

DEBT DYNAMICS AND GOVERNANCE

The Evergrande Crisis



Corporate Governance

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Executive Summary

This article analyzes the debt default issues of China Evergrande Group, exploring the roots and impacts of its financial crisis and proposing potential solutions for the future. The study utilizes various corporate governance theoretical frameworks: corporate financial structure theory, market supervision theory, and corporate governance theory, to deeply examine Evergrande's problems and strategic solutions. It also employs Agency Theory I, Agency Theory II, and Stakeholder Theory to provide theoretical support for analyzing Evergrande's issues and proposing solutions. Initially, from the company's own perspective, the paper identifies the aggressive financing structure and strategic layout as key factors leading to its debt problems. It analyzes Evergrande's high-risk expansion strategies to capture market share, such as substantial perpetual debt and derivative contracts, and how these strategies ultimately led to financial instability. Furthermore, from a policy and regulatory standpoint, the paper discusses how to reduce the risk of debt default by optimizing the access and supervision mechanisms of the bond market. Lastly, the article underscores the necessity of strengthening corporate governance.

1、 Overview of Evergrande's Debt Crisis

1.1 Background of Evergrande's Debt Crisis

Evergrande Group, founded in 1997, has gone through multiple development stages. Initially focusing on real estate, the group gradually shifted towards a diversified industrial approach. Throughout its evolution, Evergrande implemented eight major strategic decisions: establishing corporate culture in 1997, enhancing product quality and competitive pricing in 2004, expanding both nationally and internationally in 2006, listing on the Hong Kong Stock Exchange in 2007, boosting sales and land reserves while addressing employment in 2013, transforming its development and business model in 2017, adhering to a "low debt, low cost, low inventory, high turnover" operational model in 2018, and further increasing sales and land scale while setting debt reduction goals in 2020. These strategic decisions directed Evergrande's transition from a solely real estate business to a multi-sector operation, thereby strengthening its competitiveness in various markets.(Ge, 2022)

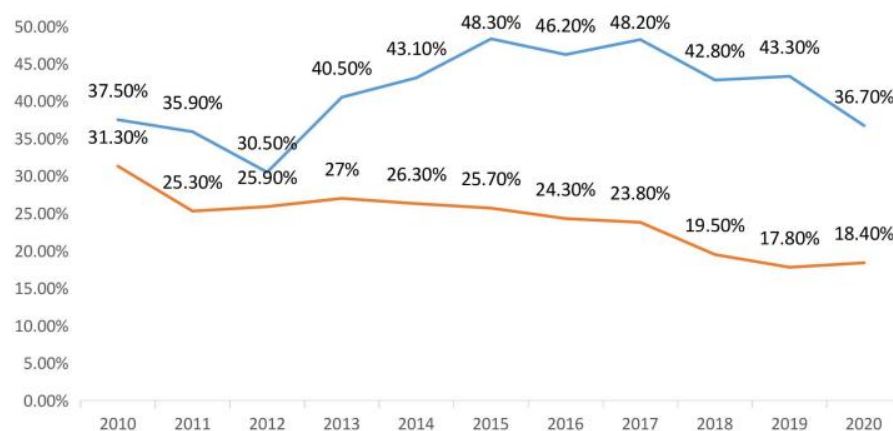
Prior to 2015, China's real estate companies experienced robust growth and aggressively expanded to capture more market share, leading to inflated property prices. To control the rapid development of real estate enterprises, the government introduced measures such as "deleveraging" in 2015, "housing is for living, not for speculation" in 2016 to stabilize housing prices, and comprehensive risk control over the real estate sector in 2017. In 2016, Evergrande made a pivotal strategic decision to undergo a transformation towards diversified development, which implied a significant need for capital, hence requiring extensive financing. Due to regulatory control and a tightening financing environment, raising funds through domestic bond issuance became challenging. As Evergrande's aggressive expansion could no longer be supported by domestic financing alone, and since overseas financing environments were relatively relaxed with fewer restrictions and higher efficiency, Evergrande turned to issuing a large volume of dollar-denominated bonds to secure funds.

