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Research on the Performance of China's Sunshine Private Equity Funds and the Factors Affecting Them

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Abstract: With the rapid development of China's securities market, the role of sunshine private equity funds in the securities market has become increasingly prominent. However, after the initial rapid development, their quality may not be commensurate with their quantity. In the face of numerous sunshine private equity fund products in the market, investors have to distinguish those products that can maintain stable and high growth. Therefore, for high net worth individuals and institutional investors, how to choose high quality fund products becomes a very important topic. Based on this, this paper starts from the concept, operation mode and basic characteristics of sunshine private equity funds, launches a continuous comparison of the medium-term and long-term performance of sunshine private equity funds and public equity funds, and analyzes the influencing factors affecting the performance of sunshine private equity funds, and proposes management measures to optimize the performance of sunshine private equity funds for reference.

1. Introduction

In recent years, the stable development of the Chinese economy and the rapid accumulation of social wealth have led to the growing number of high net worth individuals (HNWI). As a result, many investors are considering hiring a professional investment manager to help them with their investments and financial management. On the one hand, this is because it saves time for investors, and on the other hand, because investors often believe that a professional investment manager can bring them higher returns. In the secondary market, traditional financial products are no longer able to meet the needs of HNWI who seek more customized and high-yield financial products. Unlike mutual funds that pursue relative returns leading the market, sunshine private equity funds benchmark their performance and operate with greater flexibility. Therefore, sunshine-type private equity funds have been increasingly favored by high-net-worth investors. This article analyzes the performance comparison between sunshine private equity funds and public funds, and discusses issues affecting the development of sunshine private equity funds, such as performance disclosure, external regulatory mechanisms, and inadequate supervision of managers. Several management strategies are proposed, such as standardizing performance disclosure, strengthening government regulation, reviewing managers' qualifications, and establishing laws to promote the sustainable development of sunshine private equity funds in China [1].

2. Definition of the Concept of Sunshine Private Equity

2.1. Concept analysis

Private equity funds have a long history of development abroad. However, in recent years, with the rapid development of China's stock market, private equity funds have gradually formed a scale in China as well. They can be divided into private equity funds and private securities funds according to their investment directions. The former invests in shares of non-listed companies and puts them into their incubation and growth periods. The latter mainly invests in stocks, bonds, commercial papers, asset-backed securities, central bank bonds, closed-end funds, open-end funds, financial derivative products, and other investments allowed by the China Securities Regulatory Commission in the Chinese securities market. In actual operation, the securities investment targets are mainly stocks and bonds. Sunshine private equity funds belong to the latter category which generally refers to private equity funds that mainly invest in securities, operate on the secondary market, conform to legal provisions, and are composed mainly of private investors [2].

2.2. Sunshine private equity fund operation model

Currently, there are three major models of sunshine private equity fund operation in China, namely Shanghai, Shenzhen and Yunnan.

(1) Shanghai model

The Shanghai model adopts the "structural trust" approach, which divides the trustee into two categories: preferred beneficiaries and ordinary beneficiaries. Preferred beneficiaries are general investors who can receive fixed income. The latter generally refers to some institutions or high-risk preference investors. These investors invest a portion of their funds to safeguard the rights and interests of the maximum beneficiaries. They have the right to extract additional profits after the trust plan is profitable. This model has become the "Shanghai model" due to its large-scale issuance in the securities market. It distinguishes traditional "conservative" and "high-risk" models to some extent. For preferred beneficiaries, this model has the minimum guarantee and interest. Essentially, this model belongs to a mandatory basis project, so it is more like financial tool instead of a standard private equity model [3].

(2) Shenzhen model

The Shenzhen model belongs to a type of "non-structural trust", where the collective trust plan does not divide investors into priority and inferior levels. Investors enjoy the distribution of income and sharing of risks according to their own investment shares. Its name comes from the fact that there are many such trusts in the Shenzhen market. The Shenzhen model does not make any promises to investors regarding capital preservation or minimum investment returns. Therefore, investors generally have higher requirements for the sunshine private equity fund management company and fund manager in which they invest. They also take factors such as the ranking of the fund company, the investment style and R&D capabilities of the fund management team, and the performance of the fund manager in the past, into consideration when making their investments.

