ISSN : 0974 - 7435 Volume 10 Issue 18

2014

BioTechnology

An Indian Journal

FULL PAPER

BTAIJ, 10(18), 2014 [10268-10274]

Innovation research on value-creating type financial management mode of large chemical fiber enterprises ——based on case analysis on Hengyi group

Ni Defeng
School of Accounting of Jiangxi University of Finance and Economics, Nanchang, Jiangxi province, 330013
E-mail : 2360199318@qq.com

ABSTRACT

Features of chemical fiber industry determine the features of financial management. At present, the chemical fiber industry is facing rigorous business environment, for example, centralized releases of capacity, demand growth slowing down, production cost staying at a high level, which makes the chemical fiber enterprises need to change and update the traditional concept of financial management urgently into value-creating financial management mode. As a leading enterprise in chemical fiber industry, through introducing high-quality talents of financial management, with the help of VBM concept, Hengyi Group takes the lead in developing innovative financial management mode in the industry, establishing value management institutions to undertake the function of creating value directly, supporting the function of creating value indirectly and protecting value from losing so as to promote the enterprise to create the whole value. Such successful practice of value-creating type financial management mode can be taken as reference for chemical fiber enterprises which are staying in the period of industry adjustment to get rid of difficulty, turn a profit and realize transformation and upgrading.

KEYWORDS

Hengyi group; Chemical fiber enterprises; Value creation; Financial management.

INTRODUCTION

At present, the strategy of structure adjustment of economy and industry is under implementation in China, many industries with traditional advantages have difficulties including excess production capacity, prominent imbalance between supply and demand, fierce market competition, difficulty in management and nervous funds, so preserving their capital for low profitability or guarding cash flow have become the financial target that every enterprise is pursuing.[1] Under such background, “Financial management creates value” will not only a slogan for management, but also recognized and pursued by many enterprises. In order to be able to get over the industry difficulty period, preserve the accumulated power effectively, enhance the enterprises’ comprehensive competitive power and win a place in the fierce market competition, many chemical fiber enterprises started to adjust strategies, cut down the investment and control expenditures. As the core of enterprise management, financial management also needs to take advantage of an opportunity and makes positive response to external unfavorable environment change.[2] In this article, basic characteristics of financial management of chemical fiber industry have been analyzed with introduction of VBM concept to explain the basic connotation of value creating financial management and the system and practice of value-creating type financial management of Hengyi Group were introduced in order to provide theoretical thinking and practice reference for transformation and upgrading of financial management of chemical fiber enterprises in our country.

BASIC CHARACTERISTICS OF FINANCIAL MANAGEMENT OF CHEMICAL FIBER INDUSTRY

Chemical fiber industry is a traditional industry beneficial to the people's livelihood with petrochemical industry as the upstream industry and textile and garment as the downstream industry and is highly related to the daily basic necessities of life. For one hand, it is affected by domestic and foreign macro policy and economic cycle with a large fluctuation between demand and supply with obvious industry periodicity features; for the other hand, the raw material and product price are frequently affected by the international oil price every day, so the enterprise of this industry has a high management risk and unstable management efficiency. It is well known that chemical fiber industry also belongs to a capital-intensive industry, especially over recent decades, there are fast industry technology improvement, doubled and redoubled installment scale, high threshold for fixed-asset investment and large capital requirement. Meanwhile, for the chemical fiber industry, due to a high input-output ratio and fast turnover of operating cash flow, it is extremely important for chemical fiber enterprises to do a good job in daily fund management. For a long time, the chemical fiber industry in our country belongs to typical foreign trade industry which put both ends of the production process (the supply of raw materials and the marketing of products) on the world market. For one hand, there is a lack of raw material, the import volume is increasing substantially year by year and the degree of dependence on import of the main raw materials (such as PX, MEG) reaches up to over 50%; for the other hand, downstream products are highly dependent on export. Therefore, interest rate change, exchange rate fluctuation and protection policies issued frequently for international trade have a significant impact on management and development of chemical fiber industry. To sum up, financial management of chemical fiber has the following characteristics:

Firstly, predicting industry periodic fluctuation scientifically for making plans of funds in advance. Chemical fiber industry belongs to an industry with strong periodicity, and fluctuation of domestic and foreign macro policies will affect the cyclical fluctuation of the industry. If the two cycles are staying at the valley at the same time, the chemical fiber industry which is highly dependent on capital will suffer a bigger shock. Therefore, for financial management of chemical fiber industry, primarily, it is necessary to pay high attention to the periodic features of the industry, predict the periodic fluctuation scientifically and timely make fund procurement and usage plans so as not only to prevent the enterprise from confronting with risks of declining profitability in the industry valley and insufficient capital and difficulty in financing, but also to meet the enterprise’s fund demand during industry recovery period with a rebound in profits and investment growth.[3]

Secondly, make good future goods for preserving or increasing the value by making use of the financial features of the product. The chemical fiber industry is liable to be affected by petroleum, so frequent fluctuation of prices of the raw material and products every day brings a large challenge to enterprise management. In order to reduce the risk brought by price fluctuation, the main products of chemical fiber industry are designed with the corresponding variety of future goods, for example, foreign crude oil futures and domestic PTA futures, which undoubtedly put forward a higher requirement on financial management. To make predictions and plans for financial management, it is necessary to know about and grasp features of financial derivatives, and make schemes of raw materials and preserving or increasing the value of products by making use of its financial feature. And an approach and channel creating profit and increasing efficiency can also be added when controlling and reducing the risk of enterprise management.

Thirdly, collect development fund for project and manage daily operation fund. Chemical fiber industry is an industry with concentration of capital. Investment of fixed investment needs not only a large amount of capital, but also a longer financing period. The fixed assets usually take up over 50% in the chemical fiber industry with bad asset liquidity and the asset-liability ratio reaching up to over 70%, so the phenomenon “short-term loan for long-term application” of capital is extremely common. Therefore, for the chemical fiber industry, investment projects must be matched with project financing projects with the deadline of 3 years, 5 years and 7 years and other years to avoid “short-term loan for long-term application” and to prevent liquidity risk. The gap of daily operation fund is mainly resolved by means of working capital loans, bank acceptance of notes discounted and documentary credit and other ways. The input-output ratio of chemical fiber industry is high, usually, the investment of fixed assets of 1RMB can bring a sale value of 3RMB or even 5RMB, therefore, the operational cash flow is ampler for project fund and the chemical fiber industry needs to carry out scientific management to different cash flows so as to remedy the problem of insufficient business fund on the one hand and improve the efficiency of fund turnover on the other hand and reduce financial cost.

Fourthly, predict the situation of exchange rate and make preparations for foreign exchange risks. The chemical fiber industry needs to import a large quantities of main raw materials, for example, PX, MEG and CPL, meanwhile, needs to export products directly, such as, polyester chip, bottle grade, filament and short fiber or needs to export products indirectly, such as textile and garments, and needs to settle accounts in US dollars, Japanese yen or Euro, so the exchange rate risk becomes increasingly prominent. In recent years, with further deepening of reform of exchange rate of RMB, exchange rate risk will also become one of the main risks facing the chemical fiber enterprises. Therefore, making evaluations and managing exchange rate risk will be bound to become another basic function of financial management of chemical fiber enterprises.

Fifthly, reduce the financing cost by enhancing enquiries on interest rate. The financing cost with RMB stays at a high level recently, while the overseas interest rate of US dollar maintains at a historic low level, so there is an obvious interest arbitrage existing in the interest rate between the domestic financing and foreign financing. The chemical fiber enterprises could make use of its advantages in import and export to realize foreign financing for domestic application, which not only can enjoy the advantages of low cost of foreign financing and also can obtain a larger exchange earning with appreciation of the yuan.

EVOLUTION OF VALUE-CREATING TYPE FINANCIAL MANAGEMENT MODE OF HENGYI GROUP

Basic condition of Hengyi group

Being founded in 1994, Hengyi Group is reorganized on the basis of Xiaoshan Yarn-dyed Fabric Mill-a township enterprise founded in 1974. After exploring, innovating and developing for forty years, this group has become the biggest manufacturer of phthalic acid (PTA) and polyester fibre (PET) in the world starting from making socks and then to open up towards the upstream refining and petrochemical fields constantly along the direction of contexture, textile printing, lining, texturing, polyester (filature) and purified terephthalic acid (PTA). As of the end of June, 2014, Hengyi Group possesses PTA capacity reaching up to 13,000,000 tons and PET capacity of 3,700,000 tons, which takes up 1/3 and 1/10 of the domestic market share respectively. And this group’s total asset is over 35billion RMB and it has over 8000 employees and its sales volume in 2013 was over 78billion RMB. Since 2004, Hengyi Group has been staying at the first position of the chemical fiber industry in our country, and for 10 consecutive years, has edged itself into top 500 Chinese enterprises (ranked 162th in 2013), top 500 Chinese private enterprises (ranked 16th in 2013) and top 100 enterprises in Zhejiang province (ranked 9th in 2013). In terms of construction of financial management, Hengyi Group has the honour to win the second prize for innovative products of enterprise management in China, the title of Credit Management Model Enterprise in Zhejiang province and Advanced Unit in Internal Audit in Zhejiang province successively.