To realize its strategic transformation and diversify its development, Evergrande opted to issue dollar bonds for rapid financing. In 2018, while continuing to expand its real estate ventures vigorously, Evergrande also pursued its goals of developing diversified industries such as the new energy vehicle sector, tourism, and healthcare. These chosen industries required substantial initial investments with long development cycles and were unable to generate quick returns. The uncertain progress in these sectors put Evergrande under financial pressure due to a shortage of funds. The diversified industrial development compelled Evergrande to issue a large volume of bonds to ensure smooth operations. As debts matured and the return on investments in these industries took longer than expected, Evergrande faced funding gaps, with available funds insufficient to cover its debts, forcing it to further increase financing. This led to a cycle of issuing new bonds to replace old ones, resulting in massive bond issuances that could not be repaid timely, ultimately leading to bond default incidents.

1.2 Overview of Governance Crisis

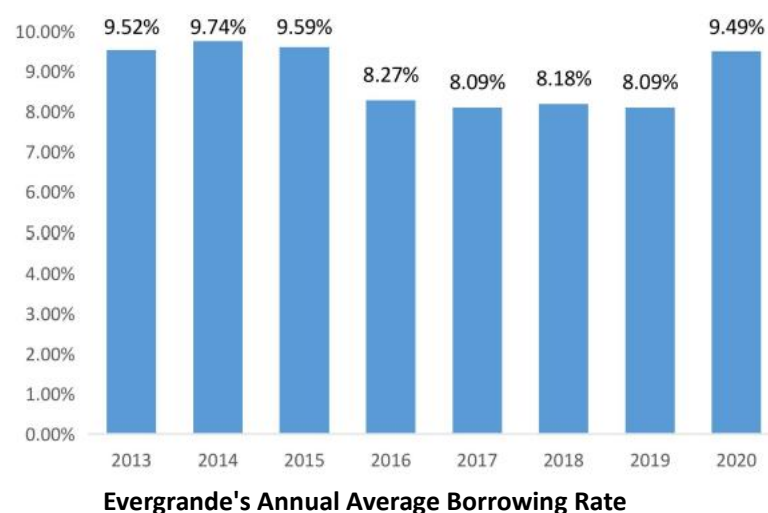
Evergrande has been characterized by high-debt expansion since its inception, with its actual debt-to-asset ratio reaching a peak of 96.33% in 2016. The first crisis occurred between 2012 and 2013 when the focus of Evergrande's real estate developments in third and fourth-tier cities suffered due to falling house prices, leading to significant challenges in bond and trust financing. Moreover, Evergrande's strategic expansion into first-tier cities in 2013 involved an expenditure of 70.7 billion yuan on land reserves. In the same year, Evergrande faced a current debt obligation of nearly 135.7 billion yuan, while only possessing 40.1 billion yuan in unrestricted cash at the beginning of 2013, resulting in a funding shortfall of nearly 100 billion yuan. However, Evergrande ingeniously utilized "perpetual bonds," an innovative financing tool, raising 100 billion yuan to bridge this gap and cleverly categorized these bonds as other equity instruments under accounting standards, thus lowering its reported debt ratio. The first crisis was safely navigated. (Goddard and Ajami, 2022)

The second crisis stemmed from the "interest rate jump" mechanism of the perpetual bonds. Evergrande issued these bonds under a "2+N model," where they carried an initial low-interest rate of 8.2% to 9% for the first two years, followed by a 30% annual increase, jumping to 18%. This back-loaded mechanism forced Evergrande to issue new perpetual bonds every two years to pay off the old ones. The onset of volatility in the perpetual bond market would expose Evergrande to significant risks of interest rate hikes or redemption. However, leveraging the opportunity during the "Baoneng Vanke dispute," Evergrande introduced a restructuring plan for its real estate segment with Shenzhen Real Estate. Strategic investors acquired approximately 36.50% of Evergrande Real Estate and were promised net profits, excluding non-recurring losses, of no less than 50 billion yuan, 55 billion yuan, and 60 billion yuan for the years 2018 to 2020, with 68% of annual net profits distributed to shareholders. If profits fell below these thresholds, Evergrande would cover the difference using its own funds. Additionally, Evergrande pledged to complete this restructuring by January 31, 2021, or else it would have to repurchase shares from strategic investors or compensate them with an additional 50% of their existing shareholdings in Evergrande Real Estate. This allowed Evergrande to secure three rounds of strategic investments totaling 130 billion yuan, averting the perpetual bond crisis.