(3) Yunnan model

The "Yunnan model" is one in which the trust company itself is the manager and trustee without the involvement of an asset management company. This model reduces to a certain extent the external risk caused by information asymmetry. However, on the other hand, it increases the moral hazard of the trust company, thus increasing the chances of insider trading. From the perspective of protecting investors' interests, this is not a healthy development direction for China's sunshine private equity funds [4].

2.3. Characteristics of sunshine private equity

(1) Private placement

A private equity fund is a type of sunshine private equity fund that differs from a public equity fund, as it is a non-publicly issued private equity fund. It is established based on the Trust Law, and is a collection fund trust plan based on a trust company platform and foundation. Therefore, its financing model is also limited by trust regulations. The "Measures for the Administration of Trust Companies' Collective Fund Trust Plans" stipulate that sunshine private equity fund companies cannot conduct large-scale, public promotion in any form, nor can they engage in any form of advertising through the media.

(2) Pursue absolute returns

Just like foreign hedge funds, China's sunshine private equity funds also seek absolute returns to a large extent, as opposed to traditional public funds that earn profits based on relevant performance indicators of their investments. Therefore, they generally do not use public funds to invest but use other means to achieve positive returns. This is largely due to the fact that private equity funds are generally small in size, and their fixed costs typically only account for 1-2% of the total assets they manage. Performance-based compensation mainly comes from a commission on outstanding performance, usually charged at 20% of the absolute return. In this case, there is a close relationship between the fund company and investors, in which investors can benefit, and private equity funds can receive additional commissions from investors [5,6]. This will greatly stimulate sunshine private equity and fund managers to make excellent investment decisions.

(3) Flexible operation mechanism

In China, the investment scope of sunshine private equity funds is relatively wide, and there are generally no particularly strict rules on the percentage of shareholdings they hold, making them very flexible in investment operations. However, for public equity funds, there are relatively strict regulations on their investment types and holding proportions. For example, for an equity-based public fund, its holding proportion cannot be lower than 60%. When it encounters systematic risks, the fund will bear the price decline caused by holding shares, while sunshine private equity funds can actively reduce or even liquidate their positions, making them more advantageous in terms of flexibility and profitability compared to public equity funds [7].

3. Performance Persistence of Sunshine Private Equity Funds vs. Public Equity Funds

3.1. Sample data selection and examination interval

Selection of the study population and sources of information. In the study of the long-term performance of the four modal funds, two did not receive a good ranking; therefore, the sample number of sunshine private funds was reduced by two to 131, while the number of publicly-traded funds was still 133.

Scope of the survey: The sample for this part of the survey focuses on the period from January 2017 to October 2022, with a continuous comparative analysis of two time periods from six months to one year. Since market fluctuations will affect the performance of the funds, the analysis in this section must be linked to market performance.

3.2. Empirical comparative analysis

We perform a positive performance sustainability analysis using two classifications, also known as linked table analysis. The symbols "WW, LL, WL, and LW" used in the table represent the state of money in a cycle, which are "win-lose, lose-lose, win-lose, and lose-win. CPR represents the cross product ratio, and LNCPR represents the logarithm of the cross product ratio.

(1) Interim (semi-annual) performance persistence,the interim (semi-annual) performance persistence test for sunshine private equity funds is shown in Table 1, and the interim (semi-annual) performance persistence test for equity-based public net bases is shown in Table 2:

Table 1: Sunshine private equity funds interim (semi-annual) performance persistence test

(* indicates 5% significant level)

