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Analysis of the Causes and Countermeasures of Financial Explosion

--Taking Shanghai Electric Group Co., Ltd. as an Example

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Abstract: With the steady and rapid development of China's economy, the performance of enterprises shows an excellent growth trend. However, there are also negative news caused by a large number of corporate financial fraud and a significant decline in performance. This paper takes the financial explosion event of Shanghai Electric in 2021 as an analysis case and uses systematic theoretical knowledge to analyze the causes and consequences of the case in detail. We summarize the problems and put forward the safeguard measures. Finally, we provide corresponding suggestions to help enterprises avoid relevant financial risks and hope to further help the future development of the electrical equipment manufacturing industry.

Keywords: Financial explosion, Shanghai Electric, Information disclosure

1. Introduction

In recent years, the phenomenon of financial fraud in many listed companies has emerged endlessly, which has led to significant financial losses for investors, such as the well-known Kangmei pharmaceutical financial fraud case. Such fraud cases have caused serious disruption to China's securities market, but also have a bad impact on China's stable operation of the capital market, in the past few years of financial fraud events, Shanghai Electric's financial explosion incident is a classic one.

Enterprise financial explosion refers to the financial performances that do not meet expectations in the financial reports. These financial performances may be due to the company's exposure to significant risks, market fluctuations, asset impairment and other factors, resulting in a significant decline in the company's performances. Shanghai Electric issued a major risk warning announcement on May 31, 2021, which pointed out that in extreme cases, Shanghai Electric may suffer an expected loss of 8.3 billion yuan, which caused major investors to panic. Shanghai Electric announced another announcement about the company's information disclosure issues on July 5, which said the China Securities Regulatory Commission had launched an investigation into the company. On August 27, the company released its semi-annual report, saying that in the first half of 2021, the company's net profit attributable to the parent company was -4.97 billion yuan, a decrease of 6.19 billion yuan from the same period last year, and it failed to maintain a profitable state. The financial explosion of Shanghai Electric is mainly due to the "private network communication" business of Shanghai

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Electric Power Communication Co., LTD. The business adopts the operation mode of "100% advance payment, 10% advance receipt", that is, 10% advance payment to downstream state-owned enterprise customers, and the balance will be paid in installments after the order is completed and the goods are received according to the agreement; According to the requirements of the state-owned enterprise, the raw materials needed for production are purchased from upstream suppliers and 100% of the payment is paid in advance. Because the upstream and downstream funds cannot match, so the Shanghai Electric Power Communication Co., LTD needs to invest a lot of money. If the supplier suddenly stops the supply, the downstream customers cannot pay the balance after receiving the goods, resulting in bad debts, which is also the main reason for the financial explosion of Shanghai Electric.

In daily study and operation, it is found that the phenomenon of financial explosion is not rare in various enterprises. However, the current research on financial explosion in the theoretical circle only appears in limited fields such as construction and finance. Through the case of Shanghai Electric, this paper has further enriched the related research in the field of financial explosion risk and financing trade. Taking Shanghai Electric as the case study object, we first conduct some analysis of external and internal causes. Then we analyze a series of chain reactions caused by financial explosion so as to find out the impact of this event on Shanghai Electric and even the entire electrical industry. Thirdly, we put forward corresponding countermeasures, which will bring more inspiration to enterprises in financing trade, internal control and other aspects [1]. From a practical point of view, through the case analysis of this paper, the companies involved may be better able to cope with such crises and avoid relevant financial risks.

2. Introduction of Shanghai Electric Group Co., Ltd.

Founded in 1993, Shanghai Electric is one of China's leading electrical equipment manufacturers, headquartered in Shanghai. The company focuses on providing high-end equipment and solutions for power, transportation, construction, industry and other fields, and also has a broad layout in intelligent manufacturing, new energy, rail transit and other emerging fields.