The proportion of interest bearing liabilities to total liabilities in China Evergrande and A-share real estate sectors

The third crisis originated from the repurchase threat by strategic investors in 2020. Since the restructuring had to be completed by January 31, 2021, as a contingency, failure to do so would force Evergrande to either redeem the strategic investor's contribution, turning it into a substantial current liability, or trigger a ratchet clause, reducing Evergrande's ownership in Evergrande Real Estate to 45.18%, thereby losing control over it. Regrettably, on November 8, 2020, Evergrande announced the failure of the restructuring. However, after negotiations with various parties, only 4.3 billion yuan of strategic investor funds were withdrawn, with the remaining 125.7 billion yuan listed as nominal total liabilities in financial statements. Based on the principle that substance prevails over form, adjustments were made for perpetual bonds and strategic investments.(www.evergrande.com, n.d.) From 2013 to 2016, Evergrande had issued a total of 154.8 billion yuan in perpetual bonds, which essentially were high-interest bonds with a 2 to 3-year maturity. In 2016, Evergrande Real Estate gradually introduced 130 billion yuan of strategic investment, promising a return to the A-share market by 2021 and a cumulative net profit of 165 billion yuan from 2018 to 2020, allocating 68% of it for shareholder dividends. There was also a hedging agreement: if the net profit did not meet the target, Evergrande would compensate the strategic investors with its own funds, ensuring that they received dividends based on a profit base of 165 billion yuan, equating to an average annual guaranteed return of approximately 10.51%. Moreover, if the listing was unsuccessful, strategic investors had the right to demand a repurchase of their shares. Thus, until 2020, the funds from strategic investors were considered interest-bearing liabilities. By the end of 2020, after signing an agreement with Evergrande, strategic investors no longer demanded a repurchase and became long-term investors, forfeiting their rights to repurchase and additional share compensation. Management cleverly navigated through the crisis once again. By reviewing these three crises, the research team identified a significant feature of Evergrande' s past business model: the use of innovative financing methods to utilize high debt for land acquisition, which was then mitigated through rising housing prices.



1.3 Key Causes

1.3.1 Ineffective Governance Structure

According to Evergrande's 2022 annual report, aside from the founder Xu Jiayin, other board members have been serving the company for between 10 to 15 years. In terms of equity

structure, Xu Jiayin holds more than half of the shares, clearly indicating his position as the company's absolute major shareholder. Additionally, Xu not only serves as the chairman of the board but is effectively the CEO of the group. This type of control over the board by a single founder-major shareholder is not uncommon among Chinese companies listed overseas, as seen with NetEase's Ding Lei and Sohu's Zhang Chaoyang. This founder-dominated corporate governance model, while positively reflecting an internal selection mechanism, negatively suggests a potential for founders to strengthen their control over the board by selecting highly trusted long-term subordinates, thereby creating a highly centralized decision-making system that exacerbates both internal and external risks of the company.

Pan Darong, who joined Evergrande in 2006 and served as an executive director and CFO from 2016 until his departure in 2022 due to the company's debt issues, was investigated in September 2023. His long tenure at the company and role in the emergence of financial issues imply a potential collusion with founder Xu Jiayin or a scenario of management chaos. In either case, Xu's role as a primary responsible party is clearly visible from the governance structure of the board.(zheng, 2022)

Xu Jiayin's two sons hold senior positions within the group, demonstrating that the separation of ownership and management rights in the company's governance has not been effectively achieved, resulting in a relationship-dominated governance model. The presence of family members in significant positions and reliance on long-term internal employees reflect a family-centric employee management approach, prone to nepotism and high-risk governance structures.

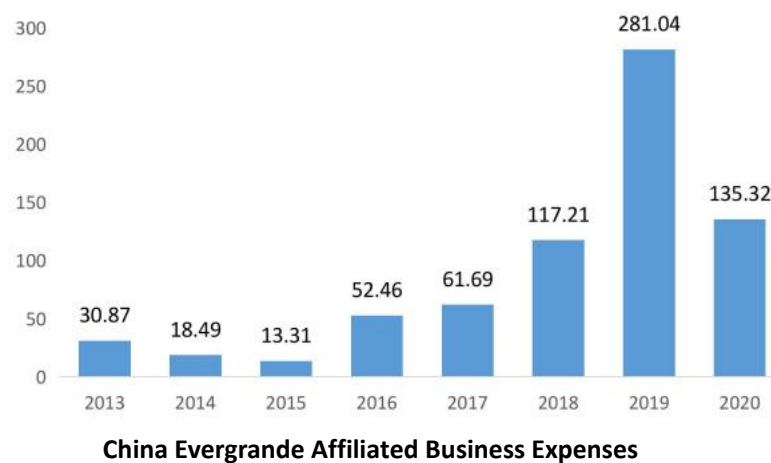
From the "Risk Management and Internal Control" section, although Evergrande is listed in Hong Kong and adopts a corporate governance model similar to that of the UK and the USA, without a supervisory board and with the board of directors taking on supervisory functions, the structure essentially remains self-supervised by the board, with close ties between the executive layer and the board, allowing internal control issues to surface. An incident involving the misuse of 13.4 billion yuan of Evergrande Property's funds further reveals severe deficiencies in the company's internal controls.

