Management Problems and Countermeasures of Private Equity Fund in China

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Abstract

With the increasing diversification of China's financial market, private equity fund has begun to develop rapidly and become a new force in the capital market. However, with the substantial increase in the number of private equity fund managers and private equity funds, related risks and problems have also occurred frequently. This paper analyzes the current situation of China's private equity, starting from the management phase of the fund's four phases of "raising, investment, management and withdraw", summing up the problems that private equity may have in the management process, making corresponding suggestions to related issues.

Keywords

Private equity, Investment, Management problems, Countermeasures.

1. Overview of private equity

Private fund, also known as private investment fund, is an investment fund established by raising fund from investors in a non-public way. The investment object of private fund can be stock, equity, bond, futures, option, fund share, etc. According to the different ways of investment management, private equity fund are mainly divided into private placement of securities investment fund, private equity investment fund and asset allocation private fund.

Private equity fund is the main type of private fund, which mainly invests in the equity of unlisted enterprises and the shares of listed companies that are not publicly issued or traded. Due to the special investment direction of private equity fund, it has the following obvious characteristics compared with other fund: firstly, the disclosure requirements are lower, because the investors of private equity funds prefer individual investors or a few institutional investors, and they are not raised in the open market, so the information disclosure requirements for raising are relatively low. In China, private equity funds need to disclose relevant information to China Fund Industry Association in the process of raising, investing, managing and withdrawing, but compared with public fund and private placement of securities investment fund, their timeliness and accuracy requirements are relatively low. Secondly, the investment period is long. Because private equity funds mainly invest in equity, the investment period is long, generally about 3-5 years, and the rest will exceed the whole period, which belongs to medium and long-term investment. Thirdly, investment funds are mostly in the form of limited partnership, because this type of organization can not only play an investment management role, but also avoid the problem of double taxation. Fourthly, there are many exit channels. Private equity investment fund can exit not only through listing on the new third board and IPO, but also through management buyback and merger and acquisition.

2. Development status of private equity fund in China

In November 2005, Bohai Industrial Investment Fund, as the first RMB industrial investment fund in China, opened the curtain of China's private equity investment fund market. Although compared with the western capital market, the development started late, but the development speed is considerable. By the end of December 2019, the number of private equity funds in China have reached 28490, 3.95 times of that in 2015. By the end of December 2019, the fund scale has reached 8.59 trillion yuan, and the management scale has reached 3.07 times of that in 2015. In addition to bank loans and securities market, private equity investment fund has gradually developed into an important financing channel in China.

In terms of fund managers, by the end of December 2019, there were 14882 private equity and venture capital fund managers in China, and the number of fund managers increased by 26.31% compared with 2015. Among them, there were 262 private equity fund managers with a scale of 10 billion yuan or more by 2019, 3.01 times of 2015. The increasing of managers is slowing down, but the number of managers with larger management scale is increasing significantly. The development of private fund managers in China is changing from quantity development to quality development.

3. Development issues of private equity fund in China

Compared with public fund, private equity fund has the characteristics of more managers and more funds. In addition, private equity funds are engaged in equity investment of non listed companies or non-public trading of listed companies. Therefore, the supervision of private equity fund is very difficult. In recent years, China's private equity fund have become a major disaster area in the financial market. In this situation, the regulatory authorities continue to strengthen the regulatory treatment, and the regulatory situation continues to strengthen, mainly through the self-examination of fund managers and spot checks by regulatory agencies to find problems. From 27, 9 and 21 in 2015 to 83, 6 and 8 in 2017, private fund managers who have been taken administrative supervision measures, put on file for audit and submitted to local government or transferred to public security department. It can be seen that with the development of private fund industry, illegal and non-compliance problems are also constantly exposed.

General fund operation foundation has gone through four stages of raising, investment, management and withdrawal. At present, there are several problems in the management stage of private equity fund in China:

3.1 Incomplete qualification of private equity fund manager

China's private equity fund industry first appeared in 2005 and began to flourish in 2012. However, there are few regulatory policies for private equity fund. The first one is "Interim Measures for the Supervision and Management of Private Equity Fund" issued by China Fund Industry Association in 2014, and then in 2015 and 2016, the Association issued "Guidelines for Fund Business Outsourcing Services (Trial)" and "Administrative Measures on Information Disclosure of Private Equity Investment Funds", since 2017, the Association has successively issued more supporting rules and regulations for private equity fund. As a result, many private equity funds, especially those established earlier, are prone to illegal and non-compliance risks due to the lack of targeted laws and regulations at the beginning of their establishment. The main performance is as follows: firstly, the qualification of employees. For example, there are employees without certificates, or senior executives lack of corresponding qualifications or work part-time in multiple institutions. Secondly, the fund under management does not belong to the management scope of the manager's private fund. In the early years, some private equity fund managers set up debt or other types of funds, which led to the type of funds they managed did not match their management types. Thirdly, there are other conflicts or non related businesses with private funds. Many private equity fund managers are specifically set up for private equity fund investment by some large groups or financial institutions. These groups or institutions usually set up more than one private equity investment institution, so it is easy to have other conflicts or non related businesses within the group or within the system.