	Inspection area	WW	LL	WL	LW	CPR	LNCPR	LNCPR standard deviation	Z-statistic
1	2013H1-2013H2	32	39	29	31	1.39	0.33	0.35	0.93
2	2013H2-2014H1	35	31	28	37	1.05	0.05	0.35	0.13
3	2014H1-2014H2	29	33	43	26	0.86	-0.16	0.36	-0.44
4	2014H2-2015H1	30	37	25	39	1.14	0.13	0.35	0.37
5	2015H1-2015H2	42	28	27	34	1.28	0.25	0.35	0.70
6	2015H2-2016H1	24	21	52	34	0.29	-1.26	0.37	-3.38*
7	2016H1-2016H2	22	29	36	44	0.40	-0.91	0.36	-2.52*
8	2016H2-2017H1	32	34	34	31	1.03	0.03	0.35	0.09
9	2017H1-2017M10	25	36	38	32	0.74	-0.30	0.35	-0.85
	Total	271	288	312	308	0.81	-0.21	0.12	-1.78*

Table 2: Mid-term (semi-annual) performance persistence test of equity-based public net asset bases

(* indicates 5% significant level)

	Inspection area	WW	LL	WL	LW	CPR	LNCPR	LNCPR standard deviation	Z-statistic
1	2013H1-2013H2	34	36	34	29	1.24	0.22	0.35	0.76
2	2013H2-2014H1	36	32	27	38	1.12	0.12	0.35	0.93
3	2014H1-2014H2	40	31	34	28	1.30	0.26	0.35	0.76
4	2014H2-2015H1	31	30	37	35	0.27	-0.33	0.35	-0.95
5	2015H1-2015H2	36	31	30	36	1.03	0.03	0.35	0.09
6	2015H2-2016H1	39	28	33	33	1.00	0.00	0.35	0.01
7	2016H1-2016H2	45	42	27	19	3.68	1.30	0.37	3.54*
8	2016H2-2017H1	39	31	25	38	1.27	0.24	0.35	0.68
9	2017H1-2017M10	44	25	33	31	1.08	0.07	0.35	0.21
	Total	344	286	280	287	1.22	0.20	0.12	1.74*

Through the above table comparison, we found that in the nine consecutive phase cycles, the number of sunshine private equity with CPR values above 1 reached as many as 5, with an insignificant effect at the z-statistic of 5 percentage points confidence level, no performance persistence phase, and 2 performance reversal phases; in the same cycle, the number of public funds with CPR greater than 1 was 7, with an effect at the z-statistic of 5 percentage points confidence level, with a significant effect of 1 performance persistence phase and none performance reversal phase [8]. As can be seen from the data, the performance persistence of public funds is better than that of sunshine funds in the medium-term (half-year) funds, and in the seventh stage, the performance of public funds shows a persistent phenotype, which indicates that public funds have better overall control of risk than sunshine private funds against the background of a declining market environment.

(2) Long-term (annual) performance sustainability, long-term (annual) performance persistence tests for sunshine private equity funds are shown in Table 3, and long-term (annual) performance persistence tests for equity public equity funds are shown in Table 4:

Table 3. Long-term (annual) performance persistence

	Inspection area	WW	LL	WL	LW	CPR	LNCPR	LNCPR standard deviation	Z-statistic
1	2013Y-2014Y	28	41	32	30	1.20	0.18	0.35	0.51
2	2014Y-2015Y	33	31	25	42	0.97	-0.03	0.36	-0.07
3	2015Y-2016Y	34	37	41	19	1.61	0.48	0.37	1.31
4	2016Y-2017M10	22	45	31	33	0.97	-0.03	0.36	-0.09
	Total	117	154	129	124	1.13	0.12	0.18	0.68

Table 4. Long-term (annual) performance persistence test for equity-based public funds

	Inspection area	WW	LL	WL	LW	CPR	LNCPR	LNCPR standard deviation	Z-statistic
1	2013Y-2014Y	37	26	32	30	31	39	0.35	-0.65
2	2014Y-2015Y	32	21	25	42	44	36	0.36	-2.38*
3	2015Y-2016Y	37	39	41	19	31	26	0.35	1.66*
4	2016Y-2017M10	35	27	31	33	28	43	0.35	-0.69
	Total	141	113	129	124	134	144	0.17	-1.10

