Enlightenment and Suggestions of Tianjin Private Equity Fund Case on the Development of Yantai Fund Financial Agglomeration

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ABSTRACT
Tianjin, as China's financial reform experimental zone, has accumulated experience and practices in the development of private equity funds, which has implications for the development of Yantai's financial agglomeration. The Tianjin Private Equity Fund Case revealed that the fund companies are good at manipulating human weaknesses, some government officials are not aware of the bottom line and rules, investors blindly pursue private placement funds, and there are loopholes in legal regulations and supervision. Yantai should strengthen fund supervision in the development of fund finance agglomeration, strengthen the employees' awareness of bottom line, responsibility and rules, pay attention to attracting excellent talents to join fund management posts, strengthen investor education services and enhance investors' awareness of financial fraud.

Keywords: *Tianjin Private Equity Fund Case, Yantai, Fund supervision, Financial agglomeration.*

1. INTRODUCTION

Due to the narrow channels of social financing, Chinese domestic non-listed companies and non-state-owned enterprises generally face financing difficulties. Private equity funds, especially private equity investment funds, provide direct financing opportunities for unlisted and non-state-owned enterprises of a certain scale that are different from commercial bank loans, complement the supply of funds through indirect financial channels, and effectively alleviate the financing difficulties of related enterprises. At the macro level, the development of private equity funds is also of great significance for building a multi-level capital market, activating private capital, serving the real economy, and optimizing residents' wealth management.

In the "Modern Financial Industry Development Plan of Shandong Province" issued in 2018, Yantai City is clearly built as a regional fund management center. Under this plan and policy, Yantai's financial industry is positioned in terms of development, relying on Yantai Deep Blue Fund Port, focusing on building fund financial agglomeration. As of the end of December 2022, there are more than 160 funds and institutions in Zhifu District, the central urban area of Yantai, 12 fund management companies registered with the Asset Management Association of China, and more than 90 existing private equity funds on record, with a scale of 18.6 billion yuan, and the fund agglomeration effect is gradually emerging. Tianjin is the earliest private equity fund agglomeration place in Chinese mainland, and its fund agglomeration development experience has reference value for Yantai to build a regional fund management center, and the problems and risks exposed in the development of its private equity fund are particularly worthy of reference, reflection and avoidance.

2. THE POLICY BACKGROUND OF THE AGGLOMERATION DEVELOPMENT OF PRIVATE EQUITY FUNDS IN TIANJIN

In May 2006, the State Council issued the "Opinions on Issues Related to Promoting the Development and Opening up of Tianjin Binhai New Area", approving Tianjin Binhai New Area as a national comprehensive supporting reform pilot zone, covering financial reform in many fields such as financial enterprises, financial business, financial market, financial opening up, etc.

In December 2006, the Bohai Industrial Investment Fund, China's first private equity investment fund specially approved by the State Council, was launched and established in Tianjin.

In May 2008, the National Development and Reform Commission issued the "Reply on Issues Related to the Reform of Equity Investment Funds in Tianjin Binhai New Area", supporting Tianjin to accelerate the development of equity investment funds.

In October 2009, the Tianjin Municipal Government issued the "Measures for Promoting the Development of the Equity Investment Fund Industry", giving preferential treatment in tax, rent, talent settlement and other aspects, supporting and guiding fund management institutions to settle in Tianjin for centralized office, and promoting the concentration of equity investment funds in Tianjin.

Tianjin's financial reform has pioneering significance in broadening direct financing channels, carrying out comprehensive operation of financial institutions, cultivating financial market entities, and making Tianjin a fund financial city characterized by private equity investment. This wave of reform has also introduced the concept of direct investment of small and medium-sized enterprise equity funds and equity transfer of small and medium-sized enterprises to China, which has helped the knowledge popularization and industrial development of private equity funds in China. The Tianjin Private Equity Fund Case, which emerged after the explosion, is one aspect of the lessons and losses in the financial reform in Tianjin, and the positive significance of the financial reform in Tianjin cannot be denied as a whole.

