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Study on the Reasons and Countermeasures for Loss of Listed Companies in Manufacturing Industry

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Abstract In combination with the data of loss-making listed companies in manufacturing industry at capital market in 2008–2010, this paper analyzed the characteristics of loss of listed companies. Major reasons include the blind investment of management personnel, low operation and management level, blind pursuit of diversified operation, improper stock right structure, weak supervision of government, and imperfect delisting system. Finally, it came up with some countermeasures, including improving quality of management personnel, management personnel selecting proper investment projects, strengthening internal management of enterprise, implementing effective asset rearrangement, setting up effective incentive and restrictive mechanism, bringing into play regulation function of banks, improving delisting mechanism, reducing centralization of state owned stock right, and establishing and improving market information disclosure system.

Key words Manufacturing industry, Listed companies, Loss, Reasons, Countermeasures

Editor's note: Agricultural listed companies are important links connecting agricultural production and capital market. Their healthy development not only is an important issue of securities market, but also concerns benign development of the national economy. However, with changes in the demands of agricultural products and influence of international environment and climate, many agricultural listed companies go into deficit. For this, more and more agricultural listed companies carried out diversified expansion in other fields, and actions of deviation from agriculture are of frequent occurrence, which not only go against the original intension of government subsidy for agricultural enterprises, but also reduce operating performance of agricultural listed companies. Therefore, in-depth analysis on reasons for loss of agricultural listed companies and presenting some pertinent countermeasures become hot issues. On the basis of these, this paper took listed companies in manufacturing industry as an example, analyzed reasons for their losses, and put forward some countermeasures, in the hope of providing some references for agricultural listed companies, especially agricultural machinery companies.

1 Introduction

With rapid development of China's economy and further implementation of reform and opening-up, domestic securities market becomes mature and mature. However, faced with cut-throat competition both at home and abroad, there are more and more listed companies going into deficit. Among them, manufacturing enter-

prises take up a larger portion. Since the manufacturing industry plays an important role in all enterprises in the process of economic liftoff, in expanding people's employment, adjusting income distribution, maintaining social stability, invigorating entire market, and stabilizing structural distribution of national economy, study on listed companies in manufacturing industry is helpful for ensuring important functions of manufacturing enterprises in promoting sound development of national economy and keeping social prosperity and stability.

2 Characteristics of loss of listed companies in manufacturing industry

Samples of this study were taken from data of loss-making listed companies in 2008–2010. From analysis, we can know the following characteristics of loss of listed companies in manufacturing industry.

2.1 Higher proportion of listed companies in manufacturing industry

Sample data in this study involve many industries at securities market, including the manufacturing industry, social service industry, information technology industry, transport industry, and mining industry. From Fig. 1, it can be clearly seen that the manufacturing industry has the largest proportion of loss-making listed companies. Thus, it indicates important role of listed companies in manufacturing industry at capital market. Making up deficits of these companies plays a key role in sound development of capital market, which is also the intention of this study.

2.2 High amplitude of losses We carried out a descriptive analysis on loss-making listed companies in the manufacturing industry. The analysis results are listed in Table 1. From descriptive analysis, it is known that listed companies in the manufacturing industry have high amplitude of deficit. For this, we should find out some reasons for their deficit, to change current situation.

Received: September 25, 2013 Accepted: December 2, 2013

Supported by China National Social Science Fund Project (13CGL050); Humanities and Social Science Research Youth Project of the Ministry of Education (13YJC630027, 11YJC630243, 12YJC630010); Basic Research Fund of Central Universities (SWU1309116, SWU1309202).

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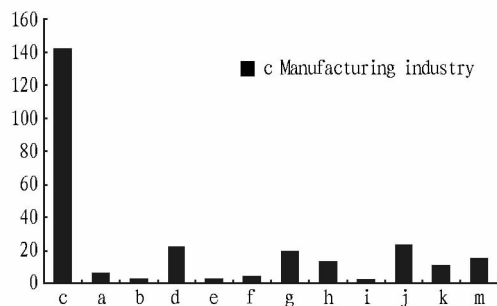


Fig. 1 Statistical chart for the proportion of manufacturing industry to sample data

Table 1 Analysis of net profit

	Min.	Max.	Average	Standard deviation	Variance
Net profit	-2.63E8	-134604.16	-1.9607E7	3.31640E7	1.100E15

2.3 High frequency of sustained losses From sample data, we selected those of manufacturing industry and summarized by categories, as listed in Table 2. From Table 2, it is known that sustained loss frequency of listed companies is high in manufacturing industry. Many companies go into sustained losses for consecutive two years. From the third year, most companies make up deficit and increase surplus, possibly because they take some counter-measures, for example, control of earning.

