The Pulse of Private Equity and Debt

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Abstract: The introduction of private placement of SMEs in 2012 is an important financial innovation. It is an important step toward expanding the financing channels for SMEs and improving the structure of China's capital market. This paper analyzes the significance, development status and existing problems of private placement, and based on the theory of property rights exchange, draw lessons from the experience of private placement in the United States, and discusses how to promote the prosperity and development of private placement in China from the aspects of liquidity, credit rating, main qualifications and other aspects of feasible suggestions. This paper is of great significance to researchers and practitioners of private debt in our country.

1. The Significance of SMEs Debt Issuance

In a market economy environment, enterprises are the main players in economic activities. The speed and potential of an economy depends on the operating vitality and development ability of the enterprises in the country. However, the operating efficiency of funds directly affects the enterprises as if blood is human beings The competitiveness of enterprises so that life and death. Throughout the world, corporate finance mainly through two channels: indirect financing and direct financing. In our country, indirect financing mainly includes bank loans, while direct financing includes issuance of corporate bonds, IPO listed equity financing, VC, PE, new three board, trust and newly emerged asset securitization of derivative financial instruments. These financing channels in the scale, performance and property rights and other aspects of the financing of the main body has a higher demand, such as the IPO requirements of small and medium-sized board business net profit for the past three years was positive, totaling more than 30 million yuan (after deducting non-recurring gains and losses lower) [1], the main body of corporate bond issuance must be a listed company[2]and the main body of issuing corporate bonds must be large and medium-sized state-owned enterprises. Too high barriers to entry will block most of the small and medium-sized micro-enterprises, making it unable to enter the capital market for financing, in order to meet the capital needs of enterprise production and development can only be financed through private channels, such as the accumulation of their own businesses, family and friends Borrowing or borrowing through private money banks can be limited to a lesser extent either by the scope of the relationship or by raising the cost of corporate finance due to a lack of formal legal protection that leads creditors to take risks. In short, China's capital market has long been a lack of financing channels for small and medium-sized micro-enterprises, which has led to the so-called financing difficulties of small and medium-sized micro-enterprises, thereby affecting the development, vitality and even viability of small and medium-sized micro-enterprises. However, small and micro-sized enterprises are a very important part of our economy relative to the low-level financing position. According to statistics, at present there are more than 10 million small and medium-sized enterprises with legal person status in China, accounting for 99% of the total number of enterprises in the country, contributing 60% of China's GDP and 50% of the tax revenue, creating 80% of urban employment opportunities. Small and medium-sized enterprises are not only the major components of our economy, but also the cornerstone and source of power for the development of the entire economy. SME private placement debt is regarded as a financing channel tailored to small and medium-sized micro-enterprises, which will play a significant role in solving its financing difficulties and stimulating its vitality [2].

2. The Development of the Private Placement Market

For now, China's private placement debts show the following three characteristics: First, the number and scale of issuance slow growth. First of all, on the overall scale, compared with the total amount of China's bond market, private debt is only a very small part. Compared with the total amount of tens of millions of small and medium-sized micro-enterprises in our country, the number of issues appears to be negligible. Second, from the perspective of the development trend of private debt, both the number of issuances and the scale of financing have entered the bottleneck of more than a year after experiencing the growth of the first year, not only without further growth, but with a downward trend. All in all, the development of private equity bonds after more than two years of launching did not show the initial popularity expected in the market. [3] On the contrary, the development of the private placement bonds has shown more difficulties and difficulties than ever before. Second, in the process of actual private debt development, the alienation of service targets has emerged, that is, the main intention of the current issuance of the main body of the issue and the design of private placement bonds deviate. The original intention of private debt is to fill the gaps in the lack of service targets for small and medium-sized enterprises in the capital market of our country, to provide financing channels for small and medium-sized private-owned enterprises and to solve their difficulties in financing. However, the actual data tells us that small and medium-sized micro-private enterprises are not the main issuers of private placement bonds. As far as the nature of the property rights of the current issuers of private placement bonds is concerned, the private issuers of privately held bonds account for 46% of the total private placement and state-owned enterprises account for 29% of the total, while other enterprises accounting for 18% And other endorsed by the government enterprises; and financing scale, the total amount of state-owned financing reached 39% or even more than a percentage point of private enterprises. Thus, both in terms of the number of issues or the scale of financing, the private equity bond market, the original owners and private enterprises have been robbed of the limelight. Therefore, comparing the corresponding data of listed companies, we find that the current assets of private issuers are not small, at least not related to micro-enterprises, and there are deviations in the targets of private placement. Third, the secondary market for private placement bonds is solid. After the launch of private debt, investors did not get sought after, on the contrary many investors complained that the secondary market liquidity is poor, reducing their willingness to participate. The short duration of our private debt is to some extent to ease investor concerns about liquidity [4].

