

# Analysis of the Development Strategy of Urban Investment Companies Under the Perspective of Financial Generosity

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**Abstract:** *This paper analyzes the current situation of the city investment company in terms of capital, funds and operation from the perspective of financial prosperity, based on the huge financing scale and potential risk situation of the city investment company, and takes A County City Investment Company as an example, and provides a new development mode and direction for the revitalization of the economy of the city investment company. From the perspective of "financial prosperity", it provides a new development mode and direction for revitalizing the economy of city investment company, and puts forward corresponding development strategies from the aspects of asset management, capital management and operation management.*

**Keywords:** Financial generosity, Urban investment companies, Land finance, Development strategies.

## 1. Introduction

In recent years, with the acceleration of China's urbanization process and the continuous improvement of the socialist market economic system, in order to expand the source of funds for urban construction, some local governments have tried to operate urban capital by means of the market economy with the concept of running the city, which has given rise to China Urban Investment Companies(CIC), as the main body of urban capital operation and the investment and financing platform of the local government, was born at the right time.

Urban investment companies refer to economic entities established by local governments and their departments and institutions through financial allocations or the injection of land, equity and other assets, which undertake the function of financing government investment projects and have independent legal personality, which raise funds for local economic and social development through debt financing, it can play a corresponding positive role in strengthening urban infrastructure construction and other aspects. As a financing platform at the most basic level of the county-level government financing platform, through the use and concentration of government credit, has better realized fund-raising and solved the problem of insufficient funds for infrastructure construction, which is of practical significance in stimulating local economic development and expanding domestic demand in the context of the current limited local financial resources, huge investment in infrastructure and insufficient supporting funds.

Based on the operating characteristics of the urban investment company, it has accumulated a huge financing scale and the potential risk situation, should start the local government investment and financing platform for standardization, market-oriented and transparent reform. This paper selects the "financial prosperity" perspective, the general point of view of the difference is that the city investment company has large-scale debt, financing scale expansion, resulting in increased risk of debt servicing of the local government, scholars are generally from the perspective of broadening financing channels to reduce the financing risk. In contrast to

the perspective of the "financial prosperity", this perspective for the revitalization of urban investment company economy provides a new development mode and direction, has a certain practical significance.

On the one hand, financial generosity can be used as the company's reserve fund to help the company's ability to cope with environmental uncertainty, and more importantly, the CIC utilizes financial generosity to carry out investment activities, and the financial generosity of the CIC can also reflect the creditworthiness of the local government to help solve the problem of infrastructure construction. On the other hand, maintaining a certain degree of financial generosity can also limit the flow of funds to a certain extent and regulate the company's performance. Therefore, financial generosity is a double-edged sword, which has both positive and negative effects, and it is necessary to rationally utilize funds to maximize the positive effects of financial generosity.

## 2. Relevant Concepts and Theoretical Foundations

### 2.1 Financial Well-being

Financial generosity is a special financial phenomenon discovered by scholars in recent years. After the research of Gan Shengdao and other related scholars, its related concepts and impacts have appeared in the field of corporate finance and management, and academics have put forward the concept of "financial generosity". The existing common logic is that the company through debt to finance itself, the use of financial leverage to expand their own profits, but the financial affluence has a different place - the company in the hoarding of cash at the same time, but also in the reduction of interest-bearing debt, it means the cash and short-term securities is greater than the sum of interest-bearing liabilities. At present, more and more companies have this phenomenon, this paper is related to the use of the concept of financial affluence, the use of cash + short-term securities - interest-bearing liabilities > 0 to define the degree of financial affluence.

## 2.2 Land Finance

The "Land finance" is a common term that generally refers to some local governments rely on revenues from the granting of land-use rights to maintain local financial expenditures. In fact, after land concessions, local governments can also obtain budgetary revenues mainly from sales taxes, including those from the construction and real estate industries, which are all at the disposal of the local government. These two items alone may account for nearly 40% of local tax revenue. In some places, "land finance" has become a veritable "second finance", and in some cases has even become the main source of fiscal revenue. If counting the land as collateral for bank loans, the actual disposable income of local governments will be more, local governments in the hands of the land and government credit is the financial institutions optimistic about the quality of the collateral. Local governments also play the role of local capitalists, who are not only the originators of land finance, but also the "chairmen" of local urban investment companies and the risk-takers of local debts. With the rapid expansion of the scale of debt financing by financing platform companies, urban investment companies, leading to increased risk of debt servicing by local governments and increased risk for banking and financial institutions, accelerating the emergence of land finance.

As the main factor influencing the financial prosperity of urban investment companies, the land premium income from land finance can effectively prevent the risk of local government debt and maintain sustained and healthy economic development and social stability by resolving the harm of "land finance".

## 2.3 The Theory of Preferential Financing

In markets with transaction costs and information asymmetry, the order of financing for firms should be internal before external, with debt being preferred to equity financing. The theory of preferential financing holds that debt financing has tax-saving effect and lower issuance cost, and it will not dilute the control of the company while financing. According to the actual situation, the existing capital structure of the company is based on the company's long-term investment and financing behavior, if the company continues to make a profit, it relies on its internal source of financing can be better management, less use of debt financing, in the long run the company because of less debt plus the accumulation of profits will be hoarded a lot of money, which will form the financial affluence.