Development history of financial management of Hengyi group

Fast development of enterprises cannot do without transformation and innovation of financial function. At the beginning of development, the foundation of enterprise management was weak, the management system was not complete and there was a lack of job responsibilities and flow system, there were only financing accounting, bookkeeping, financial report and declaring dutiable goods, which was so far from the function of financial management that service and support cannot be provided for enterprise management and decision-making. After 2000, in order to meet the demand of strategy transformation of the enterprise, improve the enterprise’s management level, the company implemented a series of reforms boldly by abandoning the concept of patriarch-based management, breaking through the management mode of township enterprises, employing high quality high level managers and introducing and cultivating specialized talents. By 2003, a batch of young, specialized and management-based financial team was formed in the company preliminarily. Meanwhile, the Company realized clearly the core position and leading role of financial management in enterprise management, so it established financial management department and formulated responsibilities for financial management, making financial management grow out of nothing and participate into the business and management activities of the enterprise. In 2008, with the financial crisis breaking out, based on the demand of enterprise sustainable development and enterprise risk management, VBM concept and method were introduced into the financial management department of the company to establish and implement value-creating financial management mode in an all round way and further innovate the function of financial management, emphasize the function of value creation, making financial management transform from passive service type into active creation type.

Value-creating type financial management mode of Hengyi group

Modern enterprise management is a huge and complicated organizational system with numerous subsystems, for example, production management, purchase management, sales management, R&D management, human resource management and financial management. And financial management system will occur simultaneously with many subsystems, so it is a management department with higher integration. The management of the company is aware that only through renewing and integrating effectively the function of the current financial management, further correcting and strengthening the awareness of financial management, appropriately adjusting and changing the positioning of financial management, defining the concept of "big finance", constructing a specialized value management institution to build it into a value creation center and value management center, we can keep pace with the times and play well the responsibilities and role of a pilot of enterprise value creation activity.[4]

VBM (Value Based Management) is one of management theories with the highest degree of attention in the field of western business management since 1990s. Such theory emphasized the core status of the value concept in enterprise management with the aim of improving the entire value of the enterprise and assisting the enterprise in clearing value driving elements.[5] The VBM tool that is widely used in management in western enterprises has two major features: one is to reshape the operations and management of the enterprise with the concept of "Value", so function activities of the enterprise including supply, production, sales, R&D, inventory, logistics, market, administration, auditing and finance, all need to be carried out surrounding "value"; the second feature is the integral angle of view "big finance" introduced the concept, tool and method of value assessment and value management fully into each business activity and management link of the enterprise with emphasis on the target of taking value as the foothold, and pursuing value creation and value increase.[6]

The trinity of the value management institution of the company takes the financial management department as the main body, with the investment development department and the audit department as two wings. It should not only undertake the enterprise's function of creating value directly, but also play the role of supporting the enterprise in creating value indirectly and protecting the value from losing, in which, the activity of creating value directly includes cost management (the key point is management of financial expense), pricing policy, striving for tax relief and striving for governmental subsidy and so on. And the activity is mainly implemented with the financial management department as the leader; the activity of creating value indirectly includes participation into enterprise strategy and investment decision-making, operation and management, supervision and control and so on and is implemented with the Investment and Development Department as the leader; the activity of protecting the value from losing includes enterprise risk management, internal control and performance assessment and so on and is mainly implemented with the Auditing Department as the leader.

