Analysis of the Financial Effect of China Unicom’s Mixed Ownership Reform

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Abstract. China Unicom is one of the first batch of pilot state-owned enterprises to carry out mixed ownership reform. This article focuses on the changes in equity structure and financial effects of Unicom before and after the mixed reform, and makes suggestions for state-owned enterprises that will participate in the reform: Enterprises should choose the right time to reform, make full use of various resource advantages of strategic investors, and improve the corporate governance structure with the board as the core.

Introduction

The “Decision of the Central Committee of the Communist Party of China on Several Major Issues in Comprehensively Deepening Reform” first proposed the creation of mixed ownership as an important form of realization of the basic economic system in November 2013. Since then, China has begun mixed ownership reform of state-owned enterprises. Scholars began to pay attention to the series of effects of mixed ownership reform on state-owned enterprises. Chen Dong and Dong Yelin [1] believe that the development of state-owned enterprises is blocked because the government has distorted the market's operating mechanism. Xu Chaoyang [2] pointed out that the key to the reform of mixed ownership lies in the reform of the government and its own behavior level such as the political and administrative systems. Han Taoqing and Xu Duo [3] studied the mechanism of mixed ownership reforms affecting the performance of state-owned enterprises. The results show that the mixed ownership reform mainly affects the performance of state-owned enterprises by improving the internal governance mechanism of the company and stripping the policy burden, and adjusting the shareholding structure is the most important way. There is no mixed ownership reform in foreign countries. Mixed ownership reform is a reform system unique to China. However, the privatization of foreign state-owned enterprises and the mixed ownership reform in China have something in common, which has certain reference significance for the study of mixed ownership reform in China. The prototype of mixed ownership was first proposed by John Maymard Keynes. It mainly said that the United States was in an economic crisis at the time. Only government departments joined the economic system to save the United States in this economic crisis. They believed that society should not be a private economy. Enterprises and the government restrict development and can play a greater role. M Cartney, E. Gedajlovic et al. [4] conducted a survey of airlines of different nature around the world and found that the economic performance of companies based on mixed ownership is significantly higher than that of national airlines, and the benefits will be even better. Christian Buchelhofer [5] pointed out that state-owned enterprises have a stock market for the purpose of financing development and realize the absorption of funds. Therefore, investors will pay attention to the role of the state as a controlling shareholder because of investment, and whether state-owned enterprises can improve economic value. China Unicom is one of the first batch of pilot state-owned enterprises to carry out mixed ownership reform. It shoulders the mission of proving the way and providing experience for the mixed reform of state-owned enterprises. This article will focus on the changes in shareholding structure and
financial effects before and after reform, and makes suggestions for state-owned enterprises that will participate in the reform finally.

**China Unicom's Mixed Ownership Reform Programme**

China Unicom Group officially released the mixed reform plan in July 2017, mainly through the introduction of strategic investors, the transfer of controlling shareholders' old shares, and equity incentives for core employees. China Unicom’s mixed ownership reform plan announced specific details, pointing out the introduction of a large number of strategic investors through public offerings and the transfer of old shares. A number of strategic investors pledged to raise 9.04 billion shares of Unicom’s A shares. At the same time, it also pledged to raise 1.9 billion company stocks of China Unicom A-share company. The price of these two stocks is around 6.83 yuan, accounting for 34.9% of the issued share capital after expansion. In addition, core employees were granted a restricted sale of no more than 850 million shares at a price of 3.79 yuan for a total transaction price of 77.9 billion yuan per share.

From the perspective of shareholding structure, after the mixed reform of China Unicom, the shareholding of Unicom Group dropped to 36.7%, strategic investors accounted for 35.2% of the total shares, and core employees held 2.7% of the shares, realizing the diversification of the shareholding structure. For China Unicom Group, the key issue of mixed reform is also the formation of directors with heterogeneous directors to check and balance each other. This article compares the structure of the board of directors before and after the mixed ownership reform of Unicom Group. Before the mixed reform, China Unicom had a total of 7 directors. Except for 3 independent directors, the remaining 4 were all stationed directors of Unicom Group; after the mixed reform, there are 13 members of the board of directors of China Unicom, including 3 directors of the largest shareholder, accounting for 23%; 5 independent directors, accounting for 39%; and 5 directors of other shareholders, accounting for 39%. Including strategic investors such as China Life, Tencent, Baidu, JD and Alibaba, a non-equal allocation of control and equity has been formed. Non-state-owned directors enter the board of directors and jointly formulate enterprise development strategies and investment decisions with state-owned directors, which not only form effective checks and balances, but also exert their excellent management capabilities and market sensitivity and adaptability, which helps to improve the efficiency of enterprise decision-making. In addition, perfecting the control structure and corporate governance structure of state-owned enterprises through the rearrangement of the board structure will effectively alleviate the agency problems arising from the separation of ownership and control of corporate enterprises, and improve the efficiency of state-owned enterprise governance.