From the above table, we can see that in the four consecutive cycles, the number of sunshine private equity CPR values exceeding l reached as many as two, and the effect of the z-statistic at the 5 percentage point confidence level was not significant, with no performance persistence phase and no performance reversal phase; in the same cycle, the number of public equity funds with CPR exceeding l was one, and the effect of the z-statistic at the 5 percentage point confidence level was significant, with one performance persistence phase and one performance reversal phase. In the same period, there is one public fund with CPR above l, and there is one performance persistence stage and one performance reversal stage with a z-statistic of 5 percentage points confidence level. From the data obtained, it can be seen that public funds outperformed sunshine funds in terms of long-term (annual) fund performance. At a 5% confidence level, the performance of public funds will show a period of reversal and persistence. In both phases, the market trend is characterized by oscillation-decline and decline-decline [9]. This indicates that in the former stage, public funds are largely in line with the market, while in the latter stage, they show better risk control avoidance and can effectively avoid the fund performance being affected by the market.

From the synthesis and statistical results of the two indices, sunshine funds are significantly weaker than public pastoral funds in terms of both performance persistence and performance feedback, and this has been verified.

4. Factors Influencing the Performance of Sunshine Private Equity Funds in China

4.1. Performance disclosure issues

Jiangsu Ruihua Fund Manager Wang Zeyuan said that private equity funds are relatively concentrated in terms of direction and have longer capital chains, which means that they have higher moral, market, and legal risks. Among these three types of risks, we must first deal with moral risk. When the fund reaches a certain size, the fund manager can use the fund arbitrarily without the consent of others to seek the maximum benefit for themselves. The fundamental reason for this phenomenon is that in certain models, the delegation relationship between the fund manager and trustee is not clear, resulting in the fund manager having almost unrestricted discretion over investor choice. If investors cannot supervise the behavior of managers, the trust between investors and managers will be eroded due to information asymmetry. Although fund managers often disclose operational data, there is little public disclosure of investment in stocks related to operations and equity [10].

4.2. Lack of external supervision and management mechanism

Due to the low threshold for entry into the market for sunshine private equity funds, particularly in recent years with the continuous expansion of the market size, various types of fund companies have emerged. These companies vary in size, with some having only a few people and others having dozens. However, the regulation of these types of funds is almost nonexistent. Many small-scale investment institutions, due to their late start, often exaggerate their returns to attract more investors and obtain corresponding capital. However, in this scenario, many controversies arise due to the lack of corresponding regulatory mechanisms. In addition, there is a lack of effective supervision over the flow of funds. Many sunshine private equity funds like to invest their equity in the secondary market, but many unregulated organizations also transfer their money elsewhere. In this scenario, there is no dedicated regulatory department to regulate them.

4.3. Inadequate supervision by managers

Managers engaged in the activities of sunshine private equity funds are required to have a high level of education and extensive investment experience. Skillful management is the first priority for fund managers, with data showing that 80% of fund managers have a master's degree or higher. By analyzing data from developed countries, we found that the age of private equity fund managers in the United States is around 42, with the youngest being 25 and the oldest being over 70. Currently, the average age of fund managers in China is around 35. Each private equity fund is operated and managed by different managers, so its operating mode and methods also vary greatly. They can be divided into active investors, quantitative investors, and so on. Each project has times of making money and losing money. This cannot be blamed on them, but rather on the fact that their investment methods may not be suitable for the current market. If an investment method does not match the current market environment, it can cause unstable performance of the fund and even lead to significant losses. In this context, China's private equity funds have experienced rapid development, which has also led many financial institution employees to enter this field. Currently, this group exhibits a clear trend of youthfulness, lacking in experience or adopting overly aggressive investment strategies, resulting in many risks for sunshine private equity funds. Under current conditions, China has not yet strictly regulated the managers of sunshine private equity funds, resulting in a mixed level of quality among these managers [11].