Table 2 Frequency of loss of listed companies

Times of deficient	4	3	2	1
Number of companies	5	36	104	78

3 Reasons for loss of listed companies in manufacturing companies

3.1 Reasons at enterprise level

3.1.1 Blind investment of management personnel. At the stock market, listed companies can raise more low-cost working capital, which will become a favorable condition for their development. However, it will also lead to the blind investment of management personnel when enjoying such favorable condition. Besides, management personnel may use the low cost capital raised to invest other projects. Investment fails to get rid of old ideas, investment is arbitrary, neither prudent nor scientific. As a result, it is probably that investment decision does not bring economic benefits for enterprises, and lays down heavy burden on enterprises due to loss of benefits. Finally, listed companies have difficulty in operation and go into serious deficit.

3.1.2 Low operation and management level. Management personnel take the leading position in operation of listed companies, and their management ability and enthusiasm will directly influence performance of entire listed companies in the manufacturing industry. If the operation and management level is low and it is impossible to improve management level with changes of market environment, listed companies in manufacturing industry remain in depression, and then the situation will be worse. This will possi-

bly lead to listed companies having difficulty in operation, and consequently going into sustained losses.

3.1.3 Reasons at research and development level. With constant development of securities market, China's market competition pressure is greater and greater. In this situation, competitiveness of listed companies becomes an essential factor determining their survival and development. This requires that manufacturing companies should constantly upgrade products, put enormous research and development cost, improve product quality, and increase market share, so as to obtain powerful competitiveness. Nevertheless, many manufacturing companies often neglect this point. As a result, research of new products is slow and fails to keep pace with market development. Accordingly, they lose advantages in intense market competition and go into deficit. For example, because of weak R&D of new products, Brilliance Automobile Group sold only 11 047 Brilliance FSV (3 compartments) cars in January to May of 2009 (dropped nearly 52%, this figure was 22 877 in the same period of 2008); it sold 2 092 Zunchi cars (dropped nearly 60%); although the new FRV (2 compartments) were sold for 20 000 cars in January to May of 2009, the profit was small and it failed to change loss of Brilliance Automobile Group. In the first quarter of 2009, Brilliance Automobile Group went into deficit.

3.1.4 Blind pursuit of diversified operation. Many listed companies in the manufacturing industry prefer diversified operation, which will cause core business of enterprise not outstanding. Since the scale and management ability of an enterprise is limited, if capital is invested to many industries, the enterprise will lose the scale effect, expend more management cost, and may make wrong decisions due to lack of management experience of respective industry. As a result, core business shrinks substantially and the enterprise gradually goes into plight and deficit.

3.2 Reasons at governance level

3.2.1 Improper stock right structure. The stock right structure is an essential part of company governance structure and is directly related to performance of listed companies in the manufacturing industry. At present, the stock right structure of listed companies in the manufacturing industry is very complex. In general, it is characterized by major public ownership, higher proportion of state-owned stock right, too centralized and impossible to circulate. Specifically, parent company excessively occupies capital, which limits further development of listed companies in the manufacturing industry. Listed companies transformed from state-owned enterprises generally possess superior assets of original state-owned enterprises, while the latter will not have independent survival ability, but have many redundant staff, huge debt and various non-profitable service facilities. Such heavy burden has to be placed on their affiliated companies, relying listed companies to raise funds, and taking listed companies as their "Teller Machine". This presents difficulty for listed companies in capital turnover, and accordingly limits development to an extreme extent.

3.2.2 Lack of incentive and restrictive mechanism. (1) In some listed companies in manufacturing industry, the wage level of managers is out of proportion to business performance. The wage structure is not reasonable and the form is single. Besides, at the end of the year, there is no significant reward to encourage managers and to effectively summon up enthusiasm of managers. What's worse, some operators with worse performance receive higher reward than annual salary of operators with better performance, which seriously dampens working enthusiasm of managers. (2) There is no effective supervision and restrictive mechanism in listed companies. In most such companies, since the state is the largest shareholder, it is difficult for other shareholders to supervise operation and management, and accordingly the supervision system fails to bring into its full play. More important, it is the state that has the right to hire members of board of directors and general manager (usually the president is also the general manager). Thus, it is meaningless to realize supervision and restriction of managers through the board of directors. In consequence, the incentive mechanism of listed companies becomes very weak and the restrictive system fails to be guaranteed. Finally, some operators take some improper or illegal means to pursue maximal benefits, which makes the listed companies go into deficit.