The three independent non-executive directors, though nominally in place, have their actual independence and effectiveness questioned. Despite being members of the audit committee, the manner of their appointment by the board fundamentally compromises their independence. Moreover, following the outbreak of financial issues, the post hoc recommendations of the independent committee, while recognizing the need for supervisory mechanisms, are more remedial than systemic preventive measures.

Overall, Evergrande's corporate governance structure exhibits significant design flaws. The board's structure, combined with a family-centric management style at the senior management level, a governance model without a supervisory board, and a superficial independent director mechanism, collectively lead to operational chaos and severe financial issues, further impacting the long-term sustainability of the company.(Deev, Lyócsa and Výrost, 2022)

1.3.2 Strategic Misalignment and Improper Diversification

In 2016, to control the overly rapid development of the real estate sector and prevent excessive increases in housing prices, the Chinese government introduced the policy of "houses are for living in, not for speculation," aiming to tighten control over the real estate industry. However, at the inception of this policy, the real estate sector was experiencing robust growth, and thus, companies did not pay significant attention to the potential constraints this policy might impose, choosing instead to continue their large-scale expansion. Evergrande Group, like other real estate companies, opted to continue its expansion. After the introduction of this policy in 2017, Evergrande proposed a strategic transformation. While continuing to rapidly develop real estate, it ventured into diversified fields including sports, culture, the internet, and automotive industries. These industries share common characteristics: large scale, high capital investment, long development cycles, and slow returns on investment.



As the financing environment tightened and due to the national policies, it became difficult for real estate companies to finance domestically, leading to a liquidity crunch. To raise substantial funds, Evergrande turned to issuing dollar bonds overseas. The expansion into multiple industries strained Evergrande's cash flow, leading to a shortage of funds and resulting in bond default incidents.

Evergrande's diversified strategy was overly scattered, primarily evident in its numerous unrelated diversified industries. The group ventured into sectors as varied as the fast-moving consumer goods (FMCG), sports, new energy vehicles, and finance, among others. The unrelated diversified industries far outnumbered the related ones, with weak interconnections between them. This approach, which included large-scale ventures into new industries over short consideration periods, reflected an aggressive diversification strategy.

In 2015, Evergrande's net profit margin from sales was above the industry average. At this time, its diversification was relatively new and not extensive, primarily focused on related industries, which had strong connections with the real estate sector. This enabled better integration of internal resources and synergy. Although certain sectors like grain and oil were operating at a loss, their impact was minimal. However, a significant decline occurred in 2019, followed by a

continued downward trend in 2020. Over these six years, Evergrande's net profit margin from sales often lagged behind the industry average, inconsistent with its ranking as a top real estate company in China in 2019 and 2020. This discrepancy indicates that Evergrande was not achieving high-quality profits, possibly due to its large inventory of properties and the overall losses in its diversified industries. To recuperate funds, it had to opt for price cuts, which increased sales volume but not profitability.(www.evergrande.com, n.d.)

This situation suggests that despite the implementation of diversification, Evergrande's primary revenue source remained the real estate sector. The development in both related and unrelated diversified industries failed to create new profit streams for Evergrande, instead dragging it down due to the investment costs from various sectors. The cash flow from operations likely could not meet Evergrande's needs. Moreover, due to its numerous diversified ventures, the company had to engage in financing, opting for debt financing which has lower costs than equity financing. This increased financial leverage and risk, contributing further to Evergrande's debt defaults.