3. OUTLINE AND TYPICAL PROBLEMS OF TIANJIN PRIVATE EQUITY FUND CASE

During the period from the end of 2010 to October 2011, the relevant leaders of Tianjin governments at all levels vigorously promoted the investment methods of private equity funds at various meetings, calling on the majority of investors to invest in Tianjin by "trying first, and all industries and projects that are not prohibited by laws and administrative regulations from enterprises or individuals are allowed to operate". Under the strong publicity and encouragement of the Tianjin Municipal Government, a large number of fund companies flocked to Tianjin to register, and many investors invested their funds in private equity funds in Tianjin. It was easier to register a private equity company in Tianjin that year, and it could quickly obtain the business license issued by the government. At that time, the country had not yet introduced the system of private fund manager registration and fund filing, and investors could not screen fund companies in this regard; when simply looking at the business license and administrative approval procedures, the company procedures are complete.

According to the information available, Wang Shuhai, then president of Tianjin Equity Investment Fund Center, disclosed publicly that by the end of 2011, more than 2400 private equity investment fund management enterprises had settled in Tianjin, with a subscribed capital of more than 460 billion yuan, and Tianjin became the largest private equity investment fund cluster in China. Subsequent news reports showed that of the more than 2400 private equity companies registered in Tianjin, there were only dozens of companies registered with the Tianjin Development and Reform Commission. For more than 2300 other private equity companies, the Tianjin regulatory authorities did not require mandatory filing or follow-up filing, which essentially leaked the regulatory gap. Some companies have done a lot of illegal things under the name of private equity fund. In 2011, Tianjin seized 13 fund companies; In the first half of 2012, Tianjin seized more than 30 fund companies. None of the fund companies involved in the case are engaged in formal private equity investment activities. They promise to attract investors with high returns (the committed rate of return varies from 8% to 18%), and then give heavy rewards (the commission varies from 17% to 18%) to the development of offline solicitation investment. They refuse to pay interest after widely raising huge amounts of funds, and the executives disappear. According to the statistics at that time, the number of people who were cheated reached nearly ten thousand, and investors lost billions. This risk event was later summarized as the "Tianjin Private Equity Fund Case", hereinafter referred to as the Tianjin Fund Case or this case. [1]

Tianjin Fund Case is the first major risk event in the field of fund finance during the reform and opening up, which has produced extremely bad social impact and hit the start and development of private equity in Chinese Mainland. From the perspective of hindsight, the logical relationship is not complicated, and it is even possible to avoid it. The typical problems exposed include:

3.1 A Large Number of Fund Companies Carry out Private Placement Business in Violation of Laws and Regulations, and Publicly Raise Social Funds Through Pyramid Selling

At that time, many companies were only registered with the Tianjin Industrial and Commercial Department, but not registered with the Tianjin Development and Reform Commission and the relevant municipal financial departments to engage in private placement business. They took advantage of Tianjin's "financial reform depression" and "equity investment fund pilot" to play the sidelines of private equity funds and illegally and widely raise social funds in Tianjin in the name of "equity investment fund". After the investigation, the public security organ summarized the illegal behavior of the fund company in the Tianjin Fund case as two points: first, the fund company raised funds in disguised form, suspected of illegally absorbing public deposits; second, the operation of the fund company was characterized by financial pyramid selling, and they were suspected of organizing and leading pyramid selling activities. [2] These behaviors run counter to the most basic business philosophy and principles of the industry, such as private funds should not raise funds publicly, private funds should only raise funds from qualified investors, the number of qualified investors should not exceed the specified number, and private funds should not promise a fixed return level.