It means the company favors the use of endogenous financing and equity financing, coupled with the company's profitability. In the long run, a pool of funds will be formed within the company, if it not be used and managed reasonably, there will be a phenomenon of hoarding of funds, the phenomenon of financial abundance in the formation of the cycle of the enterprise, the redundancy of a larger number of funds can easily lead to an increase in the enterprise's management of the funds of the agency costs, bringing unnecessary losses.

## 3. Analysis of the Development Status of County a Urban Investment Corporation

This paper analyzes the current situation of the development of A county-level municipal investment company as an example.

### 3.1 Difficulties in the Operation of Companies Due to Inaccurate Capitalization

The capital pool of the CIC consists mainly of land assets and invested infrastructure projects. At present, on the one hand, it is difficult to realise the invested infrastructure projects, on the other hand, it is difficult to solve the following problems in the land storage work:

First, it is difficult to control the land that the company has collected. Due to functional constraints, it is difficult for the urban investment company to supervise the stock of land for which land certificates have been issued, and it is difficult to control its exact use. For example, in the stock of land of A county-level municipal investment company, part of the land that has been used as the company's registered capital and loan collateral has actually been occupied, totaling about 1,266 acres, accounting for 44.8% of the company's registered physical capital (land) of 2,828 acres. Secondly, it is difficult to recover the funds lent by the Company. City Investment Company cumulative lending funds mainly include the county units, town governments, for land resources construction, capital investment, town construction and development, acquisition of related assets, etc., most of the funds according to the leadership of the approval of the views, for the borrowing procedures, is now a long-term pending accounts, recovery difficulties. Thirdly, it is difficult to balance the funds for land resumption. The company paid the expropriation and approval fees and even concessions to acquire land, but actually it was occupied, no corresponding compensation, was ceded, land concessions into the county treasury account. The company's capitalization was not carried out in accordance with the relevant requirements ("50% of the proceeds from land development and state-owned land grants in County A" as the subsequent capital injection of the CIC). In addition, when land is needed for the construction of the park's investment enterprises and related projects, the CIC must also pay for the costs of demolition and relocation compensation, land leveling, and so on. This has actually created a scissors gap between the expenditure and return of funds in the process of land acquisition and storage by the CIC, which not only fails to establish a stable growth mechanism for the company's subsequent capitalization, but also creates a serious imbalance between the expenditure and return of funds.

The above three problems have caused difficulties in the liquidity of the company's construction and operating funds, and have also caused the company to face legal risks such as capital misrepresentation and capital evasion.

### 3.2 Huge Contradiction in Financial Needs

Following the State Council [2010] No. 19, the Ministry of Finance, the Development and Reform Commission, the Central Bank and the China Banking Regulatory Commission jointly issued the "Notice on Stopping Illegal and Unlawful Financing Behavior of Local Governments" ([2012] No. 463), which further clarifies the conditions of the local government

financing projects, as well as must be prohibited by the violations, illegal capital injection and financing specific behavior, which leads to the future, such as the use of public welfare assets, and the use of reserve land expected return as a source of debt service financing will be halted. This move will lead to future financing methods such as using public welfare assets for capital injection, and using the expected revenue from reserve land as a source of debt service funds will be stopped. In addition, the Ministry of Finance requires local governments to strengthen government debt management, to establish local government debt scale management and risk early warning mechanism, to incorporate local government debt revenue and expenditure into budget management, to gradually form a standardized local government debt financing mechanism, and to strictly control the new debt of local governments. Therefore, the national financing policy will be further tightened, the company's financing is under great pressure.

First, there is a mismatch between investment projects and loan access conditions. The loan investment of financial institutions is gradually tilted to operational projects, except for some quasi-public welfare projects such as water conservancy facilities, security housing and so on in its scope of access, some of the full public welfare loan projects are difficult to be approved. County A in recent years to invest in construction projects are mostly urban infrastructure, belonging to all public welfare projects, and financial institutions are not consistent with the direction of the loan, to the loan project packaging and operation more difficult. Secondly, it is difficult to put in place supporting funds for loan projects. In the operation of specific loan projects, according to the financial institutions of the loan project requirements, each construction project local matching funds must reach more than 35%. The total investment of some major projects are in the hundreds of millions of dollars, only the local supporting funds need tens of millions of dollars or even hundreds of millions of dollars. County A has limited financial resources, most of the supporting funds for the project can only be technically processed, not really implemented. Thirdly, the loan collateral is insufficient. Financial institutions in order to avoid financial risks, called a halt to the government credit loans for local government financing platform companies, replaced by mortgage loans. In addition, according to the loan requirements of financial institutions, the total amount of loan for each project, in addition to the limitations of the total investment of the construction project, is also required to be controlled within 50% of the appraised value of the collateral. At present, all the loan projects of County A Urban Investment Company are mortgages, with a total loan amount of RMB755 million, which is equivalent to assets with an appraised value of more than RMB1.51 billion already pledged to the borrowing banks. And the company's current net assets are only about 2.1 billion yuan, which includes a large portion of the company's investment in the construction of public welfare facilities assets. Therefore, with the increase in the number of projects financed by the Company, there is a serious shortage of loan collateral.