3.3 Reasons at system level

3.3.1 Weak supervision of government. For bundled listing and packaged listing, the China Securities Regulatory Commission fails to filter mendacious information of these listed companies. However, these listed companies go into deficit in the year when they are listed. This will attract those enterprises that fail to fulfill performance to try every means to control profit beyond their operation. Thus, it shows that the punishment of listed companies for illegal actions is not harsh. In addition to weak supervision and lack of efficiency, some listed companies in manufacturing industry go into deficit and do not find solutions, but take method like control of earning, and consequently the deficit will widen.

3.3.2 Imperfect delisting system. *The Suspending and Terminating the Listings of Loss-making Listed Companies Implementing Procedures (Revised)*, issued by China Securities Regulatory Commission, stipulates that if a company posts consecutive losses for the most recent three years, the stock exchange shall render a decision to suspend the listing of the company's shares. However, such provision is too simple, it only specifies years of losses. At securities market of China, the supply of stock is far less than the demand of stock. With constant development of securities market and continuous increase of stock demand, stock supply will also constantly increase, but the reality of stock supply far less than the stock demand leads to obvious "supply and demand bottleneck" at securities market. In this situation, listing qualification becomes precious for an enterprise. If an enterprise has listing qualification, it can raise funds at the capital market. Nevertheless, for those enterprises with bad performance or even in deficit, such precious resource has the danger of loss. In this case, the enterprise may take the means of control of earning. As a result, there

is the problem of "deficit as much as possible in one time".

4 Recommendations for preventing and controlling loss of listed companies in the manufacturing industry

4.1 Countermeasures at enterprise level

4.1.1 Improving quality of management personnel. It is recommended to regularly provide systematic training of modern enterprise industrial and commercial administration knowledge for management personnel, to raise their innovation, public relation and marketing ability. In addition, personnel market can be used to recruit high quality talents to form powerful senior management personnel team. With the aid of market laws, it is expected to select really competent management personnel. Furthermore, enterprises can organize some simulated commercial war events, to stimulate workers' enthusiasm, strengthen team spirit, raise independent thinking of management personnel, and explore new development road. Through these events, it is expected to boost confidence of management personnel, keep positive attitude and keep calm when their companies go into deficit, and lead workers to make efforts and keep forging ahead to overcome difficulties and relieve their companies of loss.

4.1.2 Selecting proper investment projects. Proper investment project is the key for listed companies to get rid of loss. Thus, management personnel of companies should focus on investment strategy when choosing investment projects. Firstly, it is required to make scientific evaluation of feasibility of the project. Besides, it should care about technical content, economic benefit, and market competitiveness. Choosing proper investment projects can avoid some wrong investments and help making-loss enterprises move out of deficit.

4.1.3 Strengthening internal management of enterprises. Since listed companies in manufacturing industry can raise funds through securities market, it is easy for them to conduct external expansion of production. However, simply pursuing multiple industry development will lead to weakening of core business, loosening of exploration of internal potential. Such extensive management presents hidden troubles for loss. Instead, these companies should take the road of intensive operation, especially, expand core business to reduce risk of losses. Besides, listed companies should take strict control over expenses, increase revenue and reduce expenditure, to realize better performance. In addition, listed companies should orient towards market, take market-oriented operating philosophy, and put the core of business on market, to improve ability of enterprises to adapt to constantly changing market.

4.2 Countermeasures at governance level

4.2.1 Implementing effective asset rearrangement. Most loss-making listed companies in manufacturing industry have problems of weak profitability, low asset quality, and heavy debt burden. To turn loss into gain, it is obviously impractical. In this situation, the optimal method for reducing resource waste and safeguarding benefits of investors (particularly medium and small ones) is to attract cooperative shareholders, add high quality as-

sets that have development prospective, and help these companies conduct effective asset rearrangement and finally get rid of loss. At present, effective assets rearrangement is a short-cut for loss-making listed companies in manufacturing industry to move out of plight, while the major method of asset rearrangement is asset replacement.