3.2 Some Government Officials Misled Investors by Promoting the Fund Company Platform

At that time, the public officials of Tianjin municipal government highly respected the new thing of private equity investment, showing a high enthusiasm for work, relaxing rational thinking, amplifying the emotional rendering, and lowering the risk awareness. This enthusiasm for work has infected a large number of ordinary people who do not know much about the fund financial market, weakened the risk perception of the majority of investors on the private equity business, deepened the investors' pursuit of new private equity investment activities, and misled investors into thinking that there is government endorsement behind the fund company's behavior, objectively contributing to the outbreak of the Tianjin Fund Case.

3.3 Investors' Collective Irrational Investment Behavior

The vast majority of investors who buy the products of fund companies do not know about private equity funds and private equity investment methods, and blindly buy the products of fund companies. Many fund companies carry out financial pyramid selling under the guise of private equity funds, and their behavior is not worthy of the name and has not been questioned by investors. Investors flocked to the marketing propaganda of the fund company's commitment to fixed return, and lost their vigilance against the high risk of the fund's financial investment activities. So these behaviors are very irrational. Among the investors in the Tianjin Fund Case, such irrational behavior has occurred in large numbers. There are many highly experienced and highly educated people among them. Even so, they are still deceived. The reasons behind this are worth pondering.

3.4 Regulatory Authorities Fail to Fulfil Compliance Management and Supervision Responsibilities

Relevant departments of Tianjin Municipal Government have not implemented strict access filing requirements and compliance review on companies that carry out private fund business in the whole city, lack of awareness of financial risk prevention, weak means of risk prevention and control, lack of supervision before, during and after the event, and unclear regulatory powers. [3] Many companies only registered in Tianjin or changed their registered place to Tianjin, and did not substantially carry out office business in Tianjin and did not substantially subscribe to capital, but engaged in businesses outside the scope of business license registration. From the perspective of government management and supervision, it was only necessary to pay low administrative costs and use conventional risk prevention and control measures to identify and eliminate these violations. However, in the Tianjin Fund Case, Tianjin paid a huge economic and social cost to realize the lack of regulatory responsibility.

4. LESSONS AND REFLECTIONS ON TIANJIN PRIVATE EQUITY FUND CASE

From the current perspective, the problems exposed in the Tianjin Fund Case in that year were caused by the "savage growth" of the fund companies, the government officials, the investors, and the market subjects, the administrative bodies, and the investment subjects under the temporary absence of supervision in the local financial field. Cases with such traces of "barbaric growth" were once seen in the "August 10 storm in Shenzhen" and "foam in Hainan real estate" in the early period of reform and opening up. The Tianjin Fund Case occurred at the beginning of the second decade of the new century, and the reform and opening up cause has gone through a new era of more than 30 years. This contrast gives people a strong sense of age mismatch and shock. This unexpected case, which could have been avoided, has a very strong warning significance for all parties. It is necessary to fully learn from it, deeply reflect on the reasons and take a warning.

4.1 The Fund Companies Are Good at Manipulating Human Weakness Through Speculation

At the stage when the "hedge" of financial regulation at the national and local levels is not firmly established, the fund companies and other market entities are very keen to catch the "regulatory vacancy" state and have aggressively entered the policy vacuum gap zone at a very fast speed. On the one hand, they used the advantage of information asymmetry to confuse a large number of government officials and win the latter's active support; On the other hand, they took advantage of human greed for wealth, manipulated and set financial pyramid selling traps, and captured a large number of investors. The illegal products of these fund companies are very simple and low-level, without complicated design and packaging.

Despite the low level of fraud, a large number of investors were cheated in the Tianjin Fund case. The crux of this is that the fund company threw the bait of high return on investment to lure greedy investors to take the bait. It is not excluded that while a large number of fund companies are fishing in troubled waters, some fund companies are still engaged in private equity investment activities in a standardized manner. However, because a large number of companies have damaged the industrial ecological environment, resulting in the phenomenon of "bad money drives out good money" in Gresham's Law, the "good currency" fund companies will be dragged down by the "bad currency" fund companies, which will ultimately damage the healthy development of the private equity fund industry in Tianjin.

