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HD 'Red Capitalist's' Firm Makes a Shift

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When China's late leader Deng Xiaoping held a meeting with the country's few remaining businesspeople in January 1979, he singled out Rong Yiren, a former textile tycoon, to "do some actual work and play a role" in Beijing's nascent economic-overhaul efforts.

The meeting was China's way of drawing the nation's residual industrialists into helping the Communists rebuild a shattered economy and restore social order after the Cultural Revolution ended in 1976.

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Within a month, Mr. Rong, known as the "Red Capitalist" because he chose to stay in China after the Communist takeover in 1949, responded with a proposal to establish China International Trust & Investment Corp. Eight months later, the company, now known as Citic Group, was in place, with Mr. Rong as chairman and chief executive officer, seeking to attract foreign capital and help Beijing invest overseas.

In return for the trust that Deng gave him, Mr. Rong laid the groundwork for Citic Group to become China's most influential conglomerate. A Citic Group unit, Citic Pacific Ltd., was one of the first "red chip" stocks, mainland-controlled companies listed in Hong Kong. The conglomerate now boasts a suite of financial services from banking to insurance, iron-ore mines in Australia, one of China's richest but most underachieving soccer clubs and the country's top offshore-oil helicopter-service operator.

On Tuesday, Citic Group returned to the vanguard of China's efforts to overhaul its state sector. Independent shareholders approved Citic Pacific's $37 billion takeover of Citic Group's assets, effectively listing nearly all of Citic Group in Hong Kong, where it will be subject to tougher rules and disclosure requirements than on the mainland. Advocates say the move could become a blueprint for overhauling China's huge, inefficient state-owned enterprises.

"Citic has always been right at the heart of the process of reform and development in China, and this landmark transaction marks the next stage of the group's transformation," Chang Zhenming, chairman of both companies, said when the deal was unveiled in April.

Citic Group didn't have the right to vote on the transaction because it is the controlling shareholder of Citic Pacific. But independent shareholders still passed the takeover measure with 99.3% of votes in favor.

To pay for the deal, Citic Pacific, which will be renamed Citic Ltd., will issue around $29 billion in shares that will be bought by its parent company. It will also issue $8 billion in shares that will mostly be bought by state entities such as China's National Social Security Fund. After the transaction, Citic Pacific, which is now 58%-owned by the Chinese government, will be almost five times as big in terms of market value. The government's stake will rise to 82%.

The scale of the deal is a far cry from Citic Group's more humble beginnings. A graduate of an elite Catholic university in Shanghai and partial to well-cut Western suits, Mr. Rong founded Citic Group with about US$5 million in 1979. At the end of 2012, the company had assets totaling US$572 billion.

Inside China, much of Citic Group's investment initially went to heavy industry. The company gradually spread its wings into banking, insurance, real estate, commodities trading, travel and publishing.

In a sign of appreciation for Mr. Rong's accomplishment, Beijing appointed him to the largely ceremonial but prestigious position of vice president in 1993. The first nonmember of the Communist Party to rise so high, Mr. Rong died in 2005.

Wang Jun, son of China's late Vice President Wang Zhen, took over stewardship of Citic Group in the mid-1990s. Mr. Rong's son, Larry Yung, was put in charge of the conglomerate's international expansion in Hong Kong and beyond.

As his father returned to influence after the Cultural Revolution, Mr. Yung, as the Mandarin Chinese name Rong is pronounced in Cantonese, had moved to Hong Kong in 1978. He joined Citic Group in 1986, leading the acquisition of an existing listed property developer. Citic Group moved assets into the property firm and renamed it Citic Pacific in 1990.

Citic Pacific has played a central role in Hong Kong since the early 1990s. Its transactions have often reflected Beijing's interest in reducing Britain's influence over the city's economy. Over the years, the firm has gobbled up investments in Hong Kong shopping malls, power plants, tunnels and the city's de facto flag carrier, Cathay Pacific Airways Ltd.

Citic Group's overseas adventures have been less aggressive than those of its Hong Kong subsidiary. Apart from small-scale investments in an Australian aluminum smelter, a Thai prawn farm and a Canadian paper mill, its only noteworthy and high-profile move took place just last year, when Citic Securities completed a takeover of CLSA Asia-Pacific Markets, Credit Agricole's Hong Kong-based brokerage business.

As a pilot project for China's economic liberalization, Citic Group's experience has been far from smooth.

The bumps included a $5 million fine imposed by Beijing in 1989 after a broader investigation into illegal trading in foreign exchange, reselling production materials at a profit and evading taxes. Citic Group made no public comments at the time.

In a 1994 trading scandal that analysts described as a result of loose controls on risk, the company lost $40 million, an especially large sum given the scale of trading at the time, on copper futures in London.

In the fall of 2008, six weeks after discovering the problem, Citic Pacific revealed a bad bet on the Australian dollar that had the potential to cost it as much as US$2 billion. Shareholders dumped the stock, wiping out two-thirds of the company's market capitalization in two days of trading.

Mr. Yung said at the time that it was regrettable that company risk-management policies "were not followed." Citic Group replaced him and Citic Pacific's managing director with people from the Beijing headquarters, and Citic Pacific received a bailout from its parent company.

Analysts said at the time that the root cause of the trouble was a failure to properly estimate the cost of Citic Pacific's investments in Australian iron-ore mines purchased at Beijing's behest to satisfy growing Chinese demand.

In early 2008, Citic Securities avoided a potentially embarrassing loss, dropping plans for a $1 billion cross-investment with Bear Stearns after the U.S. investment bank's decline and takeover by J.P. Morgan Chase & Co.

"The conglomerate's upcoming listing in Hong Kong will definitely improve corporate governance and help make operations more market-oriented and transparent," said Jiang Shiqing, an analyst with Industrial Securities.

Amy Li contributed to this article.

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