2.Theoretical Application Analysis of Ethical Frameworks

2.1 Agency Theory - I

Agency Theory I focuses on the separation of ownership and control in corporate governance, a common scenario in modern large enterprises. Under this structure, there exists a natural conflict of interests between shareholders (owners) and management (agents). Shareholders aim to maximize their investment returns, while management might prioritize increasing their power and compensation, or pursue objectives that do not directly enhance shareholder value, such as business expansion and market share growth. This conflict of interest, compounded by the information asymmetry where management has more information than shareholders, can lead management to make decisions that are not in the best interests of shareholders. To mitigate these issues, modern corporate governance has introduced several mechanisms: the establishment of independent boards helps oversee management ensuring their actions align with shareholder interests; performance-based compensation systems aim to align management's motivations with those of shareholders; transparency and disclosure requirements mandate the company to publish key financial information, reducing information asymmetry. In the framework of Agency Theory, there is a natural divergence in objectives between management and shareholders. Shareholders usually focus on the long-term value growth and robust returns of the enterprise, whereas management may prioritize short-term performance or personal benefit maximization, such as through expansion and high-risk investments to enhance their market position and professional reputation. Evergrande's rapid expansion strategy, including large-scale real estate developments across the country and diversification into industries like football and insurance, ostensibly increased the company's scale but added to its debt burden and operational risks.(DEMARZO et al., 2012)

In the Evergrande Group debt crisis, Agency Theory I provides a framework for understanding issues surrounding information asymmetry and conflicting objectives. Evergrande's rapid expansion strategy reflected management's personal motives for scale expansion, which appeared to boost company market value in the short term but accumulated substantial risks. These risks ultimately did not provide corresponding returns to shareholders. Furthermore, due to incomplete information disclosure, shareholders and potential investors struggled to fully understand Evergrande's financial conditions and risk exposure, leading to investment errors. Ethically, management should be accountable to shareholders and other stakeholders, ensuring their decisions not only pursue economic benefits but also consider long-term sustainability and social responsibility. In Evergrande's case, management failed to properly manage their relationship with shareholders, particularly in aspects of transparency and risk management, damaging not only shareholders' financial interests but also the company's reputation and market trust.(Kingston and Weng, 2014)

The Evergrande crisis exemplifies the "separation of ownership and control" issue in Agency Theory, showing how management decisions can deviate from the best interests of shareholders in the absence of adequate supervision and proper incentive mechanisms. To prevent similar crises, enhancing governance structures, ensuring comprehensive information disclosure, and appropriate ethical considerations are key.

2.2 Agency Theory - II

Agency Theory II focuses on issues that arise when ownership is highly concentrated in the hands of a few major shareholders (blockholders). These major shareholders wield significant influence over corporate decisions, which can lead to decisions that disadvantage minority shareholders. In such situations, major shareholders may prioritize their own interests, overlooking or sacrificing the interests of minority shareholders. Hence, securities laws and regulatory frameworks often need to specifically protect these minority shareholders, ensuring they are not marginalized or overlooked. Additionally, to increase governance transparency and fairness, it is recommended to include board members representing minority shareholders.(Rahmawati et al., 2018)

In the case of Evergrande, the company's founder Xu Jiayin and his confidants controlled significant decisions. Despite Evergrande being a publicly listed company, theoretically supposed to have a balanced shareholder structure and an independent board to oversee management, Xu's control as a major shareholder was evident, possibly leading to the neglect of minority shareholders' interests. Evergrande's decisions in high-leverage operations and financial maneuvers tended to favor maintaining the assets and interests of major shareholders without fully considering the risks to the broader shareholders and creditors.

From an ethical standpoint, major shareholders, especially controlling ones, have a responsibility to ensure their decisions not only serve their own interests but also do not harm the rights of minority shareholders. However, in Evergrande's situation, management and major shareholders may not have adequately fulfilled this responsibility. (Heracleous and Lan, 2011)

The lack of transparency and insufficient disclosure of risks led minority shareholders to make investment decisions under conditions of information asymmetry, exacerbating the company's

risks and resulting in a liquidity crisis. If Evergrande had considered all shareholders' interests more equitably in its governance structure and established a more independent board to oversee management, it might have reduced crises caused by moral hazards. To mitigate these agency issues, strengthening protections for minority shareholders is crucial. This can be achieved by implementing stricter information disclosure rules, ensuring the independence of the board, and increasing representation for minority shareholders on the board. Additionally, enhancing external regulatory bodies' monitoring and assessment of major shareholders' actions to ensure their decisions align with all shareholders' long-term interests is also vital in preventing similar crises.(van Oenen, 2011)

In summary, the Evergrande event reveals the risks of major shareholder control potentially overlooking minority shareholder interests. By strengthening legal protections, improving corporate governance structures, and enhancing ethical standards, these risks can be effectively mitigated, enhancing the overall health of the company and the stability of the market. Such measures are crucial for protecting the interests of investors, particularly small shareholders, and are key factors in maintaining the credibility of the capital market and promoting healthy economic development.

