Battle for Corporate Control with Chinese Characteristics

The unfolding battle over China's largest residential real estate developer – China Vanke

Edward Tse

Alexander Loke

Alan Chan

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Background

Entering into 2016, the feud between Vanke and Baoneng continues to intensify. China Vanke, the country's largest-listed property developer, is actively trying to fend off the potential takeover from Baoneng Group, a lesser-known Shenzhen-based property and insurance conglomerate who has suddenly became the largest shareholder of Vanke by acquiring 23.52 percent of the developer's shares (estimated at RMB 40 billion).

Vanke management labels it as a "hostile takeover", worried that Baoneng could become a controlling shareholder and steps into the boardroom if it continues the buying spree and accumulates more than 30 percent stake.

Wang Shi, Vanke's Chairman, has publicly expressed that the company does not welcome Baoneng's move as it will harm the reputation and credibility of Vanke. He criticized that Yao Zhenhua, Baoneng's Chairman, lacks credibility and questioned Baoneng's financing capacity, highlighting that Baoneng's property transactions totaled only a few billions RMB compared to Vanke's RMB215 billion 2014 from both commercial and residential sales. Yao responded *that Baoneng is a law-abiding firm and believes in the market force of the capital market.*

Chinese regulators are watching the battle closely and is stepping-up its scrutiny on the matter. At the beginning, the China Securities Regulatory Commission (CSRC) stated that it would not interfere in market-driven acquisitions as long as they abide by the laws and regulations. However, soon after the China Insurance Regulatory Commission (CIRC) has announced new regulations that insurance firms must in a timely manner publicize plans to buy stakes that exceed 5 percent of the total share capital of a listed company. It also requires insurers and related parties to disclose details including their existing investment in the targeted company, transaction type and the sources of funding. Now, the CSRC has confirmed that it is working with CIRC and China Banking Regulatory Commission (CBRC) to examine the Vanke case in hopes of ensuring "an open, fair and just market order" and to "protect those involved, especially the small and medium investors' legal interest".

On Dec 18, Vanke suspended trading in its shares in order to avoid price fluctuations and gain time to seek outside capital or alternative partners to retain *corporate control. Meanwhile, it plans to announce details of a major asset restructuring plan by the end of January, which may involve stock issue and asset purchase. Presumably, all this is done with an aim to dilute Baoneng Group's ownership.*

This case has generated a lot of public attention, as this is the first time in the Chinese market that we have seen such a large and well-established listed company become targeted by a comparatively small and low profile corporate raider.

Hostile or Friendly Takeover?

There is a lot of chatter on social media and from analysts speculating the underlying implications of this hostile takeover. Chairman Wang has publicly stated that though "hostile take-over is a neutral word in law, but ethically speaking, it neglects social interests and is hostile." There is also talk by some analysts that the so-called hostile takeover and reverse takeover is simply a game between Vanke and senior officials behind Baoneng.

If there is indeed any malicious intent that crosses legal boundaries, these will likely be exposed during the confrontation between the two companies as the CSRC and CBRC begin to examine the Vanke-Baoneng case in detail.

During the investigation and as news of the proceedings become publicized, any malicious and illegal intent is sure to shift the direction for this currently still legally neutral takeover, and the party who has stuck to the law more firmly will more than likely become the eventual winner.

However as many have pointed out, both parties actions at this stage can still be presumed justifiable as Baoneng has every right to purchase Vanke's shares through the secondary market, while Vanke is sticking to its vision over the quality of its capital and management.

Influence of Social Media

Chairman Wang is not only a high-profile entrepreneur but he has also cultivated for a long time an image that included studying at Harvard and Cambridge at an advanced age, scaling Mount Everest, sky diving, as well as offering “instant advice” to Chinese youths. The dissemination of his profile was aided by the prevalence of social media in China, and through the development of this case, as chatter began on social media. Wang himself has also been vocal on social media sites, sharing his views on this clash of corporate interests.

As both parties continue to fight for ultimate corporate control over Vanke, more people are expressing their opinions and taking sides through social media. Users of Chinese social media have revealed that Wang gave an internal speech to Vanke’s employees, stating that Baoneng and its affiliates do not deserve to be Vanke’s top shareholder. Quickly, the public aided with the frenzy of social media has turned a corporate incident into a personal war, involving the personality and characters of those involved rather than discussing about the aspects of the actual takeover.