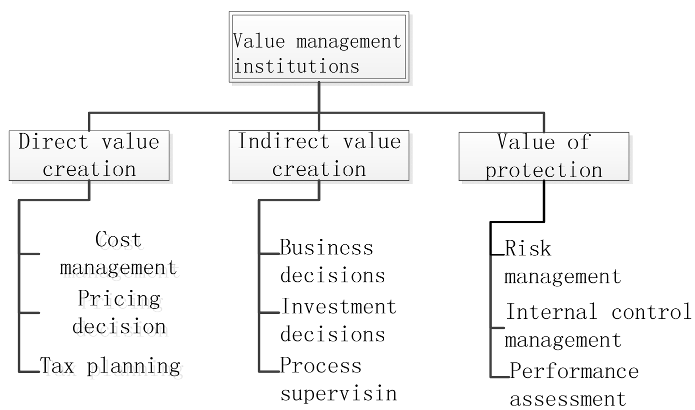

Figure 1 : Occupational frame of "big finance" management department of Hengyi group

The value management institution needs to play the role of a pilot of enterprise value creation and value management, firstly, it is necessary to set the concept of value management firmly, and popularize this concept to the entire enterprise, all departments and every employee. It is necessary not only to provide services in aspects of investment decision-making, operating management and risk management and supporting and promoting the company in creating value indirectly and protecting the value from losing, but also to bring the short-term financial management in cost management (for example, in terms of funds management, it is necessary not only to meet the fund demand of production development of the enterprise, but also try to reduce the financing cost), policy research (for example, making plans to reduce the tax cost by making use of taxation preference policy; striving to get subsidy to create revenue by making use of encouragement and assistance policies issued by the central government and the local government) and idle money of specialties, advanced management tool and policy resource into play to create value for the enterprise directly.[7] Secondly, it is necessary to change passive management into active management. The company's value management institution have reached a consensus that there are only status, therefore, to have a certain power and authority in the enterprise, it is necessary to have one's own management space and authority. And providing good service is the best way of opening the wide management space, as management is the best service, and service is the tool of promoting management. The company's value management institution can make use of perfect informatization platform and means to let the information run through the entire business process by converting passive management into active management and serve as a coordinator of management and a decision-making participant of the company to exclude the difficulty and anxiety for the enterprise. Thirdly, to establish a value creation management system. Management rules serve as the basis of system.[8] Without guarantee from the management rules, the system cannot be established and management cannot be implemented easily, so target is only empty talk.

Therefore, the company's value management institution needs to formulate relevant financial management system for value creation and value management so as to form value management system by focusing on the target of value creation.

PRACTICE OF THE FUNCTION OF VALUE-CREATING TYPE FINANCIAL MANAGEMENT OF HENGYI GROUP

Since Hengyi Group implemented the value-creating type financial management mode, not only the industry risk and management risk brought by industry periodic fluctuation and cost inflation facing the company have been controlled and dispersed effectively, but also the capital demand due to fast development of the company has been met and guaranteed, creating enterprise value directly.

Function of creating value directly

(a) Expand the value of operating leverage through cost management, reduction of cost. Cost variance strategy is the main competitive strategy of chemical fiber industry and the company also takes low cost as the core competitiveness of the enterprise. Therefore, by making use of the information software SAP system, the financial management department of the company established a Cost Management System, formulated cost control system and defined methods of examination of cost. Firstly, delicacy management disaggregate the cost items in details so as to decompose equally fees including consumption of materials, utility bills, personnel wages, depreciation and three charges and share them to each category products and each specification of each product to make the management, operator and the staff read the cost composition of each specification like a book and know them fairly well. Secondly, strengthening cost assessment. List the cost index as the main content of assessment on production and management; determine the budget indicator according to the industry advance level and historic advance level each year; issue the assessment index in the order of four levels of "group company, production enterprise, workshop and working team" and publish the assessment results every month for variation analysis. Thirdly, strengthen the input of technological innovation. The company will issue budget for technological innovation each year for energy-saving and cost-reducing, process optimization and equipment replacement so as to ensure stable operation of the devices. Over the years, the company have implemented strict cost control and assessment system and obtained optimum performance within the industry, take the leading product PTA for instance, after deducting the cost of PX raw material, the finished cost (three charges are included) for production of one ton PTA is much lower than the average value of RMB300-500 per ton, which is the core competitiveness for the company to remain profitable.