2.3 Stakeholder Theory

Stakeholder theory emphasizes the ethical responsibility of managers towards all stakeholders within and outside the company (including shareholders, employees, creditors, suppliers, consumers, communities, etc.). This theoretical framework suggests that a company's success should not only be measured by the maximization of shareholder value but also by achieving a balance in meeting the needs and expectations of all stakeholders. In this theory, managers act as custodians for a variety of interests, aiming to satisfy all parties involved with the business in a harmonious and sustainable manner.(Greenwood and Mir, 2018)

Evergrande, being one of China's largest real estate developers, significantly impacts numerous stakeholders. The company's debt crisis not only affects its shareholders but also has a wider impact on employees, customers, suppliers, and even the global financial market. Many homebuyers, for example, have purchased units in yet-to-be-completed projects, making them direct stakeholders whose lives and financial stability depend on the company's decisions. Similarly, the suppliers and subcontractors dependent on Evergrande's business are left facing financial uncertainty, further demonstrating the interconnectedness of stakeholder interests.

Ethically, the management of Evergrande has a responsibility to consider these stakeholders in their decision-making process. However, the focus on rapid expansion and accumulating debt without sufficient consideration of the broader implications reflects a failure to balance these responsibilities. The ethical implications of such management decisions are profound, as they have led to financial and emotional distress for numerous stakeholders, including employees facing job insecurity and customers experiencing loss of their investments.(Greenwood and Mir, 2018b)

Stakeholder theory argues for a more inclusive approach to management, where decisions are made considering the impact on all stakeholders. In the case of Evergrande, adopting a stakeholder-oriented approach could have involved more cautious financial management, better risk assessment, and a focus on completing projects to meet customer expectations, thereby enhancing company sustainability and ethical standards. Implementing practices that ensure transparency and engage stakeholders in decision-making processes could mitigate risks and foster a more stable and ethical operating environment.

The Evergrande case highlights the importance of stakeholder theory in corporate governance. It underscores the need for companies, especially those of significant societal impact, to operate responsibly, considering the well-being of all stakeholders. Adopting a stakeholder-centric approach not only helps in managing ethical issues but also promotes long-term sustainability and corporate resilience, critical in today's interconnected and rapidly changing business environment. Thus, stakeholder theory provides a crucial perspective in examining the ethical obligations of companies like Evergrande and presents an opportunity to redefine success in the corporate world to encompass a broader array of interests and impacts. (Danielson, Heck and Shaffer, 2008)

2.4 Summary and Reflections

Each theoretical framework provides a unique lens through which to analyze the Evergrande crisis, highlighting different aspects of the problem and suggesting specific solutions. Agency theories focus on the relationship between shareholders and managers and between majority and minority shareholders, emphasizing the importance of governance mechanisms and protection of minority interests. Stakeholder theory broadens the analysis to include a variety of interests, advocating for a balanced approach to corporate governance that considers the impact on all stakeholders.

In analyzing the Evergrande crisis, it becomes evident that a multifaceted approach is necessary. Not only must the immediate financial issues be addressed, but a long-term strategy focusing on ethical practices and robust governance must be implemented to ensure sustainability. Each theoretical framework contributes to understanding how corporate decisions can have far-reaching consequences and how ethical considerations can be integrated into business practices to prevent such crises in the future.

In summary, the Evergrande crisis serves as a critical case study for examining corporate ethics and governance. The lessons learned from applying these theoretical frameworks stress the importance of ethical decision-making and responsible management, essential for the health and stability of the global economy.

3. Impact on Stakeholders

3.1 Shareholders and Investors

Evergrande's debt crisis first and foremost impacted its stock price, which has seen a significant decline since 2021, leading to a reduction in market value. This situation has affected not only the asset values of major shareholders but also inflicted substantial losses on ordinary small shareholders. Particularly affected were entities like retirement funds and individual investors, who might have invested their life savings hoping for stable returns. As Evergrande's liquidity crisis worsened, the company announced the suspension of dividend payments, further eroding investor confidence and financial returns.(Rappaport, 1999)

3.2 Creditors

Evergrande's total debt exceeds \$300 billion, involving major Chinese banks as well as international creditors. In 2021, Evergrande repeatedly failed to meet its domestic and international debt interest payments on time, leading to debt restructuring and emergency financing measures. This not only threatened the asset quality of creditor banks but also risked causing a credit crunch among banks, affecting the stability of the entire financial system.

3.3 Employees

As a leading real estate developer, Evergrande directly and indirectly employed tens of thousands of individuals. With the tightening of the company's cash flow, many employees faced delays in salary payments and job instability. More severely, if the company were to progress towards bankruptcy, many employees might face unemployment, directly impacting their families and livelihoods.

