Lessons not Learned

At the age of 67, Larry Yung Chakin (or Rong Zhijian in Mandarin), chairman of CITIC Pacific Limited (CITIC Pacific), had not thought about retiring from the company that he had founded two decades earlier, at least not in such a dismaying way. However, things changed in 2008 when an unsuccessful bet on the direction of currency moves caught the company wrong-footed amid the global credit crunch. Faced with the “great impact in society” following the Hong Kong police force’s probe into the debacle, Yung was forced to resign “in the best interests of the company,”1 ending a century-long family history in both Hong Kong and mainland China, as well as his legendary status as the “red tycoon.”

Once topping the Forbes’ list as the wealthiest person in China, Yung still leads his “relatively lavish lifestyle, despite the incident. He has a penchant for flashy sports cars and expensive suits,” and remains “an avid racehorse owner and stalwart of the Hong Kong Jockey Club,”2 while pursuing many other luxury hobbies. However, he faced the possibility of being held responsible for the currency debacle at CITIC Pacific, and a consequent jail term.

CITIC Pacific and the Yung family

To understand the rise and fall of Yung’s family as well as CITIC Pacific, it is helpful to know a bit of the historical context. Based in Hong Kong, CITIC Pacific’s businesses included special steel, power generation, aviation, infrastructure and property. It was 29 percent owned by the CITIC Group, a leading state-owned Chinese investment company. CITIC Group was established in October 1979 by Rong Yiren, Yung’s late father. Rong was born into one of China’s most prominent families who ran textile and flour businesses and his father, Rong Desheng, was one of China’s richest men and a well-known entrepreneur in the late Qing Dynasty.

When the Chinese communist party came into power in 1949, Rong stayed in China and handed over his family fortune to the state. Thereafter he was known as the “red capitalist.” This also allowed him to pursue a dual career in both business and politics. Rong played a key role in the opening of China and its economic reform. He was vice premier of China from 1993 to 1998 and helped the country to move from a centrally planned economy towards a market economy. Rong was handpicked by the then Chinese leader Deng Xiaoping to set up CITIC Group as a window for the opening up of China.
CITIC Group became a catalyst in attracting foreign investment to China. In 1986, CITIC Group acquired the Hong Kong-listed Pacific Development and renamed it CITIC Pacific, which went on to become the first red-chip company in Hong Kong and a Hang Seng Index constituent stock.

The eldest son of Rong, Yung was born in 1942 with the proverbial silver spoon in his mouth. However, because of his “capitalist” family background, Yung had some turbulent years during the Cultural Revolution and in 1966, he was exiled to a factory in Sichuan province. In 1978, Yung managed to move to Hong Kong. With some of the remaining family fortune that had been kept in Hong Kong, Yung, an engineer by training, set up his own electronics factory with his two cousins. Then, in 1986, he joined CITIC Hong Kong. Together with Henry Fan, the managing director of the company and a descendent of another Shanghai tycoon, Yung established CITIC Pacific in 1990. Yung’s family connections to the centre of the power in China helped him to build CITIC Pacific into a sizable company through acquisitions and consolidation and made him one of China’s most powerful tycoons.

The currency debacle

CITIC Pacific was dubbed by investors in Hong Kong as a “purple chip” (a unique combination of blue chip and red chip) company. On the evening of October 20, 2008, however, the company stunned the market with the disclosure of potential losses (realized and unrealized) of HK$15.5 billion ($1.99 billion). The losses stemmed from some “unauthorized” foreign exchange trades, which had assumed the US dollar would weaken against the Australian dollar and euro, to hedge the company’s substantial iron ore investments in Australia. These contracts, known as “accumulators,” carried features with a limited upside but an unlimited downside. The company shares plunged by 55 percent the day after the announcement. On March 25, 2009, it posted its first annual loss (HK$12.7 billion or $1.6 billion, compared with a profit of HK$10.8 billion of the previous year).

A wrong bet beyond needs and control

The numbers disclosed by the company revealed that the exposure it had was far beyond its hedging needs—nearly five times its capital expenditure

* Red chip companies were mainland companies incorporated and listed in Hong Kong, with Chinese controlling shareholders.
† CITIC Pacific was a prudent blue-chip company and one of the 93 red chip companies in Hong Kong.
‡ Accumulator: nicknamed by traders as “I kill you later” due to its high-risk nature, was a leveraged derivative product that allowed investors to exit their position if the currency they were betting on strengthened, but not if it depreciated.