In the field of power equipment, Shanghai Electric has become one of the largest power generation equipment manufacturers in China, including various voltage levels of generator sets, switchgear, transformers, etc. The company produces generator sets with a capacity of up to 1 million kilowatts, covering various models from 1000 kilowatts to 300 megawatts. In the field of transportation, Shanghai Electric has become one of the largest railway signal equipment manufacturers in China, and has a wide layout in high-speed trains, urban rail transit and other fields. In addition, the company has also carried out active exploration and practice in the field of intelligent transportation, including research and development and promotion of intelligent transportation systems. In the field of new energy, the company has a number of technical patents and product research and development capabilities, which can provide customers with a full range of energy solutions. The company also actively participates in international market competition and constantly expands new markets and new businesses.

Shanghai Electric Company has made remarkable achievements in various fields, and its continuous innovation, forging ahead and pioneering spirit has also won high recognition from the industry.

3. Analysis of the Cause of the Financial Explosion of Shanghai Electric

3.1. Internal Cause

Among the causes of this incident, the most important reason is the illegal financing trade within the enterprise [2]. The sales model adopted by the power communication is: 100% advance payment for upstream suppliers of private network communication business. It allows corporate customers to pay

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10% payment in advance, and pay the remaining 90% of the customer payable after the completion of the sales order and delivery of use, in accordance with the contract instalment payment. This phenomenon is very common in China's financial trade, and has been controlled and even banned by various countries. In the Shanghai electric explosion incident, the tray side is the power on communication, the seller is the upstream supplier of power on communication, the buyer is the downstream customers of power on communication which has sales contracts with both upstream suppliers and downstream customers.

Due to the large amount of funds needed in the sales model of the subsidiary power on Communication, which caused its financing through accounts receivable, after the customer could not pay the loan, power on communication applied for loans to shareholders, Shanghai Electric provided a large number of shareholder loans 7.766 billion, so far has not been returned, not to mention a series of loans made by Shanghai Electric. The book value of the shares of Power Communication is 526 million yuan, it is also likely to not get back, comprehensive consideration, Shanghai Electric judgment there is a major risk, and even this matter may cause 8.3 billion yuan of losses, investors have panic, which triggered the financial explosion [3].

3.2. External Cause

The external cause of the financial explosion is mainly the uncertainty of relevant laws. Prior to 2013, the law of China had been cracking down on the illegal financing trade business of central enterprises, and after 2013, especially in recent years, the state has strictly prohibited this kind of business. Although Shanghai Electric is also limited by the relevant provisions, but in the actual operation of the company, how to operate, hide, tamper, is out of control [4]. There is no specific punishment for the illegal behavior of violating the financial transaction rules. The state has issued only a few documents, several of which are intended to prohibit illegal financing transactions, as well as virtual illegal transactions such as "moving orders" and "idling." Also, this document is not entirely about financing transactions, there are many other situations that can put a company's capital at risk, so there is not much focus on the risk of financing transaction violations [5]. If the listed company does exist illegal financing transactions, there are no explicit provisions on how to determine and punish them, there are actually large gaps in relevant laws and regulations, resulting in the power communication reckless, which finally leads to performance explosion.

4. The Impact of Financial Explosion

When a listed company has some negative information and the information is made public, the company itself will suffer some negative impacts, such as reputation damage, stock price decline, and company market value reduction. Furthermore, this will not only cause damage to the reputation of the enterprise itself, but also other enterprises cooperating with the enterprise [6].

Based on the third quarter report of Shanghai Electric, announced on September 30, 2021, the shares held by Shanghai Electric among the top ten shareholders are shown in Table 1. Compared with June 30, 2021, the top ten shareholders held 12.496 billion shares, accounting for 79.55% of the total share capital. The tenth shareholder reduced the number of shares the most, followed by Shanghai Electric Corporation, Hong Kong Central Clearing (Agent) Co., LTD., Shenneng Group and Hong Kong Central Clearing Co., LTD., increased the number of shares. The number of shares held by the five major shareholders of securities finance, Hangzhou Yuanshou, Zhongcai Profiles, Lu 'an Pipeline and Fucheng Haifu remains unchanged.

Shanghai Electric's loss in the first half of the year reached 5 billion yuan, from profit to loss, and in the days after the incident, the stock price plummeted, which not only caused great harm to the interests of individual investors, but also caused a great impact on the company's reputation.

