ISSN: 2710-0170

Research on the Development Situation of Enterprise Debt Restructuring and Hong Kong Listing in the Economic Adjustment Stage

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Abstract

Systematically study the various conditions in the development environment of corporate debt restructuring and subsequent cross-border listings on the Hong Kong Stock Exchange during a period of major global economic changes in this paper. Recently, due to the economic slowdown and restructuring of the enterprise, some enterprises have encountered a cash-flow problem and had to cut back their expenditures. Based on the above, this paper puts forward a proposal for improving debt-reduction plans and enhancing the international development of Chinese enterprises through an offshore listing. Debt restructuring is to address the harmful effects of debt overhanging and to stabilise the company's operating funds for the time being. After this stabilisation, listing on the Hong Kong Stock Exchange will allow the revived enterprises to raise funds from overseas investors, expand their international investor base, and comply with the high-level and reliable international corporate governance standards in that system. Based on the general theories of corporate finance and current market conditions, this paper explores how to reduce the losses of distressed assets through the joint operation of local debt restructuring and foreign funds raising.

Keywords

Enterprise debt restructuring; Hong Kong listing; economic adjustment; capital markets; corporate governance; financial distress.

1. Introduction

The world economy is undergoing repeated cycles, restructuring at the same time, and adjusting to new levels of development. At this time, the high-leverage company will likely be in a bad cash-flow situation. A drop in consumer demand will likely lead to a reduction in profits, a tightening of the domestic credit market, higher borrowing costs, and thus, financial difficulties and even bankruptcy for the company. The management of a company will have to do more than cut operating expenses to survive a bad economic period. Aggressively pursue all-round strategic reforms to rectify the problems of the damaged balance sheet and build a strong foundation for long-term, stable capital formation.

Recently, an extremely characteristic and increasingly popular strategic path has been formulated for fundamentally feasible but financially troubled enterprises: aggressive execution of all-encompassing debt restructuring followed by an offshore public offering, mainly on the Hong Kong Stock Exchange. The two ways will address the company's past problems and future needs for funds. Debt restructuring serves as a first response to curb the drop in cash flow caused by urgent debt repayment; thus, it aims to help the company remain stable. Although it has avoided a liquidity crisis so far, it has not achieved stable growth either. To successfully conduct corporate restructuring and increase the proportion of future market share, these newly organised enterprises will need a large influx of new equity capital.

ISSN: 2710-0170

Hong Kong is a first-class overseas financial centre and therefore a suitable location for this second stage. Its capital market has good liquidity, a large number of advanced global investors, and a world-class and very strict regulatory environment. By meeting the strict listing requirements in Hong Kong, the previously distressed company can show that it has been fully rehabilitated to the world and thus significantly reduce its overall cost of capital. In addition, the traditional domestic market is generally short on the required liquidity and sophisticated financial engineering to handle and price the large volume of complicated newly issued post-restructuring equity appropriately. A large-scale equity issuance in a downturn of the domestic market is likely to be underpriced and thus lead to substantial losses for existing shareholders due to dilution. Therefore, the selection of going public abroad is not driven by a desire for a high-profile image but by the real lack of funds available in China at present. A large number of advanced-risk-assessment models for investors around the world have been developed recently to better gauge the actual recovery prospects of troubled properties.

The main purpose of this all-encompassing research paper is to study in depth the development situation and underlying financial mechanism of combining enterprise debt restructuring with a Hong Kong listing during a period of serious economic adjustment. Section 2 introduces the reasons for corporate debt restructuring from within the company and economic theories. Section 3 analyzes the strategic reason and built-in structural advantages of using the Hong Kong Stock Exchange. Section 4 will introduce the functions provided by the combination of the two difficult-to-carry-out financial operations. Section 5 is the conclusion and future prospects of the market. Therefore, this study has demonstrated that the aforementioned system can be used to stimulate the rejuvenation of enterprises in an era of major changes.

2. Mechanisms of enterprise debt restructuring

Debt restructuring for a company is generally a high-risk operation involving serious financial problems, and its overall aim should still be to maintain normal business operations. During a period of severe economic downturn, the firm is likely to be hit by the "debt overhang" problem, and due to the excessive burden of old debt repayment, new investments that create value are thus deterred [2]. The company needs to restructure its capital at this time to keep running. Generally speaking, the two types of reorganisations are either informal, private out-of-court workouts, or highly formal, court-supervised bankruptcy proceedings.