3. The Pulse of Private Debt Market Plight

(1) There is a serious degree of asymmetric information among small, medium and micro-enterprises and investors. First of all, small and medium-sized and micro-enterprises are privately-owned enterprises that are not listed. Specifically, each individual enterprise is less concerned by the media, analysts and others. Therefore, there is very little information about the enterprises that can be obtained through open channels and information is obtained through private channels. The cost is very high. Therefore, there is a serious information asymmetry between SMEs and investors. Secondly, there is a lack of senior information intermediaries in the private placement market. According to the theory of property rights transaction, information intermediary is to solve the information asymmetry between the two parties arising from the transaction. Underwriters and credit rating agencies should set up a bridge between private placement firms and investors in information delivery and play a role in alleviating the information asymmetry between the two sides through their specialized advantages. However, the development of these intermediaries in our country lags behind the development of the private placement market. On the one hand, the underwriters engaged in private placement of debt underwriting business lacks sufficient motivation. On the other hand, unlike the U.S. credit rating agencies that already have a sound and reputable reputation for developing private debt, the development of China's credit rating has just started. [5] There is no reputable advisory rating agency yet, and the rating quality is not backed by bond default data. Credit rating with credibility is an important way to reduce the information asymmetry

between private issuers and investors.

(2) The secondary market for private placement bonds lacks sufficient liquidity. The policy of SME private placement bonds stipulates that the Pilot Measures on Private Equity Bonds for Small and Medium-sized Enterprises (SMEs) have strict requirements on the scope and number of investors in small and medium-sized enterprises [5]. That is, the target investors are mainly commercial banks, trusts, brokerages and funds and insurance agencies. The total number of investors in each issue of private debt can not exceed 200. As institutional investors, fund companies can only invest in private debt with a limit of 10% of the investment quota. As an individual investor, set up a 500 million standard and so on. Although these measures are easy to control the risks, they all limit the degree of investors entering the private placement market, seriously restricting market liquidity and negatively impacting their liquidity. Lack of liquidity, investors hold claims difficult to achieve benefits in the secondary market, limiting the choice of investors to implement the option of space, increasing the difficulty of the implementation of claims, eventually leading to increased costs of enforcement of creditors, thereby increasing the private placement Transaction costs between debt issuers and investors. The experience of the development of private debt in the United States also shows the importance of liquidity in promoting private debt transactions. The arrangement of U.S. private bond markets generally relaxes restrictions on resale and enhances the flow of private bonds under the premise of not weakening investor protection sexual, active private bond markets. [6] After more than 10 years, the scale of issuance has expanded rapidly. From the current number of private placement issuances, 144A accounts for 77.58% of the total private placement stock, accounting for 94.04% of the total [7]. This shows that the lack of liquidity in the private placement market in China has raised the cost of implementing investor claims and ultimately restricted the development and vitality of private placement.

4. How to Achieve the Resumption of Private Bonds in China

The development of the private bond market is very important for the development of small and medium-sized micro-enterprises and even the entire economy. To solve the difficulties they face and to achieve rapid development are the common goals of capital market participants such as enterprises and investors as well as government regulators. Based on the above analysis, this paper puts forward some policy recommendations from three aspects.

4.1 A multi-pronged solution to information asymmetry between issuers and investors

First of all, the poor information disclosure channels of enterprises and the false disclosure of information make investors do not understand many important information such as the credit, qualification and solvency of the issuing enterprises. Such information between the financier and the investor is not symmetrical. Therefore, improving information disclosure mechanism and strict information disclosure system are significant for promoting the development of private placement bonds. At the same time, fostering more qualified institutional investors with risk appetite. In the United States, from the perspective of the market share of investors, institutional investors account for the overwhelming majority of the private placement market. Compared with ordinary individual investors, institutional investors have stronger ability and motivation in information gathering and analysis.