3.4 Suppliers and Partners

Evergrande's operations relied on an extensive supply chain, including building material suppliers, construction contractors, and advertising partners. Due to the rupture in the financial chain, Evergrande failed to make timely payments on substantial debts, placing suppliers and contractors in a financial crisis, particularly affecting small and medium-sized enterprises whose financial resilience may not be strong enough to withstand such shocks.

3.5 Homebuyers

The most direct victims of the Evergrande crisis might be the numerous homebuyers. Many purchased properties that were not yet completed, having already made down payments. As projects stalled, they faced the risk of homelessness. Moreover, the instability in the real estate market could lead to a decrease in the market value of purchased properties, depreciating the assets of homebuyers.

3.6 Government and Regulatory Bodies

For the government and regulatory agencies, Evergrande represents not just a financial crisis but a test of social stability and economic confidence. The government's intervention is necessary not only to prevent further turmoil in the financial markets but also to address social issues arising from widespread unemployment and investment losses among residents. Furthermore, this crisis has exposed issues of inadequate regulation in the context of rapid growth, demanding that regulatory bodies enhance their risk monitoring and management of large corporate groups.(Smith and Gravelle, 2001)

3.7 Loss of Reputation

3.7.1 Decline in Public Trust

Following the public exposure of the Evergrande crisis, coupled with the emergence of debt default risks and news of project suspensions, the company's reputation has drastically declined. As one of China's largest real estate developers, Evergrande had earned the trust of consumers and investors through its scale and commitments. However, after the crisis erupted, a broad spectrum of consumers and investors began to doubt its operational sustainability and the transparency of its management.(Paul Ramírez Jonas, Gilbert and Provan, 2016)

3.7.2 Impact on International Markets

Evergrande's image has also been severely tarnished in international markets. As a company listed in Hong Kong, Evergrande's debt issues have attracted global investor attention. Several international rating agencies have downgraded Evergrande's credit ratings, increasing its financing costs in the international capital markets and reducing its ability to attract external funds.

3.8 Decline in Market Value

3.8.1 Plunge in Stock Prices

Evergrande's stock price has been severely affected during the crisis. Beginning in early 2021, as negative news accumulated and the debt crisis intensified, the stock price continued to decline, evaporating tens of billions of US dollars in market value. This not only reflects investors' pessimistic expectations of Evergrande's future financial performance but also directly impacts the wealth of the company's shareholders. Between the end of 2020 and 2021, Evergrande's stock price fell by over 80%, with a market value loss of more than 200 billion RMB. Additionally, some of Evergrande's bond prices fell to 25% of their face value, and bond yields soared to over 35%, significantly higher than the industry average, reflecting the market's extreme concern about its default risk.

3.8.2 Bond Market Reaction

As part of debt restructuring, various bonds issued by Evergrande experienced a sharp price drop and spike in yields on the secondary market. This indicates investors' concerns about Evergrande's default, and also reflects its weakened ability to finance in the capital markets.

3.8.3 Pressure on the Balance Sheet

Evergrande's enormous debt and cash flow problems have directly impacted its balance sheet health. With the disruption of the funding chain, the company had to sell assets to pay debts, further reducing the value of its assets. The decline in asset quality, in turn, has intensified market concerns about Evergrande's financial condition. Due to a high proportion of unsold properties and unfinished development projects, Evergrande faces significant liquidity pressures. A 2021 report showed a continuous decline in the ratio of liquid assets to total debt, raising questions about the quality of its assets.

3.8.4 Delays and Suspensions of Projects

Many of Evergrande's construction projects have been forced to delay or suspend due to a shortage of funds. This not only damages the company's market reputation but also directly impacts its revenue sources, further weakening its market value.

3.9 Comprehensive Impact

The effects of the Evergrande crisis extend beyond a single financial dimension, with the dual decline in reputation and market value severely affecting the company's overall competitiveness. Against a backdrop of damaged trust and financial stability, Evergrande faces the daunting tasks of rebuilding its reputation and restoring market confidence. Moreover, the crisis has impacted the Chinese real estate market and the broader economic environment, prompting government and regulatory bodies to reassess and strengthen the supervision of financial risks in the real estate industry.

Evergrande Group's crisis has not only garnered widespread attention but has also revealed significant shortcomings in its corporate governance, financial management, and market credibility.