3.2 Irregular investment and operation

Private equity funds should comply with relevant laws and regulations and contract agreements when conducting investment operations. However, some private equity funds are prone to irregular investment operations in the process of operation, mainly including the following types: Firstly, private equity fund must be registered with China Fund Industry Association before carrying out project investment operation, while some managers invest without filing after receiving investors' funds. Secondly, out of scope investment or investment strategy does not conform to the provisions of the contract agreement. Thirdly, illegal related party transactions. The related party transactions of private equity fund often occur between the fund and the manager and its related parties, between the fund and the investment target enterprise, and between the fund and the related fund. When these related party transactions occur, they cannot be priced fairly and reasonably, and cannot follow the principle of equal voluntariness and equal compensation, which will produce conflicts of interest and encroach on the interests of investors. Fourthly, structural and leverage conditions exceed the standard. In 2016, the new regulations on asset management issued by the CSRC stipulated the investment structure of various types of asset management plans, among which, the leverage ratio of stock and mixed structured asset management plans should not exceed one time, that is, the sum of priority and intermediate shares should not exceed the inferior shares, but many private equity investment funds exceeded this limit in the investment operation.

3.3 Irregular information disclosure

At present, both the fund manager and the private equity fund need to be filed through the asset management business comprehensive submission platform of China Fund Industry Association (hereinafter referred to as "ambers system"). During the operation process of the manager and the fund investment process, it is necessary to disclose the operation and major changes of the manager and the fund to the ambers system and the private equity fund information disclosure backup system （Hereinafter referred to as "backup system") for information submission and change application. Ambers system and backup system were launched successively in 2017. The management measures for information disclosure of private investment funds related to information disclosure was published in 2016. However, there are still many problems that private equity funds fail to comply with the requirements of filing and information disclosure. The main performance is: first, the manager information, fund information, etc. are not truthfully registered with the association. For example, the type of funds under management is inconsistent with the registration, the information registration of managers is not true and complete, and the information registration of fund projects is not true and accurate; secondly, the relevant information is not disclosed in compliance with the regulations, some private equity fund managers fail to disclose the information of managers and funds in time according to the ambers system and backup system, in addition, many institutions fail to disclose information to investors in a timely, accurate and comprehensive manner in accordance with the "Administrative Measures on Information Disclosure of Private Equity Investment Funds".

3.4 Lack of internal control system or poor implementation

On February 1, 2016, the Association issued "Guidelines for Internal Control of Private Equity Fund Managers", which requires private equity fund to form an internal control framework for self-regulation, and further defines the scope and requirements of fund management compared with the previous pilot guidelines. However, at present, the internal control risks of private equity fund still exist widely, which are mainly manifested in the lack of safety isolation between the manager's assets and the fund's assets, the failure to establish an internal governance framework and internal control norms that meet the needs of the development of the industry, or the weak implementation or mere formality of the relevant internal control system.

3.5 Investors fail to know everything

As a private equity fund, its primary task is to protect the interests of investors, but because of the operation mechanism of the fund, it is easy to have principal-agent problems. Thus, the damage to the interests of investors occurs from time to time, such as failure to disclose risks and information to investors in accordance with the provisions, failure to invest in accordance with the contract, failure of normal liquidation and withdrawal of due funds, failure to properly manage investors in accordance with the provisions, etc.

4. Suggestions on the management of private equity fund

4.1 Expand the scope of supervision and promote peer supervision

Although in recent years, China Securities Regulatory Bureau and its branches, China Securities Fund Association and other regulatory agencies are constantly strengthening the supervision of the private equity fund industry, through the form of self-examination of managers and spot check by regulators, some problems of private equity funds and their managers are found. However, due to the large number of private equity fund managers and the large number of funds, it is necessary to increase the scope of supervision and the team of supervision, we can enrich the existing supervision force by moving employees from relevant industries or different regions to join the team of on-site inspection, and also let employees see their own problems from other private fund problems in this way, so as to improve their business level and management level.

4.2 Improve the professional level and risk awareness of employees

The professional level of employees shall be improved through extensive training, peer exchange and other forms, especially the risk awareness of employees shall be improved. The division of responsibilities should be clear, the responsibility management of each position should be strengthened, and the situation of multiple responsibilities in one post should be reduced or avoided. In particular, the posts that need to be separated in information disclosure and fund system filing, investor appropriateness management and internal control must be specialized, and the regulatory agencies and self regulatory organizations shall conduct regular training on these posts to improve their business capabilities.

4.3 Introduce professional investment funds to promote the development of regional industries

At present, the management level of private equity fund industry in China is uneven, and there are more obvious regional differences, and the industry gathering strength is not strong is a very important reason. Therefore, we can consider introducing professional investment institutions through strategic cooperation, joint ventures, etc., and learning the advanced and standardized management methods of professional private equity investment institutions through cooperation to improve the level of the private equity fund industry in the region, thereby radiating more excellent investment institutions.

4.4 Improve the risk awareness of investors and give full play to the function of market supervision

We should strengthen the risk awareness of investors. The reason why private equity funds are prone to damage the interests of investors is that, in addition to the malicious behavior of the investment institutions themselves, most of the situations are that there is no damage at present, however, when the investment of the project is not smooth, it is easy for investment institutions to not disclose or conceal reports to investors, which prevents investors from making correct judgments. Therefore, investors should improve their risk awareness, fully understand their rights in the investment process, clearly understand the operation of the investment project, and play the market supervision function of investors.

With the increasing diversification of China's financial market, the role of private equity investment companies in China's financial market is increasingly strengthened. Therefore, only through the joint efforts of regulators, self regulatory organizations, private equity investment companies themselves, practitioners and investors, can we bring the healthy and sustainable development of this industry.

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