In order to develop the private equity industry, it is necessary to make the market entities more, more active and stronger, but it is also necessary to manage and be strict and not disorderly. Building a multi-level and high-level capital market is a significant sign of the full development of the market economy, and is also a major goal of deepening reform in China's financial sector. The capital operation rules and characteristics of the financial market are different from those of the real economy, so it is more urgent and necessary to study the restriction and regulation of the profit-seeking nature of the fund companies and other financial market operators.

4.2 The Awareness of the Bottom Line, Responsibilities and Rules of Government Officials Is Not Strong

The government officials subjectively hope to take advantage of the national pilot and financial reform to vigorously develop Tianjin's financial industry. Under the circumstances of incomplete understanding of the development rules of the fund industry and limited understanding of the regulatory principles, they fail to reasonably predict that the fund companies and other market entities will produce radical or even illegal business activities, and fail to effectively block the large-scale outbreak of risk in Tianjin's private equity industry. Compared with public funds, private funds have a late start in China. Before this case, the private equity industry did not appear in public view and financial reports on a large scale. Many government officials do not know about private equity funds, nor do they maliciously speculate about the business purpose of fund companies coming to Tianjin. The host-like "hospitality" and preferential policies released by them are regarded as "naive" and "gullible" by illegal fund companies and are fully utilized. Unlike the general investment promotion activities of the government, the private equity industry has a high professional threshold and high risk characteristics. Public officials need to have professional knowledge background to better deal with the business entities of the private equity industry.

If public officials can perform their administrative functions more responsibly and strictly, and take the initiative to assume regulatory responsibilities, they can largely avoid the occurrence of this risk event, and will not expose the majority of investors to the fraud of illegally absorbing public deposits and financial pyramid schemes.

After this service, the staff of Tianjin Municipal Government realized the problems of negligence and dereliction of duty in previous work. The implementation of accountability and rectification measures has produced a warning effect in Tianjin and other provinces, regions and cities across the country. The majority of government staff has generally strengthened their sense of responsibility and discipline in financial work, greatly weakening the possibility that some problems exposed in the Tianjin Fund case would recur in the future.

4.3 Limited by the Lack of Investment Channels, Investors Blindly Pursue Private Equity Funds

As investors, there is a necessity to be responsible for their own investment behavior, consciously shape the awareness of risk prevention and control, actively identify financial investment risks, and assume corresponding financial investment risk responsibilities. However, investors involved in the Tianjin Fund Case were generally confused by the investment prospects described by the fund companies and the high level of return promised: before the investment behavior, they lost the awareness of independent thinking and risk screening and prevention before investment, and the amount of investment exceeded their own risk tolerance; In the matter, the focus of the fund company's attention is on the realization of investment income and the return of rewards for offline investment; after the event, the focus of investment losses was attributed to the government's improper supervision rather than its own investment decision-making mistakes. The way of thinking and knowledge reserves of investors involved is far from the "qualified investors" required by private equity investment. [4] The fraud of fund companies is not sophisticated, but it can capture a large number of irrational investors, which is worth investigating. The reasons for analysis are roughly divided into the following three aspects.

From the perspective of fund company layout, private equity investment in that year was a popular financial product, and the vast majority of people did not know it very well. Criminals have exploited the loophole of poor information, hidden illegal fundraising and financial pyramid schemes under the shell of fund investment, used the public's psychology of "curiosity" and "early adopters" to attract investors' attention, and at the same time used various false promises to induce investors to amplify greed, reduce defense, shake the sense of independent thinking, and even become accomplices in developing downline and pulling more people to invest.