4.2.2 Establishing effective incentive and restrictive mechanism. Through setting up incentive mechanism similar to stock option, it is expected to make managers engaged by the board of directors bring into full play their enthusiasm for operation and management, find out reasons for losses, and lead all staffs to realize better performance of listed companies in manufacturing industry. Besides, we propose distributing dividends for workers with better performance and letting workers become master of their companies, to stimulate their working enthusiasm and make companies get rid of plight as soon as possible. Furthermore, these companies should set up and improve effective incentive and restrictive system, carry out regular auditing of financial report, and take strict evaluation on operating performance of manager, so as to decide to continue engaging the manager or dismiss him from duty. Later, management right of managers should be reallocated, to impose more restrictions on managers in implementing major decisions, so as to really realize supervision and restriction of managers and prevent improper operation and management actions.

4.2.3 Bringing into play regulation function of banks. At the same time of realizing diversified stock right structure, it is required to strengthen functions of banks in treatment of company loss. Since banks have net cost advantages in economic control and supervision and information cost advantages in implementing economic control, introduction of banks to company governance is favorable for bringing into play supervision and control functions. From actual conditions of China, it is possible to allow banks to hold shares of companies and let banks intervene with management of companies. However, the proportion of shares held by banks should be not great. After banks holding shares of listed companies, it is required to set up a proper system to specify rights of banks in production and operation of these companies. The state should grant some rights to banks intervening in operation and supervision of companies. Only through this, may active role of banks be ensured in controlling losses of companies. Besides, it is proposed to establish adequate incentive mechanism to take charges of risks of credit and stock right, and select qualified managers and suitable investment to offer loans, so as to get rid of loss as soon as possible.

4.3 Countermeasures at system level

4.3.1 Improving delisting mechanism. According to provisions of *Suspending and Terminating the Listings of Loss-making Listed Companies Implementing Procedures (Revised)*, if a company posts consecutive losses for the most recent three years, the stock exchange shall render a decision to suspend the listing of the company's shares; the stock exchange shall, within five working days of the date on which the listed company applies for restoration

of its listing, render a decision on whether to accept the application. Where, after the listing of the company's shares has been resumed, a company has not disclosed its first annual report after the restoration of its listing when the statutory time limit ends, the stock exchange shall render a decision to terminate the listing of the company's shares within 10 working days of the end of the statutory time limit. Where, after the listing of the company's shares has resumed, a company discloses its first annual report after the restoration of listing of its shares within the statutory time limit but the company shows a loss, the stock exchange shall render a decision to terminate its listing within 30 working days after the disclosure of its annual report. These provisions are so simple that listed companies in manufacturing industry make effort to avoid punishment through control of earning. To prevent such situation, it is recommended to cancel the provisions on suspension and termination of listing due to consecutive losses for three years, and let loss-making listed companies die out by market laws.

4.3.2 Reducing centralization of state owned stock right. This means transforming the current stock right structure that state-owned stock takes up the dominant part, and realizing diversified development of the stock right structure. It is recommended to optimize those listed companies whose shares are largely held by the state according to nature and functions of the state-owned economy, to gradually quit industries where the state-owned stock is necessary. Besides, listed companies in manufacturing industry should cultivate diversified shareholding entities, loosen limitation on individual shareholding, and gradually reduce centralization of state owned stock right. These can be realized in two ways: (1) increase new shares, but never sell new shares to old shareholders, which will naturally reduce the proportion of state-owned shares; (2) transfer state-owned stock right, such as contractual transfer, placing of state-owned shares, or transfer to some powerful companies for free. Through these, it can invigorate listed companies, improve their stock right structure, and take full advantage of their assets.

4.3.3 Establishing and improving market information disclosure system. The disclosure of market information is of utmost importance. On the basis of market regulation, the state should reinforce macro control, to make market information disclosed to the maximum extent. Then, it is possible to provide analysis data for investment and decision of listed companies. Also, related authorities can supervise whether enterprises manipulate their profit or not. In addition, it can help shareholders monitor if managers carefully make proper decisions for development of companies, or if they try to obtain profit for themselves. In sum, the disclosure of market information is particularly important, thus it is required to constantly establish and improve the information disclosure system at the same time of economic development.

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