(b) Realize overall listing of the enterprise and expand the channel for direct financing by making use of the strategic opportunity. By making use of super good cycle brought by golden industry recovery during 2009-2011, the financial management department realized listing of the entire assets of the main business by buying a shell of ST Guanghua. The company became a public company from a private enterprise, which not only realized asset securitization, but also broke through the direct financing channel, improved the enterprise brand image and the market value of the enterprise. Meanwhile, the investment and development department of the company explored actively financing of the bond market. Since 2006, the company issued in succession short- term financing bond, medium term note, privately raised company bonds and other varieties of bonds (17 periods in total) in the interbank bond market with the accumulated capital financed reaching up to RMB13bn and the saved financial cost being close to RMB0.3bn and the amount financed via bonds taking up 40% of the total amount of corporate finance, which not only provided a strong capital guarantee for the company to realize the strategic target of developing and consolidating its industry position rapidly, and also provided sufficient cash flow for the management and development of the enterprise during the difficult industry period and changed the limitation of dependence on single bank financing, optimized the financing structure, reduced the mutual insurance risk among enterprises and accumulated high quality credit resource and built up good market financing image.

(c) Make an enquiry for the rate of interest, break through the foreign and domestic financing channel, excavate the financing potential of the enterprise and reduce the financial cost. By relying on its own industry chain mode, the financial management department of the company makes an enquiry for the rate of interest, breaks through the financing potential of the enterprise so as to reduce the financial cost significantly by making use of the interest margin between the foreign and domestic USD and RMB and the appreciation expectation of RMB, using overseas US dollars for liabilities and enjoying low interest rate of US dollar and advantage of RMB appreciation. For example, through establishing a subsidiary corporation in Hong Kong for carrying trade of raw materials, the financial management department adjusted the letter of credit opened in mainland China with the credit period of 90 days into the letter of credit opened in Hong Kong with the credit period of 180 days, which not only extended the credit period to alleviate the capital demand of the enterprise, but also lets the company enjoy a lower interest rate of US dollar in Hong Kong. In addition, the financial management department also carried out settlement and financing businesses by making use of the operating characteristics of different banks. For example, process the export seller's credit operation through Export-Import Bank of China; conduct discounting business of bank notes pool through Industrial and Commercial Bank of China; and conduct foreign exchange risk management through Bank of China. Since 2013, yuan continued its stable appreciation state, and meanwhile, the interest margin of loan between yuan and US dollar has been kept at about 3%. The company improved the proportion of US dollar in financing by combing the tendency of external finance market with characteristics of internal import and export businesses, and reduced the cost of enterprise financing by making use of interest margin of US dollar and appreciation of yuan. During the business operation, the company will give priority to foreign suppliers of raw materials and use letter of credit in US dollar for settlement under equal conditions. Meanwhile, by making use of the combined variety including documentary credit, the credit period can be extended, exchange earning can be increased, and the financing cost can be reduced by making use of documentary credit in US dollar. Through adjustment on the financing strategies, the financial cost of the group in 2013 has reduced by RMB0.35bn on year-on-year basis, therefore, the enterprise was provided with solid guarantee for achieving profitability during the low industry valley period.

(d) By making use of the preferential tax policy, special encouragement and assistance policies issued by the central government and local government, make tax planning and policies to generate profits. For example, the financial management department of the company knew about and grasped the updated policy-related information through policy consultation and studying each week to fight for a low tax cost and more subsidy income for the enterprise. For example, in order to encourage enterprises to make technology innovation and develop new products, the central government implemented 15% corporate income tax and “R&D expenditure” double deduction to new and high technology enterprises, so the financial management department of the company organized the production enterprise and the R&D center to make application actively and obtained the title of new and high technology enterprise for the company. In addition, the financial management department of the company organized applications for a series encouragement and assistance policies issued by the local government, for example, financial aid for the group headquarters, subsidy for big enterprise and big group, award for export earnings, award for platform of sci-tech innovation and subsidy for introducing high-end talents and so on.

Function of creating value indirectly

The value management institution of the company participated into the whole process of the enterprise operation and activity of management and decision-making. The institution integrated into the business process comprehensively through management ways like pre-incident plans, during service and after supervision, and created value for the enterprise indirectly during this process.

