and financial restructuring.

Private enterprises pay more attention to the adjustment of corporate strategy and business strategy.

For companies in financial difficulties, government intervention is mainly a “supporting hand”. The “supporting hand” of government intervention will play a role in private enterprises. However, investors' negative response to government intervention has led to the non-marketization of private companies' response to financial distress.

The theoretical research contributions of this paper are mainly reflected in the following aspects:

(1) This paper systematically studies how companies deal with financial distress from the four dimensions of corporate governance restructuring, strategy and operational restructuring, asset restructuring and financial restructuring, emphasizing that corporate financial distress should break through the limitations of financial restructuring or reorganization of a certain aspect, and expand The theoretical framework of financial distress research has enriched the relevant theories of financial distress research.

(2) This paper studies the measures, costs and economic consequences of enterprises' financial difficulties in the context of government intervention, and provides case evidence support for the dispute between “the theory of government plundering hands” and “the theory of government support”.

2. Literature Review

2.1 Research on countermeasures for financial distress in enterprises

Drawing on the research ideas of Sudarsanam and Lai (2001), we summarize the countermeasures of financial distressed enterprises from four dimensions: corporate governance restructuring, strategy and operational restructuring, asset restructuring and financial restructuring.

(1) Corporate governance restructuring

The core of corporate governance restructuring is management change. Daily and Dalton (1994) based on organizational transformation theory found that distressed companies tend to change, the most common is to change management. Gilson's (1990a) study found that after the financial distressed company was reorganized, the company's original board members were heavily resigned, and more professionals with professional skills, such as investment bankers and restructuring experts, entered the board of directors. Gilson (1990b) found that 52% of the financial distress sample companies experienced management changes. Zhu Hongjun (2002) found that A-share listed companies with declining operating performance were more likely to change executives and directors.

(2) Strategic and operational restructuring

The main purpose of strategic and operational restructuring is to obtain cash flow in the short term and gradually improve the company's performance and enhance corporate value. Kang and Shivdasani (1997) argue that controlling costs is only effective for companies that are poorly managed. Dai Deming and Deng Wei (2007) found that loss-making A-share listed companies will adopt business strategy changes to improve company performance, and business strategy adjustments have a positive impact on the company's performance improvement.

(3) Asset restructuring

Asset restructuring includes the divestiture of business segments/subsidiaries or the addition of new investments. Liao Li and Zhu Zhengqin (2004) found that asset restructuring is a common business performance improvement measure. He Xuqiang and Zhou Ye'an (2006) analyzed six applications for bankrupt companies and found that asset replacement and main business change are the main means of enterprise restructuring, and the performance of the company after reorganization

is good. Fan et al (2013) found that listed companies with bank loan defaults often deal with financial distress by selling assets.

(4) Financial restructuring

Financial restructuring includes debt-for-equity swaps, liquidation or debt restructuring. Gilson et al (1990) found that companies with more intangible assets, more bank liabilities, and fewer creditors are more likely to restructure debt, and the securities market can identify companies that can restructure successfully. Xie Deren and Zhang Gaoju (2007) found that debt restructuring has become an important means of restructuring A-share listed companies in financial difficulties.

2.2 Nature of Property Rights, Government Intervention and Corporate Financial Distress

In the transition economy and socialist countries. Zhu Hongjun et al. (2006) found that the existence of soft budget constraints distorted the real financing constraints faced by state-owned enterprises, making their financing constraints less than that of private enterprises.

Shleifer and Vishny (1994, 1998) proposed “the theory of government plundering hands” and “the theory of government support” to explain government intervention. China is a country with relatively poor development of institutions, laws and financial systems. The government has extensive intervention in corporate decision-making. Then, what impact does government intervention have on corporate financial distress? One view is that government intervention will affect the company's corporate governance and damage the company's performance, which will lead to financial difficulties and support the "government theory of government plunder." For example, Yang Huajun and Hu Yuming (2007) found that local government control and local government intervention significantly increased excessive investment in free cash flow. However, some studies have pointed out that when enterprises face financial difficulties, government intervention plays the role of “supporting hand”. For example, Pan Hongbo et al. (2008) found that local governments would support local loss-making enterprises through mergers and acquisitions.

In summary, the literature has mainly analyzed a certain aspect of corporate governance restructuring, strategic and operational restructuring, asset restructuring and financial restructuring, ignoring the systematic characteristics of corporate response to financial distress. Moreover, the literature has less analyzed how private enterprises can cope with financial distress and the cost and economic consequences of taking countermeasures in a market environment where property rights protection is weak and government intervention is strong.

3. Case introduction

Li Ning was listed on the Hong Kong Stock Exchange in June 2004 (stock code: 2331) and its main business is sporting goods.

3.1 Financial distress introduction

With 2008, with the increasing investment and penetration of international sports brands in the Chinese market and the rapid development of other domestic sports brands, the competitive environment facing Li Ning has become very fierce. Since 2010, Li Ning has experienced a decline in orders and inventory backlogs. In 2011, Li Ning's sales were overtaken by Anta, losing its position as the number one brand in China. In 2011 and 2012, several senior executives including Li Ning's former CEO Zhang Zhiyong resigned.