### 3.3 Difficulty in Reflecting Operating Gains

Generally speaking, the initial intention of the establishment

of county-level urban investment companies is to finance and infrastructure construction for the local government, but with the national cleanup and standardization of local platform companies, as well as the development and accumulation of urban investment companies over the past few years, vigorously expanding the operation and maximizing the return on the operation of the government's capital has become the first priority for the development of urban investment companies, and also an inevitable part of the company's rolling development, sustained development, and healthy development. In recent years, A County Urban Investment Company has also made efforts to make some business attempts, but due to a variety of objective reasons still feel the lack of business, the company's accounts on the low cash flow, operating income is not a high problem still exists objectively.

First, it is the lack of professional development team. In order to increase the operating strength of the establishment of a wholly owned subsidiary of the City Investment Real Estate Development, the company has now risen from the initial provisional qualification to the third level of qualification, the development and construction of content involved in the field of commercial housing, stores, office buildings and sheltered housing and so on. But to this day, the real estate company's personnel all by the city investment company's existing personnel, there is no one specialized in real estate development management, planning, marketing team, the company's business scope and operating income is difficult to expand. Second, the lack of operating assets. In the city investment company's existing assets, in addition to the land assets have been used for capital injection and loan collateral, public welfare assets accounted for a greater weight, fewer operating assets, the development of operating assets is even less. Due to the lack of operating resources, the city investment company has always been in the embarrassing situation of "clever woman can't cook without rice". Third, it's the small space for self-management. City Investment Company and City Investment Real Estate Company is a parent-subsidiary relationship, from the "Company Law" in the sense that the real estate company's business behavior as long as the authorization of the City Investment Company within the scope of the company. But in practice, the real estate company's business activities in the project approval, land, business practices still need government authorization, it is difficult to truly realize the corporatization, market-oriented mode of operation, independent operation of the smaller space.

## 4. Development Strategies based on the Perspective of Financial Generosity

The company can alleviate the financial constraints through financial generosity, so that the company has sufficient funds, and excess high degree of financial generosity will also slow down the development of the enterprise. Therefore, on the one hand, the company needs to take measures to strengthen the management of capital and funds, on the other hand, the need to grasp the degree of financial generosity and the development of the company, under the condition of maintaining the existing profitability of the company as much as possible to improve its financial generosity, the use of financial generosity targeted to carry out foreign investment

and promote the development of the company.

#### 4.1 Strengthening Land Asset Management

Promoting compliance between the financial and administrative powers of local governments, and standardizing land grant revenues. In the "land finance" model, it is inevitable to produce high-priced land and then produce high-priced housing, contrary to the basic attribute of state-owned land for all people, land finance has formed a "land expropriation - land sales - tax collection and charges -collateral-requisition land". In this process, local governments, developers and banks become the biggest beneficiaries. In order to maintain this pattern and obtain high returns, they may face illegal land use, expropriate land at low compensation rates, and then sell the land at a high price through auctions and other means. Land grant in the county financial land grant account, excluding policy expenditures, its balance should be fully allocated to the city investment company, used to offset the city investment company's land storage costs and the company's financing projects supporting, loan principal and interest repayment and non-loan project inputs, etc.. On the one hand, it will establish a stable follow-up fund injection mechanism for CIC, and on the other hand, it will increase the cash flow of CIC's accounts.

#### 4.2 Adoption of Diversified Channels of Financing

Transform the government's coordination advantage into the enterprise's operation advantage, so that the city investment company can raise funds from several aspects: First, extract a certain percentage of land transfer income; Second, raise a certain amount of funds from municipal supporting fees; Third, concentrate a certain percentage of the proceeds from state-owned assets; Fourth, make an article in the financial cash flow management, depending on financial and economic performance, the bottom of the coffers as an auxiliary tool for compression of government debt or motorized financial resources Fifth, the recovery of assets owned by the debtor, through the auction, transfer of cash after offsetting the debt; Sixth, the debt owed by administrative institutions, the preparation of departmental budgets should be arranged for special loan repayment reserve. Multi-pronged approach to increase the volume of funds of the City Investment Corporation.

#### 4.3 Active Reorganization of Assets to Improve Their Profitability

The CIC can merge a number of existing companies, choose to retain a company with a low gearing ratio and strong profitability, integrate advantageous resources, and carry out asset reorganization. On the other hand, as local governments have injected a large number of land use rights and public welfare assets into CIC in order to expand the financing capacity of CIC, mainly including roads, bridges, water conservancy facilities, parks, administrative office buildings and other municipal facilities, county-level financing platforms can adopt the asset stripping method to remove some public welfare assets and improve the quality of the company's net assets. In addition, some assets with operational nature will be included in the scope of the financing platform and integrated to realize the optimization

of the company's asset structure and sustainable development, and enhance the company's cash flow.

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