From the perspective of investors' psychology, its psychological process and decision-making mechanism lie in: the investors value the high commitment "pie" drawn by the fund company, and shake the risk awareness in the face of high returns; From the rapid and high profit model of fund investment, they have gained the sense of superiority and satisfaction compared with other financial products and other investment groups; Under the condition of limited information and limited experience, this psychological sense of superiority will in turn drive investors to be overconfident, feel "superior", and trust, belong and identify with the same people who invest in the fund; Although the statement of the fund company is fundamentally untenable from the perspective of rational analysis, the investors are collectively "selective deaf" and are unwilling to expose the fund company's unreliable promises like "emperor's new clothes" in the group, thus committing irreparable investment mistakes and generating collective irrational behavior.

From a macro perspective, China's multi-level capital market is still in the stage of construction and improvement. Except for the stock exchange in Shanghai and Shenzhen, the investment opportunities and channels of residents are very limited. There are a lot of funds available for investment in society, but there are very few financial assets available for investment. A large number of investors blindly pursue new private equity investment methods and actively enter the investment trap set by illegal fund companies.

4.4 There Are Loopholes in the Legal Regulation and Supervision of Private Fund Industry

There is a game relationship between financial development and financial supervision. If the regulatory authority is stricter and stronger, the fund company as the main body of the market will be more disciplined and less active in violating the rules, and the violations that want to exploit the loopholes will be found in a greater probability. If the supervisor is absent, leaving a regulatory vacuum in the market, it will give lawbreakers an opportunity to disrupt the order of the financial market, destroy the financial market environment, and cause huge economic losses and social impact. [5] The biggest lesson of the Tianjin Fund Case is that the legal regulation and financial supervision of the private fund industry and the private fund market are not perfect, which could not effectively prevent the fund financial crime at that time.

Under the supervision and guidance of the China Securities Regulatory Commission, the China Securities Investment Fund Industry Association (hereinafter referred to as the "China Securities Association") came into being in June 2012. With the gradual institutionalization, systematization and standardization of the supervision of the private fund market, the top regulatory framework of the administrative supervision of the CSRC and the industry supervision of the China Securities Association has been constructed. The new fund law came into force in June 2013. Before that, the legal regulation of the fund industry was more concentrated in the field of public funds. The revised new fund law includes private equity funds into the scope of adjustment for the first time, which not only affirms the legal status of private equity funds from the legal perspective, but also ends the dilemma of the lack of special legal regulation of private equity fund activities before. [6] After the case, with the strengthening of legal regulatory means and administrative supervision, the chaos of private equity funds in Tianjin was curbed, and the relevant market violators were subject to legal sanctions and administrative penalties, and China's private equity industry embarked on a positive development track.

5. POLICY SUGGESTIONS ON THE DEVELOPMENT OF FUND FINANCIAL AGGLOMERATION IN YANTAI

From the national level, the development of private equity funds is a starting point for the construction of multi-level capital markets and the deepening of financial development. Relevant management policy design focuses more on the overall situation of macro-financial reform, focuses on the construction of institutional guarantee and mechanism guarantee, further improves the fund management laws and regulations system, strengthens supervision, inspection and law enforcement inspection, protects the legitimate rights and interests of investors, and promotes the healthy development of the industry, which is the key direction of development. From the regional level, in view of the specific situation of Yantai City, the construction of Yantai Regional Fund Management Center, in addition to standardizing and strengthening the regulatory function, also has a long way to go in cultivating market entities, forming agglomeration effects, driving the development of local real economy, and should focus on the following aspects:

5.1 Strengthening Supervision and Strengthening Personnel's Awareness of Bottom Line, Responsibility and Rules

Building a fund supervision team with a high awareness of bottom line, responsibility and rules is the organizational guarantee for fund supervision. It is necessary to conscientiously strengthen the consciousness and firmness of abiding by the rules, standardize the regulatory activities by relying on the system, improve the initiative of supervision in performing their duties, and adhere to the principle of "three fairness" and the principle of supervision according to law; it is also necessary to conduct comprehensive supervision over the four links of fund companies' "raising, investment, management and retirement", with the focus on the fund raising link, and strictly require the fund company to update and report the information to the relevant municipal financial department for the establishment, operation, merger, reorganization, transfer, bankruptcy and change of major executives; there is a must to strengthen the review of the authenticity and accuracy of various information disclosure of private equity funds and the consistency of information submitted by various platforms; At the same time, it should be noted that government supervision should not directly interfere with the internal operation and management of fund institutions, and the scope of supervision should be strictly limited to the field of fund market failure.