Increasing competition in the industry and problems in the company's internal management have caused the company to fall into financial difficulties. In 2012, Li Ning's gross profit margin was 37.84%, operating profit margin was -23.63%, and ROA was -32.42%. The financial problems that Li Ning mainly faces can be summarized into two aspects. The first aspect is the decline of net profit, and the second aspect is the shortage of cash flow. The following are the main business data of Li Ning in 10, 11 and 12 years.

Table. 1 Main business data of Li Ning in 10, 11 and 12 years (100 million)

	2010	2011	growth rate	2012	growth rate
Sales revenue	94.78	89.2	-5.9%	67.3	-24.6%
profit	15.46	4.1	-73.5%	-19.55	-576.8%
Gross profit margin	47%	45%	-4.3%	37.8%	-16%
Profit margin	16.3	4.6	71.8%	29	732%
Number of stores	7915	7495	5.3%	5803	22.6%
Number of direct stores	582	760	30.6%	631	-17%
Total inventory	8.055	11.3	40.3%	9.2	18.6%
Provision for inventory	1.15	1.8	56.5%	5.87	226.1%
Total accounts receivable	16.12	20.94	29.9%	14.87	29%
Bad debt preparation		0.1		9.37	9270.0%
Total accounts payable	11.9	14.62	22.9%	9.6	-34.3%
Average inventory turnover days	52	72	38.5%	90	25.0%
Accounts receivable turnover days	52	97	86.5%	76	21.6%

We can see that Li Ning has increased 900 million yuan in 11 years of bad debt provision in the past 12 years (the goods in the channel are mostly in the form of dealers' arrears); the inventory is reduced by 200 million; the receivable is reduced by 600 million; and the reduction is 500 million. The loss of 2 billion is hidden in these figures: it should mainly be used to repurchase dealer inventory and inventory provisions.

The main financial problems can be roughly divided into two categories, one is the decline in net profit, and the other is the shortage of cash flow. Similarly, we can also roughly see the strategy of Li Ning in the past few years: to clear the funds for the recovery of stocks, to raise funds for external debts, and to re-adjust the direction of business operations in the future.

After 2008, with the increasing investment and penetration of international sports brands in the Chinese market and the rapid development of other domestic sports brands, the competitive environment facing Li Ning has become very fierce. Since 2010, Li Ning has experienced a decline in orders and inventory backlogs. In 2011, Li Ning's sales were overtaken by Anta, losing its position as the number one brand in China. In 2011 and 2012, several senior executives including Li Ning's former CEO Zhang Zhiyong resigned. Increasing competition in the industry and problems in the company's internal management have caused the company to fall into financial difficulties. Li Ning's gross profit margin in 2012 was 37.84%, operating profit margin was -23.63%, and ROA was -32.42%.

3.2 Financial distress response

In order to cope with financial difficulties, the measures taken by Li Ning mainly include:

(1) Corporate governance restructuring

Li Ning has repeatedly adjusted a number of company executives including the general manager. In 2011, six senior executives such as Guo Jianxin, the chief operating officer, resigned. On July 4, 2012, the former president of the company, Zhang Zhiyong, resigned. The strategic investor TPG (Detai Capital) partner Jin Zhenjun joined Li Ning as the executive vice chairman of the board of directors.

(2) Strategic and operational restructuring

In addition to maintaining the traditional advantage of product areas, Li Ning began to increase investment in basketball. On October 10, 2012, Li Ning signed a contract to sponsor NBA star Wade and China's CBA league, and launched Wade series basketball products. The signing fees of the two companies reached 10 billion US dollars in 10 years and 2 billion yuan in 5 years. Li Ning Company also increased its investment in running. In 2012, it held the "Li Ning China 10km Road Run League" of the official competition level of the China Association of Athletics Associations in 2012, and expanded the competition nationwide in 2013. In addition, Li Ning has also expanded its children's wear business.

(3) Asset restructuring

In 2012, Li Ning proposed a channel revitalization plan, which mainly includes integrating sales channels, establishing a rapid response mechanism, and adopting discount sales to clear inventory. In 2012 and the first half of 2013, Li Ning closed 1600 stores.

(4) Financial restructuring

On February 8, 2012, Li Ning Company issued RMB 750 million convertible bonds to TPG (Detai Capital) and GIC (Singapore Government Investment Corporation); in April 2013, it also moved to Extraordinary China (controlled by Li Ning himself). TPG and GIC issued HK\$1,850 million convertible securities to ease financial pressure.

4. Conclusion

Through the research on Li Ning's typical case enterprises, this paper systematically analyzes the financial distress response measures, coping costs, market response and economic consequences. This paper finds that in order to cope with financial difficulties, Li Ning has carried out corporate governance restructuring, strategic and operational restructuring, asset restructuring and financial restructuring.

Li Ning Company mainly adopts market-oriented means to deal with financial distress. For companies in financial distress, government intervention appears as a “supportive hand”. However, due to government intervention, private enterprises responded to the non-marketization of financial distress measures, and the investor market reacted negatively. In short, this article takes Li Ning as a case study. The conclusions of the study highlight the importance of corporate financial distress to deal with systemic thinking, and emphasize the nature of property rights and the important impact of government intervention on corporate financial distress.

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