4.2 Strengthen the cultivation of market intermediaries

Credit rating makes the risk assessment of the main issue objective, comparable. The United States is the birthplace of high-yield bonds, but also the birthplace of credit rating. As early as the issuance of the first high-yield bond in the United States in 1977, the United States has formed a strict credit rating mechanism: the higher the credit rating, the lower the corresponding issue rate, and the high rate of return reflects the high default rate Marginal cost compensation. However, there is still a great lack of rating in our country, lagging behind the development of the bond market. Therefore, it is imperative to set up a reporting mechanism for reporting the credit rating of private-equity bonds for SMEs and a statistical system on the rate of default. Through the compilation of credit rating reports and credit ratings, the basic statistical data of the private placement market, including the default rate, are set up. After the market reaches a certain stage, a corresponding relationship between credit rating and default rate is established. To verify the rating agencies rating level and quality. In the process, our regulators should be able to tolerate a certain default rate of private debt and should not pursue zero default rate of private debt so as to promote the establishment of a credit rating system. In addition, we must create the environment to help the underwriters to form a specialization advantage and economies of scale in the underwriting of private placement bonds. This needs to change the situation that a large number of potential small and medium-sized micro-enterprises are now blocked from the private placement market. At present, the actual path of private placement for SMEs has a considerable deviation from the original intention of design. Due to the large number of state-owned backgrounds in the government's credit endorsement, enterprises of the nature of cities and cities have been pouring in and large numbers of small and medium-sized private-owned enterprises have been rejected Outside the door, at the same time the current issuance of the main body of the provisions of the threshold is too high, in accordance with the "pilot scheme for SME private placement bonds," the pilot period, the scope of the bond issuers only meet the "provisions on the issuance of SME Notice" [MIIT (2011) No. 300], which are not listed in Shanghai and Shenzhen Stock Exchanges (hereinafter referred to as "Exchanges"). The Ministry of Industry and Information Technology finds that the starting point for small and medium-sized enterprises is low, such as "small and medium-sized industrial enterprises with less than 1,000 employees or less than 400 million operating income", so large non-listed manufacturing enterprises with operating income exceeding 400 million will miss the issue of private placement bonds , While this part of the medium-sized enterprises are high-quality private issuers, solvency is strong, this should be the first contact with private debt, such as Wenzhou SMEs have more than 40 million, and in accordance with the Wenzhou Association for the Promotion of SME meet the debt issuance requirements Only 70-80 companies. Lower the threshold of private placement bonds, so that a large number of small and medium micro-enterprises into the private placement market, is to promote the enthusiasm of the underwriters to achieve the basis for the scale effect.

4.3 Improve the efficiency of the implementation of investor claims

As mentioned earlier, raising the efficiency of investor claims needs to provide more ways for them to profit from debt trading. First of all, to improve the liquidity of the secondary market for private placement, on the one hand, to amend the definition of non-public offering of securities law in our country and to relax restrictions on the number of resale of qualified institutional investors. At present, the limited issue and transfer of private pilot bond business in China should not exceed 200 people. We suggest further moving closer to the 144A rule in the United States to remove restrictions on the number of eligible institutional buyers of 200, allowing more investors to participate in secondary market transactions and increase market liquidity. At the same time, in addition to playing the role of the SSE fixed-income securities comprehensive electronic platform and the Shenzhen Stock Exchange's comprehensive agreement trading platform, it is necessary to speed up the construction of the regional over-the-counter market and the launch of the regional over-the-counter market [7]. Based on the well-known local conditions, Undoubtedly can more effectively promote the local investors' private sector debt investment in local enterprises. Second, by promoting the financial innovation that promotes the private equity risk hedging instruments, investors will be able to reduce the risk of private equity claims and expand their ways of making profits. One of the important reasons for the current difficulties in the issuance and sale of private placement bonds is that investors consider the credit default risk of private placement bonds to be high, and lack of other means of profit before expiration. In October 2010, the China Association of Banks Market Dealers published "Guidance on Pilot Business of Credit Risk Mitigation Tools in the Inter-bank Market", formally introducing credit default swaps (CDS) tools and credit risk mitigation instruments (including credit risk mitigation contracts (CRMA) and credit risk release certificate (CRMW)) into the Chinese market. The introduction of CDS and CRM means that the diversification of private equity investors monetization methods will significantly reduce the implementation costs of investors' claims, so as to promote the issuance and trading of private placement bonds.

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