1. Separation of Management and Ownership: Evergrande's governance structure exhibits typical agency problems, namely the separation of ownership and control. The executive team may focus more on personal short-term benefits rather than long-term shareholder value, likely leading to the adoption of excessive expansion and high-risk debt strategies. It is reported that between 2010 and 2021, Evergrande's debt increased by several billion dollars, while the growth rate of shareholders' equity lagged far behind.
2. Inadequate Internal Controls and Transparency: Evergrande lacks transparency in its financial reporting and project progress, reducing external investors' confidence in its operations and financial condition. Furthermore, regulatory agencies and auditing processes failed to adequately reveal its strained funding chain until the crisis erupted.

4. Lessons from Evergrande's Debt Default and Future Recommendations

4.1 From the Perspective of the Enterprise: Optimizing Financing Structure and Strategic Layout

During the Evergrande debt default crisis, the company's aggressive financing structure and strategic layout played a significant role in the unfolding of the debt default event. A key issue was the long project cycles and large initial investments required; these were also influenced by geographical location and policy constraints. Under these conditions, it was challenging for businesses to make accurate and timely judgments about the actual revenues and expected returns from project developments, which hindered appropriate adjustments and resource allocation. Despite rapid growth in on-paper assets, actual asset growth lagged behind. Evergrande's risky expansions, such as high perpetual bonds to capture markets in lower-tier cities and costly agreements to acquire assets like Shenzhen Real Estate, sowed the seeds of the eventual debt default. From this perspective, it is essential for enterprises to optimize their financing structure by seeking diverse financing sources, such as attracting more equity financing to relieve the pressure from debt financing. Concurrently, the introduction of the "Three Red Lines" policy by the government aims to guide real estate companies, reduce their debt financing scale, and decrease large-scale debt defaults to foster the healthy development of the industry.(SARKAR, 2011)

On the other hand, companies need to adjust their expansion pace. In the earlier era of real estate "bonuses," continuously expanding assets, opening markets, and seizing market shares were optimal for maximizing benefits. However, maintaining aggressive expansion strategies is unwise when the industry bonus begins to wane. Growth and profit are not always aligned, which necessitates a balance between the two under operational, managerial, and resource constraints. Enterprises must avoid blindly pursuing profitability, particularly in high-risk areas; instead, they should focus on strategic alignment and policy constraints on financing capabilities. Looking at real estate companies like Wanda Group, which managed a liquidity crisis by divesting large, non-core projects such as e-commerce ventures and overseas properties, shows the effectiveness of such strategies. Thus, dealing with non-core assets to quickly liquidate funds while maintaining sustainable operations can significantly help enterprises navigate crises.(Grajo, 1995)

4.2 From the Policy and Regulatory Perspective: Optimizing Bond Market Access and Supervision Mechanisms

Bond default is a major form of debt default, with broad impacts and significant implications for corporate reputations and the entire industry. Optimizing the bond market's access and supervisory mechanisms is crucial for addressing debt default issues and improving related policies and regulatory frameworks.

Firstly, improving the credit rating system and its regulation is essential. This includes enhancing the timeliness and accuracy of rating adjustments, refining evaluation systems, and implementing rewards and penalties to encourage accuracy. Secondly, stringent enforcement of disclosure requirements for listed companies should be implemented, with severe penalties for non-compliance to ensure transparency. Lastly, maintaining the delisting mechanism is vital for removing low-quality companies from the market, reducing the spread of debt default risks and ensuring smooth market operations. Utilizing the delisting system also serves as a warning to market participants about potential risks, prompting them to manage and control debt default risks proactively.

4.3 Future Recommendations: Strengthening Corporate Governance

The inappropriate corporate structure of Evergrande was also a contributing factor to its debt issues; therefore, strengthening corporate governance is necessary. On one hand, companies need to establish and improve governance structures to limit the powers of controlling shareholders. Implementing substantial modern corporate governance systems and enhancing internal management and risk control are imperative. Establishing robust internal controls and risk management systems ensures effective supervision and management of financial and operational aspects, identifies and resolves issues timely, and establishes risk management systems and emergency plans. (Corporate Governance Report: Corporate Governance in Canada, 1999) Furthermore, enhancing social responsibility and ethical management will boost the corporate image and reputation. Strengthening governance will enhance operational efficiency, risk management, and sustainable development capabilities, reducing default risks and associated costs. In summary, Evergrande needs to take proactive measures, communicate with creditors and the government to find solutions, strengthen internal management, optimize business structures, and seek diversified development paths to navigate through the crisis successfully.

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