Based on the above studies, due to relatively small direct financial costs and the capacity to repair damage to a company's market reputation promptly, private out-of-court debt restructuring has been frequently chosen by both corporate management and senior creditors [1]. Under such severe private training sessions, creditors may agree to a large-scale reduction in the principal amount, extended maturity extensions, and a significant debt-for-equity swap. These strong concessions are based on the idea that the firm's long-term 'going-concern' value is far greater than what would be achieved through a quick, uneven sale [8]. However, carrying out successful private workouts is generally difficult due to a severe holdout problem; that is to say, the minority of rogue creditors are reluctant to participate in restructuring and demand full repayment at the expense of the general body of restructuring efforts [1, 2].

When private negotiations cannot be reached, a formal court-supervised restructuring will be carried out. Although the formal bankruptcy rules aim to resolve the dangerous creditor holdout problem through the legal mechanism of mandatory cram-down, they often involve very high direct legal costs and lead to serious damage in important supplier and customer relationships [8]. In addition, the good results of an official debt restructuring will generally require all-encompassing reforms in the company's internal control system. Based on the above studies, when a company is under severe financial stress and requires restructuring, it is very common for the top management to be replaced prematurely; at this time, frustrated creditors

ISSN: 2710-0170

will actively demand the resignation of the leadership team responsible for the financial problems [3]. Ultimately, whether privately or through the courts, if the debt restructuring is successful, the serious pollution in the balance sheet can be significantly reduced, rigid and difficult-to-manage debt can be converted into highly flexible equity, and thus the newly stabilised enterprise will be better prepared for aggressive capital raising in the future.

In addition, a complex psychological conflict between the long-established management and the more assertive creditors often affects whether or not the restructuring proceeds successfully [2]. If the company does not consider the seriousness of the financial difficulties, the creditors will no longer be willing to offer favourable credit support. Given that the case involves a very toxic situation, a special restructuring advisor and an independent chief restructuring officer will be appointed as neutral and strict intermediaries. These independent professionals have stripped away any emotion from the financial models and are presenting creditors with the unvarnished truth through data. By having all parties focus solely on maximising the current enterprise value and not dwelling on the reasons for the past operational failures, these external experts have significantly increased the statistical likelihood of implementing a highly successful, value-preserving reorganization [3].

3. Strategic value of the Hong Kong capital market

Having successfully balanced the books after strict debt restructuring, the revitalised company urgently needs to raise new, long-term funds for operating capital. In the period of severe economic difficulties at home, local credit markets are relatively constrained and therefore unlikely to have a large-scale domestic equity issuance. As a result, the main direction has changed rapidly to aggressive cross-border listings, and restructured companies have been chosen by the Hong Kong Stock Exchange repeatedly for foreign recognition and substantial capital inflow [4].

Several theories of corporate finance provide a foundation for the choice of a very difficult-to-achieve offshore listing. Undoubtedly, the first reason for the large-scale flow of funds is the bonding hypothesis. By proactively choosing to cross-list shares in a highly regulated and well-known foreign market such as Hong Kong, the company's management is effectively bound by the much stricter legal and regulatory system there [4, 7]. Hong Kong imposes relatively high standards for mandatory corporate disclosure, imposes substantial penalties on insider trading, and protects the rights of minority shareholders against corporate expropriation rigorously [9-10]. Therefore, through the above, better corporate governance will reduce the significant information asymmetry between management and shareholders, and thus significantly lower the overall cost of equity capital for the company [7].

In addition, listing in Hong Kong will provide immediate, unrestricted access to a large-scale and highly diversified group of sophisticated global institutional investors for the previously distressed company [5]. In contrast to the highly volatile domestic retail market, most of the funds in the Hong Kong market are large-scale, long-term institutional investors with superior analytical capabilities for assessing the risks and values of restructured companies [6]. A large amount of funds will be provided from abroad to support the company's normal course of business and improve its international recognition at the same time. A successful initial public offering (IPO) in Hong Kong will send a strong signal to the world that cautious overseas suppliers, reluctant international buyers and other cautious banks believe the company has fully recovered from the previous financial difficulties and will operate under stricter international financial supervision [4-5]. A strong signal needs to be sent out to help the company repair the damage to its reputation in the market caused by the general economic slowdown.