(a) Insist on strategic orientation, be careful in investment decision-making and control investment activities strictly. Since 2005, Hengyi Group defined “highlight, consolidate and improve the main businesses’ competitive position in the industry” as the strategic development direction by making investment towards the upstream of the chemical fiber industry, insisting on the substantial economy and highlighting the main businesses, so that decision-making risks and capital risks brought by blind diversified development had been avoided effectively from the aspect of strategy. For decisions made to project investment, in principle of prudence, the financial management department participated into the assessment of investment projects to calculate and evaluate the prospective earnings, return and risk of each investment project; and the financial management department had one-vote veto for decisions on major investment projects. For the budget of project investment, the investment and development of the company compiled the overall budget of investment each year and compiled budget of project capital expenditure each month, and followed, analyzed and assessed the project progress, fund and risk of projects each month for strict utilization of budget and strictly prohibiting expenditure out of budget. During the project operation management, the financial management department of the company dispatched the financial manager directly to the project company to obtain the condition on project progress directly, timely follow and implement dynamic management; meanwhile, the manager audited the fund utilization and guaranteed to make the payment of investment project on schedule so as to ensure that the progress of investment project would not be affected due to fund demand.

(b) Pursue the policy of active management and participate actively into the daily operating decision and management activity. For the past few years, in the chemical fiber industry, with excess production capacity, fierce competition and prominent system risk, in order to control effectively the operational risk and market risk facing the company, the financial management department of the company initiatively got involved into the operating management and decision-making of the enterprise, and pursued the concept of active management and service, participated into the management and coordination conference each month so as to formulate a dynamic strategy for sales and collection according to the status of funds and implement dynamic management to the inventory of each product. The financial management department helped the marketing center to make gain and loss analysis for different products and different varieties and put forward optimized product mix according to the gain and loss analysis. When the DTY of a certain specification sold well, in order to ensure balance of raw material POY of the corresponding specification, POY of other specifications with unfavorable benefit had to be shut down timely; when FDY product sold bad with weaker profitability, more POY products would be produced. Thus, according to the principle of maximizing the benefits, the company restricted or stopped the production of POY, FDY, and DTY products successively to control the inventory level and reduce the inventory risk.

Function of protecting value from losing

The value management institution of the company not only tried to promote the value-creating activities of the company, but also attached importance to prevention of value damage risks. For the decision-making risks, business risks and operating risks facing the enterprise, the financial management department adopted many effective means and methods. For example, the financial management department held risk management regular meetings every month to discuss about the business risks, financial risks and exchange rate risks with fund as the core, formulated business plans, financing arrangement and risk countermeasures for the next stage and reported to the decision-making level of the company regularly. In addition to establish an early warning mechanism to the company’s risk source, the financial management department also adopted necessary insurance means and hedging tools to transfer and avoid risks initiatively, for example, reducing the risk of bad debts of receivables by purchasing export credit insurance. For daily foreign exchange risks, the company avoided these risks by means including future foreign exchange settlement, forward exchange transactions and foreign exchange derivatives. The audit department of the company established and perfected the internal control system according to supervision requirements of the listed company and carried out financial audit and internal control accountant regularly or irregularly, and formed basically a comprehensive risk management system which covered each activity and each link of the enterprise with cash flow as the monitory point by virtue of information-based means including SAP,OA,HR and fund management software.

REFERENCES

[1] Guo Min; Construction of Value-creating Type Financial Management System. Management World, **5**, 156-157 (**2006)**.

[2] Chen Zhibin; Research Value of the Analytical Model of the Value Driver based on the Management Perspective of Free Cash Flow. Accounting Research, **4**, 58-62 (**2006)**.

[3] Wang Tao, Chen Jinliang; Research on the Effect of Market Orientation on Value Creation under Uncertain Environmental Conditions. Nankai Business Review, **14(6)**, 57-66 **(2011)**.

[4] Liu Xuemei; Alliance Portfolio: Value Creation and Governance Mechanism. Chinese Industrial Economics, **6(6)**, 70-82 (**2012)**.

[5] Tang Guliang; Creating Value-based Financial Management Mode under the Framework of VBM. Accounting Research, **12**, 23-27 **(2003)**.

[6] Zhang Geling, Chen Zhihong; Case Study on Value-creating Type Financial Management of SUMEC Company. Accounting Research, **10**, 62-66 **(2010)**.

[7] Sun Yanxia; Overview on Research of Enterprise Value Creation based on Different Perspectives. Nankai Economic Studies, **6(1)**, 145-153 **(2011)**.

[8] Zhu Mingxiu Research on Value Driving Based Financial Management Mode. Finance and Economic, **10**, 83-86 **(2007)**.