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Table 1: Changes in equity of top ten shareholders of Shanghai Electric

Name of shareholder (full name)	Percentage of total share capital (%)	Holding quantity (ten thousand shares)	Actual increase or decrease (%)
Shanghai Electric Holding Group Co., LTD	52.38	8,227,400,468	-0.32
Hong Kong Central Clearing (Agents) Limited	18.59	2,919,173,331	+0.12
China Securities Finance Corporation Limited	2.59	406,740,480	0
Shenneng (Group) Co., LTD	2.39	375,800,994	+0.68
Hong Kong Central Clearing Company Limited	1.09	171,434,405	0
Xinchang Yuansou Investment Co., LTD	0.85	133,615,217	+20.50
Zhejiang Zhongcai profile Co., LTD	0.60	94,711,719	0
Lu 'an Zhongcai Pipeline Technology Co., LTD	0.54	84,199,535	0
Fucheng Haitong Asset Management - Shanghai Guosheng Group Investment Co., Ltd.-Fucheng Haitong Guangfu Single Asset Management Plan	0.44	69,348,127	0
Industrial and Commercial Bank of China Limited - China Securities Shanghai state-owned exchange traded index securities investment fund	0.34	53,004,514	-11.74

5. Analysis of Reasons based on Financial Indicators

Different financial indicators of enterprises can reflect different problems, so we choose the financial indicators of Shanghai Electric before and after the financial explosion to analyse the causes of the crisis

5.1. Analysis of Profitability

Profitability is the ability of a company to make profits, and the higher the profitability of a company, the higher the return it will bring to shareholders and the greater the value of the company. In the period of financial explosion of Shanghai Electric in 2021, the profitability of the enterprise is attracting much attention. In the analysis of profitability, we should focus on the profitability of the company's main business, and this paper mainly focuses on the financial index of return on equity.

This is one of the most comprehensive and representative indicators, and the higher its value, the better the profitability of the company, which is affected by the net interest rate on assets and the average asset-liability ratio. The return on equity of Shanghai Electric has shown a spiral growth and reached a peak in 2022, which indicates that the company's profitability and return on shareholders' equity have been positively improved. However, in the period from 2020 to 2021, the company's

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return on equity has a downward trend, but after the decline, there is a rise, which is probably because the company has problems such as reduced asset use efficiency, poor capital investment effect, or the company has a high debt ratio, or the equity structure is unfavourable to the return on shareholders' equity [7]. As a result, ROE is reduced, and through the above understanding, we can know that the reason for the decline in return on equity in 2021 is because of the financial explosion scandal of Shanghai Electric in 2021.

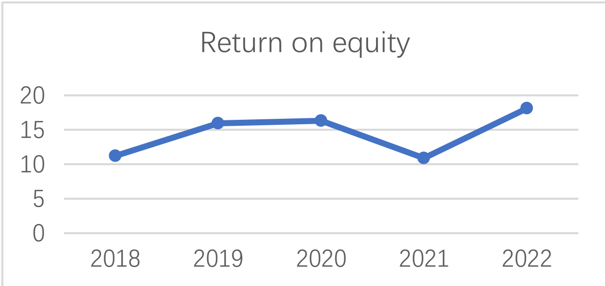

Figure 1: Return on equity of Shanghai Electric in recent five years

5.2. Analysis of Growth Ability

The analysis of enterprise growth ability is mainly to analyse the profitability generated by the expansion of production scale. Through the annual rate of return or other financing methods, the capital scale of the enterprise is expanded, and the scope of business is also expanded. In real life, the growth ability of an enterprise is the trend and development speed of the enterprise in the future development plan, whether the scale of the enterprise can continue to expand, whether the profit can increase, and whether the owner's equity can increase. Under normal circumstances, the growth of a company is the standard to measure whether the company is worth investing. This paper will analyse the financial situation of Shanghai Electric in the past five years through the growth rate of net profit. As we all know, a company's net profit is a final embodiment. If a company's operating ability is better, the fiercer the competition in the market, the higher its net profit, which also represents its future will be better.