5.2 Paying Attention to Talent Training and Selection, and Attracting Excellent Talents to Join Fund Management Posts

The fund industry, especially the private fund industry, has the characteristics of high knowledge threshold, high investment threshold, high risk, strong mobility of industry personnel, and strong information asymmetry. In addition, the income of the fund industry is relatively high, and the siphon effect on high-end talents is relatively obvious, which is easy to cause the professional difference between the regulated party and the regulator. It is of great significant to strive to build a high-quality and highly educated fund management team, cultivate, select and attract experienced fund talents to join relevant posts, provide staff with continuous learning and training of professional skills, regulatory laws and regulations, improve their business level in a normalized manner, and highlight the role of the supervisor and the focus of work in the specific supervision work. If the driver is compared to the personnel of the fund company and the traffic police is compared to the government supervision personnel, the latter may not have the same "driving" skills as the former, but the latter is better than the former in terms of the understanding of "traffic regulations" and the degree of vigilance of "accident-prone areas". Adhering to this is beneficial to do a good job of the fund government service and administrative supervision.

5.3 Strengthening Investor Education Services and Enhancing the Awareness of Guarding Against Financial Fraud

The participation and confidence of investors are related to the healthy development of the fund market. Only when investors' rights and interests are protected can the authority of regulators be recognized. The basic principle of investment is that investors are responsible for their own investment behavior. It is not excluded that some investors can accept the failure of financial investment frankly. However, if the loss of family wealth is superimposed with some probability social events, or a massive loss of group family wealth occurs, it is easy to brew and cause greater negative social impact and public opinion. It is more meaningful to avoid the occurrence of fund risk events to the greatest extent than to pursue liabilities after the event and litigate claims. Investors with background knowledge and independent judgment are the lowest cost prevention against illegal activities such as fund accumulation. There should be specially-assigned persons responsible for investor education and provide education content and education services in a non-profit manner; it is also necessary to urge and promote fund management institutions to do a good job in investor education, increase transparency, distinguish marketing activities from investor education activities, and prevent misleading; and there is a must to strengthen communication and cooperation with the news media to guide the formation of a sound and orderly rational public opinion atmosphere for fund financial investment; At the same time, it should be noted that investors cannot make specific judgments and decisions on behalf of investors in investor education activities.

6. CONCLUSION

Yantai has a profound manufacturing industry development background and strength. At present, it has 4 industrial clusters of 100 billion level, including green petrochemical and high-end equipment, 4 industrial clusters of 10 billion level, including automobile and food intensive processing, and 5 provincial characteristic industrial clusters of chemical new materials. By the end of 2022, the total number of Yantai listed companies reached 59, and the enterprises that had applied for counseling and filing and had entered the listing process formed a relatively sufficient capital market development echelon. The concentrated development of private equity funds can effectively expand the direct financing channels of local enterprises, and help Yantai manufacturing enterprises to further expand and strengthen. In the future development process of fund financial agglomeration, Yantai should fully learn from the lessons and experience of the Tianjin Private Equity Fund Case, adhere to the basic principles of financial services for the real economy, strengthen financial supervision, strictly prevent and control the financial risks of funds, promote the gathering of high-quality fund institutions, comprehensively improve the quality and efficiency of the development of the fund industry, strive to build a regional fund financial center, and promote the better integration of Yantai's finance and industry.

ACKNOWLEDGMENTS

Fund: Soft science general project of Shandong Province, "Research on the mechanism and countermeasures of science and technology finance to promote Shandong's independent innovation competitiveness" (2021RKY04075), hosted by Yu Huiqian.

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