**Analysis of the Financial Effect of China Unicom's Mixed Ownership Reform**

The financial ability of an enterprise can be analyzed from four aspects: profitability, operating ability, debt-servicing ability, and growth ability. This article selects several representative indicators to analyze and explain Unicom’s mixed reform effect.

**Profitability Analysis**

Profitability refers to the ability of enterprises to obtain profits. This article analyzes the change trend of China Unicom's profitability from 2014 to 2019. It mainly selects four indicators: gross profit margin, net operating profit margin, and return on net assets.
It can be seen from Figure 1 that after China Unicom's mixed reform in 2017, the gross profit margin did not change much, but the gross profit margin declined two years before the mixed reform, and the gross profit margin rebounded in the year of mixed reform. Mixed reform reverses the decline in gross profit margin to an increase. This part of the rise should be attributed to the introduction of Internet strategic investors, which increased the number of users and thus increased revenue. Reanalyzing the changes in the return on net assets, the return on net assets suddenly showed a decline in 2016, and then rebounded in the following year with a larger recovery rate. In order to analyze the reasons for the sharp decline in the return on net assets, this article uses DuPont analysis to further analyze: it can be seen that from 2014 to 2015, the return on net assets has shown a small decline, but it still shows a downward trend in 2016. This shows that the business conditions in 2015 and 2016 are deteriorating. Therefore, this paper analyzes the decline in the return on net assets in 2016 based on 2014, and then finds the reason for the decline in the return on net assets:

\[ \text{Return on Net Assets} = \text{Net Sales Interest Rate} \times \text{Total Asset Turnover Rate} \times \text{Equity Multiplier} \]

Return on net assets in 2014 =1.38%×0.54×7.09=5.28%

Net sales margin changes= (0.058%-1.38%) ×0.54×7.09=-5.06%

Total asset turnover changes=0.058%×（0.45-0.54）×7.09=-0.04%

Equity multiplier changes=0.058%×0.45×（7.88-7.09）=0.02%

Net assets net interest rate in 2016=0.058%×0.45×7.88=0.20%

Through DuPont analysis, we can see that the main reason for the apparent decline in net asset yield in 2016 is the sharp decline in sales net interest rate. The decline in sales net interest rate led to a decline of 5.06% in 2016. The main reason for the decline in sales net interest rate is the increase in operating costs in 2016, but the operating income fell from the previous period, which resulted in a substantial decline in operating profit in 2016 compared to before. Further analysis of the financial data after the mixed reforms, comparing the 2017 data in the financial statements with 2016, it can be seen that the revenue in 2017 increased slightly, but the operating cost decreased significantly, so the net profit margin was small. The increase in the range can confirm that China Unicom's operating conditions have been improved after the mixed reform, so the return on net assets has increased slightly. China Unicom's gross profit margin has also undergone similar changes and has undergone mixed reforms. It is also affected by the net profit margin.

**Business Capability Analysis**

Operating capacity reflects the operation capabilities of an enterprise. Generally speaking, the
company's ability to obtain profits through the use of resources and efficiency of the company's resources. Therefore, this article selects the inventory turnover rate, receivables turnover rate, total asset turnover rate and current asset turnover rate for analysis, as shown in Figure 2:

![Figure 2. Business Capability.](image-url)

In the past six years, the largest change in operating capacity is the inventory turnover rate. The inventory turnover rate in 2019 doubled in 2014. The company's inventory management capacity improved significantly. Other three indicators have changed less. It can be still seen that the company's ability to manage accounts receivable improved, the current asset turnover ratio has declined after mixed reforms, and the company's total assets are not large. But for China Unicom, which has just undergone mixed reforms, a lower current asset turnover ratio may be more suitable for current development. On the whole, the reforms have not brought dramatic changes to China Unicom's operating capabilities, but there have also been slight improvements.

**Debt Repayment Capabilities Analysis**

The solvency of an enterprise is to analyze whether there is currently a risk that the enterprise cannot pay its debts. This article selects four indicators: quick ratio, current ratio, cash ratio and asset-liability ratio to analyze China Unicom's solvency. As shown in figure 3:

![Figure 3. Debt Repayment Capabilities.](image-url)

First of all, the asset-liability ratio has declined after the mixed reform, which shows that some of the capital introduced after the mixed reform has improved the capital structure to a certain extent; the current ratio and quick ratio are both used to measure how short-term the solvency of an enterprise is. Generally speaking, this value should be around 1 is the best. The data shows that short-term solvency is relatively weak in terms of current ratio and quick ratio excluding the impact...
of inventory factors. In addition, from the year of the data, since mixed reforms, this two indicators have increased. However, there is still a big gap with the optimal ratio of China Mobile, the leader of the telecommunications industry. China Unicom can choose the borrowing method that matches its own development and formulate the most reasonable debt repayment plan in the future according to the company's development needs. And eventually to optimize the capital structure to enhance its solvency.