Observing the net profit growth rate of Shanghai Electric in the past five years, it can be found that the profit growth of Shanghai Electric in recent years is very unstable, especially in 2021, the rapid decline to negative, and then in 2022, the rebound and exceed the previous level, 2021 is already the post-epidemic era. It can be seen that the impact of epidemic factors on the net profit growth rate of enterprises is not enough to produce such a significant downward trend, so this once again confirms that the financial explosion in 2021 has brought a heavy blow to Shanghai Electric [8]. If the value of net profit growth rate is larger, it means that the company's profit has increased more, the company's operating performance is better, and it has strong market competitiveness [9]. A low value of this index means that the company's earnings growth is low, and it also means that the company's operating condition is poor and it is less competitive in the market. The analysis of a company's net profit growth rate also needs to be combined with the company's sales growth rate. When the company's net profit growth rate is greater than the sales growth rate, it indicates that the company's product profitability is continuously enhanced, and the company is in a period of rapid growth and has good development potential. If the company's net profit growth rate is less than the sales growth rate, especially the operating profit growth rate, it indicates that the company's cost expenditure increase is greater than the sales increase, indicating that the company's growth ability is poor. According to the net profit growth rate of Shanghai Electric in the past five years, it can be analysed that although the company's operating status is not satisfactory after the financial explosion in 2021,

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the company's operating status is not satisfactory. However, Shanghai Electric has made adjustments in a very short period of time, and it cannot be said that it has no room for growth and ability.

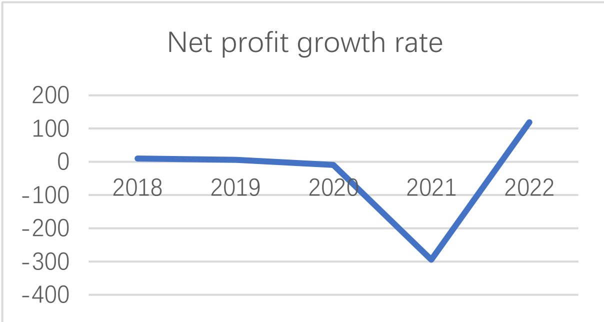

Figure 2: Net profit growth rate of Shanghai Electric in recent five years

From the analysis of the above financial data, we can see that the return on equity and the growth rate of net profit of Shanghai Electric have been seriously affected, and cast a cloud over the future development of Shanghai Electric. The importance of profitability and growth ability for an enterprise is obvious. Therefore, the next part is to put forward the corresponding countermeasures and suggestions for Shanghai Electric

6. Countermeasures and Suggestions

Based on the above analysis, we have some suggestions for Shanghai Electric:

First, the company can take some internal preventive measures, for example, in the internal of Shanghai Electric Communication Company, strict prevention of illegal financing trade, investigation of operational risks of private network communication business, optimization of its operation mode, and strengthening inventory management and customer credit management to prevent the recurrence of illegal financing trade. Secondly, the company's earnings management should be strictly standardized to prevent the management from using financing trade to expand the company's revenue scale because of performance assessment. At the same time, the company's capital flow should be correctly evaluated [10]. Finally, it is necessary to strengthen the exchange of information with the outside world, achieve timely information disclosure, and increase the implementation of internal control, so that internal control can achieve balanced development in all aspects.

7. Conclusion

With the global economy becoming more dynamic and complicated, there will be more enterprises with various causes of financial crisis events. After a specific analysis of the causes, effects and financial data of Shanghai Electric's financial explosion event, this paper draws the following three inspirations: Firstly, market regulators should optimize regulatory measures, strictly prevent illegal financing transactions, and timely detect and take measures against illegal financing transactions, so that they can be dealt with more quickly and the interests of investors can be better safeguarded. Secondly, companies, especially private network companies, should avoid transaction risks, treat state-owned companies with caution, and change the original unreasonable sales methods, strengthen the management of accounts receivable, and improve the company's internal control system. At the same time, investors should also be vigilant, enhance their financial, financial and other aspects of knowledge, in a reasonable way to invest.

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