5. Policy Recommendations

5.1. Regulate performance disclosure

Currently, there are some problems in the development of private equity funds in China, with the most important reason being the existence of internal non-compliant operations and improper transactions by some managers. If disclosure of relevant information can be improved and performance can be fully disclosed, it can to some extent increase the transparency of private equity funds and reduce the occurrence of non-compliant operations and other phenomena. As for current sunshine private equity funds, their performance is generally released on a regular basis, which can be weekly, monthly, or quarterly. The performance trend of private equity products has a great impact on investors' choices. Good performance will prompt investors to add more investment, while poor-performing products may see large-scale withdrawals. This approach can have a significant impact on the flow of funds, and in severe cases, it can cause a significant shortfall in funds. Due to the existence of these problems, corresponding measures must be taken to plug these loopholes. Some fund managers use false performance information to deceive investors, thereby obtaining additional investments from them. If performance is not disclosed in a timely and truthful manner, it is always the investors who suffer losses. If such incidents occur frequently, investors will lose confidence in the sunshine private equity market, and sunshine private equity funds will not be able to achieve healthy and stable development, ultimately leading to the decline of this capital market. Therefore, for China's private equity fund industry, the truthfulness and timeliness of information disclosure are essential to its survival.

5.2. Strengthen government regulation

In light of the characteristics of China's sunshine private equity funds, we should actively establish a dedicated regulatory agency to standardize their behavior. This specialized agency should collate information on each sunshine private equity fund's fundraising amount, fundraising methods, and profit distribution methods and monitor this information in real-time, thereby effectively reducing illegal and non-compliant operations and moral risks. Given the extraordinary rapid development of China's private equity funds in the current context, there must be a sound management system in place to safeguard their development. To this end, the state must assume its responsibilities, strengthen legal supervision over funds, establish corresponding legal systems, and severely crack down on illegal behaviors. If previously enacted laws are found to be incompatible with the current development of the industry, timely measures must be taken to ensure that new policies serve the market and allow sunshine private equity funds to rapidly develop under good market supervision and management. Due to these reasons, China's sunshine private equity funds have certain characteristics that require the establishment of a dedicated agency to undertake supervisory and management activities. Information on the total amount of funds raised, fundraising models, and profit distribution methods for each sunshine private equity fund needs to be reported to the supervisory and management unit to prevent illegal operations. Meanwhile, as a government regulatory agency, the self-regulatory capabilities of the private equity industry must be greatly improved because legal supervision is omnipresent, and there will inevitably be some gray areas at certain levels. Therefore, to effectively address this deficiency, private equity funds should actively begin a model of self-discipline and self-regulation. Compared to government agencies, self-regulatory bodies and mechanisms within the private equity industry typically have more flexibility and applicability, greater professionalism, and better meet actual needs, with more efficient enforcement of laws. Therefore, government departments need to actively promote the work of the self-regulatory committees in the sunshine private equity industry.

5.3. Review manager qualifications

Chinese relevant government departments should strengthen the auditing of fund managers, with a focus on: firstly, whether they have any bad credit liabilities; secondly, whether they have experience in similar work; and thirdly, issues related to insider trading. Fund company managers and employees should not be in incompatible positions and should fulfill their non-compete obligations to prevent conflicts of interest. The China Securities Regulatory Commission (CSRC) may require fund managers to: (1) change their regulatory agencies and senior management; (2) conduct audits of the funds they have served after their terms have expired by regulating their rights and obligations, prohibiting their improper conduct, improving their internal management systems, establishing risk prevention systems, and strengthening constraints and supervision over fund management shareholders and controlling shareholders.

6. Conclusion

The sustainability of the performance of sunshine private equity funds refers to their performance consistently outperforming the market average during a certain period and having strong continuity. In the following period, the retirement pension will be maintained above average, which means the strong ones will continue to be strong, and the weak ones will continue to be weak. The sustainable development of sunshine private equity funds depends not only on the study of market efficiency but also on providing important bases for scientific investment and management decisions for investors and managers based on historical data and other influencing factors. Therefore, researching issues related to the sustainable development of performance of China's sunshine private equity funds has both theoretical value and practical significance.

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