ISSN: 2710-0170

Strictly enforce the principle of good corporate governance, and at the same time, serve as a stable financial platform for the internationalization of China [5]. It has eased some of the stringent foreign-exchange controls and other high-capital-control measures that have often limited the development of the domestic economy during the period of large-scale structural reform. By building a large-scale financial base in Hong Kong, the newly restructured company can join the wave of international commerce and foreign capital freely [7, 10]. The firm's deepening integration into the global economy is unlikely to be severely affected by fluctuations in the local economy and will thus have a large, diverse source of international income to absorb any damage to the balance sheet after the repair period [4, 9].

4. Synergy between restructuring and offshore listing

The combination of domestic debt restructuring and the following Hong Kong listing will achieve deep, high-functioning synergy and exceed the sum of its parts considerably. Both of the above ways are closely linked in a chain, and highly distressed and illiquid assets have been successfully transformed into fully capitalized, globally traded securities. At the heart of this extraordinary synergy is the fact that a clear promise of a high-profit future offshore listing actively aids in conducting the difficult and contentious initial debt-reorganization talks [1].

During the debt-restructuring talks, angry and frustrated creditors are frequently told to accept significant financial losses or to convert their secured senior debt into high-risk, heavily subordinated corporate equity. It is extremely difficult to convince these deeply skeptical creditors to accept equity in a failing, unlisted company, as this equity is inherently illiquid and very hard to price accurately [2, 8]. However, if the corporate management team can present a very credible and well-organised plan for a near-term initial public offering (IPO) on the Hong Kong Stock Exchange, then the reasons for the negotiation will change significantly. The prospect of a Hong Kong listing offers a clear, highly attractive and very desirable exit path for the trapped creditors [4, 10]. The previously illiquid and high-risk private equity has now suddenly acquired a large number of potential freely tradable public shares around the world [5, 7]. An explicit promise of substantial future liquidity will encourage creditors to provide complete financial support for the high-risk restructuring plan and thereby hasten the process of complex restructuring [1, 3].

At the same time, the difficult-to-handle process of debt restructuring is also necessary for the Hong Kong listing. The high-level, internationally renowned listing requirements of the Hong Kong Stock Exchange demand an extremely clean and highly transparent balance sheet, without a large amount of pending litigation or highly toxic, unsustainable debt [9]. Ruthlessly carry out the debt restructuring first to eliminate the large-scale financial risks that would automatically disqualify the company from going public abroad [2, 8]. In addition, high-pressure management turnover and full-scale corporate governance reform are often triggered by serious financial distress and proactively prepare the company for stringent regulatory inspection by overseas capital markets [3, 10]. The restructuring provides the necessary foundation for building the large-scale structure of the international public offering safely. In short, the two have achieved a smooth merger, providing a very strong and stable support system for the complete restructuring and high-tech foreign-invested capital introduction of large enterprises.

5. Conclusion

With the expansion of large-scale corporate finance in recent years, atypical cases of debt restructuring and cross-border listings have become increasingly complex and prominent. As shown in the above comprehensive analysis, to deal with the problems of a major global economic downturn, fundamentally sound yet high-leverage enterprises will need to make large-scale changes to their overall capital structure. Local, scattered fixes to the operating

ISSN: 2710-0170

problems will not be adequate in the face of a large-scale, systemic liquidity shortage. Therefore, an all-encompassing debt restructuring and the immediate listing of the Hong Kong Stock Exchange have been chosen as two very aggressive measures to provide full-scale structural support for the entire company.

Debt restructuring provides urgent, high-level relief; thus, it must urgently address the severe problems in the balance sheet and eliminate the cause of over-indebtedness. Although it is difficult to do so, it will enable the company to raise funds in the world market in the future. Subsequently, the Hong Kong listing will give the newly revitalised company immediate, high-quality access to the overseas capital market, establish a high-level system of financial monitoring, and send a clear signal to the entire world that the company has fully resumed normal business operations. The two large-scale financial operations are in considerable harmony: the explicit pledge of a high-earning overseas listing will actively secure the cooperation of creditors during the difficult restructuring period, and at the same time, strict discipline will be imposed during the restructuring to make a public offering possible.

Given that the world economy will continue to undergo frequent, large-scale and unpredictable cyclical fluctuations, the demand for high-efficiency, globally integrated corporate rescue systems will only increase. Policymakers, financial regulators and global institutional investors need to keep improving the level of integration of the legal and financial channel connecting domestic corporate restructuring efforts with top-tier international capital centers and actively protect this link. Thus, these assets can be systematically preserved to protect jobs and maintain the entire structure of the global market under conditions of severe economic downturn.

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