Growth Ability Analysis

Growth capacity measures the company's future development trend and growth rate. This paper mainly chooses the growth rate of main business revenue, net profit growth rate and net asset growth rate per share to measure the growth ability of China Unicom. Figure 4 reflects the changes in the above indicators in the past six years.

The operating income growth rate and the net profit growth rate did not achieve positive growth until 2017. This is mainly because the strategic investors introduced by the mixed reform have brought new growth points to Unicom. Since the mixed reform, Unicom has been actively exploring new operating models and carrying out differentiated precision marketing, which brings operating profits And the rapid growth of net profit, (operating profit from -275 million in 2016 to 11.921 billion in 2018, and net profit also reached 9.301 billion in 2018 from 480 million in 2016). At the same time, it also attracted a large number of new users. According to statistics, China Unicom added 70.33 million 4G users in 2017, and even surpassed China Mobile in the first half of 2018s by various network cards in cooperation with Internet strategic investors. But it is worth noting that this trend turned sharply in the second half of the year, indicating that the benefits brought by these network cards are slowly fading away. China Unicom needs to find new products to attract users.

The Enlightenment of China Unicom's Mixed Ownership Reform

Through the research and analysis of China Unicom's mixed reform, it can be seen that the mixed ownership reform has indeed improved the business situation. China Unicom's mixed reform can better integrate the advantages of state-owned capital and non-state-owned capital and promote the development of enterprises. The mixed reform of state-owned enterprises has reference significance.

Choose the Right Time to Reform

The reform of state-owned enterprises should emphasize "time, location, and harmony". The best time to reform is that the company still has certain development prospects. The enterprise can further enhance its competitiveness through reform. Therefore, it is very important to choose the
right time for reform. When China Unicom carried out mixed ownership reform, although the company's performance was a bit low, it still had strong competitiveness in the industry. The purpose of the reform is to improve the company's operating performance and governance structure, and change from individual state governance to joint holding of state capital and private capital. In addition, Unicom's mixed reform equity structure design is reasonable, in line with the optimal model of "one share leading + highly decentralized + equity incentive". To maintain the control of state-owned capital, increase the value of state-owned assets, and give full play to the enthusiasm of enterprise backbones, at present, this is the optimal structural model for the mixed reform of large state-owned enterprises.

**Introduce Strategic Investors**

The introduction of strategic investors is an important model for the reform and development of state-owned enterprises. Strategic investors generally have rich investment experience and integration experience. They can provide enterprises with reference in the industry, market and business model, and assist the invested enterprises to create and realize greater value in the capital market. The 14 investment companies and institutions introduced by Unicom's mixed reform are divided into four categories, namely China's four strongest Internet companies BATJ, vertical industry leading companies such as Suning and Didi, long-term financial institutions and enterprise groups such as China Life Insurance, CRRC, as well as financial industry funds and state-owned asset structure adjustment funds. Whether strategic investors can cooperate with enterprises is particularly important for mixed reform enterprises. In this regard, China Unicom has clearly proposed three strategic investor standards, the first standard is solid fundamental, the second is synergetic cooperation, and the third is complementary edges. These three standards fully illustrate that a successful mixed reform enterprise introduces not only capital but strategic resources, so as to promote the new growth of mixed reform enterprises.

**Improve the Corporate Governance Structure**

A good governance structure can effectively check and balance the interests of all stakeholders, balance the interests of all parties, and ensure that the interests of the company are not violated. Through this mixed reform, Unicom has adopted the board of directors as the core in the reform of the corporate governance structure, and accordingly adjusted the members of the board of directors, and appropriately selected several representative non-state-owned shareholders from the strategic investors introduced by the mixed reform. The formation of a diversified board of directors protects the legitimate rights and interests of various investors and allows all types of capital involved to have a real voice. The first is to adjust the structure of board members and implement board responsibilities. The company can properly allow non-state-owned shareholders to participate in the board of directors. Secondly, it has reformed the selection and management of the company's managers, and implemented a market-based, contractual management and tenure system. The last is to establish a community of employees and company interests, a long-term equity incentive mechanism can fully stimulate the vitality, creativity and corporate cohesion of employees.

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