Wang then started to voice his opinion on social media, to clarify and support his own position and to avoid any negative connotations, “an enterprise is a group of people bound together by philosophy…if the philosophy changes, it would be a disaster. That’s just a matter of fact, not a value judgment.”

However, worth noting is that though Wang is extremely active on social media, his counterparts from Baoneng have not been quite as keen, and it has become a one-person on stage social media battle. At this stage, one has to question whether this method and style of expression is appropriate for this case and, if anything it has clearly triggered more public and government scrutiny in the case.

Social media can be a double-edged sword for today's corporations. It can work for or against companies, and undoubtedly carries a strong influence on the public's views while potentially allowing the company to share insights into the situation. If used correctly, social media will help companies get their story out and potentially negate or control any negative impacts.

Next Moves – China Resources and Anbang

Various possible next moves were discussed in several leaked internal meeting conversations and Chairman Wang's social media postings.

One way to dilute Baoneng's shares is to issue new shares by private placement. However, issuing new shares requires approvals from shareholders and it will be challenging to seek new investors for the new shares. It is reported that China Resources Holdings, Vanke's previous largest shareholder with a 17 percent stake, had no intention to try to regain its position by buying more shares.

Other sources close to the matter claim that Vanke has gained support from the state-owned asset regulator and major investment banks including Goldman Sachs Group for its asset restructuring plan to issue more shares.

On December 23, 2015, Anbang Insurance Group, who previously owned 5.69 percent in Vanke, raised its stake to more than 7 percent by acquiring shares worth over RMB 2.8 billion, followed by a public announcement by Anbang that they will actively support Vanke's management team and Chairman Wang to run the company and fend off the hostile takeover by Baoneng Group. This helped Chairman Wang's alliance, which includes China Resources, Wang himself and his management team to retain shareholding of about 30 percent, exceeding Baoneng's 23.52 percent holding.

Will this be A Trend?

Corporations in China are becoming increasingly comfortable in launching hostile bids on foreign companies. Some examples include, Guangdong Rising Assets Management's bid for Australia's PanAust and China Petroleum & Chemical Corp's play on Hong they have been more docile in their home soil, potentially due to uncertainty in the system and less precedence.

The problem in the Vanke case is the fact that the takeover from Baoneng was conducted without an invitation from Vanke's side and Baoneng has replaced China Resources Co as the largest shareholder out of the blue. The key will be in long term management, whether the smaller investors will be persuaded by either side, and which will yield more profits for them. The battle for Vanke will rest on public relations and business expertise for the two companies to convince minority shareholders in the wisdom of their respective plans. If Baoneng's move results in a deal it will no doubt set an interesting precedent for other Chinese companies.

Further Implications

Since 2015, Vanke has entered various new business areas such as logistics property, industrial property, elderly house property and education. To build a new business ecosystem, Vanke has embraced trial-and-error experimentation to search for new opportunities in a chaotic market landscape. Many saw this as the first step of Vanke's latest strategic transformation. The "barbarians at the gate" will harm Vanke's new development plans and pose immediate challenges to Vanke's 30 years of culture and operational style. Vanke's growth in China's real estate industry has led its position to become one of the most respected private enterprises in China, and the development of this case is sure to gain the interests of the public and China's corporates.

A hostile takeover is a phenomenon of a market economy with typically low success rate. And Vanke's "self-defense" has shown exceptional insights into the stage of reform of China's market economy highlighting the fact that it has clearly come a long way.

Beyond the immediate corporate battle, the incident highlights how Chinese insurance companies are actively acquiring good assets as well as their essential role in consolidating industries. In fact, the Chinese government has been advocating a supply-side economic management to the Chinese economy, which aims at consolidating the over-capacity of multiple many sectors, including the property sector.

Such external pressures from potential corporate raiders will encourage the property sector and beyond to focus more on improving productivity, management capabilities and asset utilization. How the confrontation pans out will serve as a test for China's capital markets and corporate governance, of which the end result should aim to benefit the Chinese society and solidify its social-economic development towards a more transparent and stable market economy.

About the Authors

Edward Tse is founder and CEO of Gao Feng Advisory Company. A pioneer in China's management consulting industry, Dr. Tse built and ran the Greater China operations of two leading international management consulting firms for a period of 20 years. He has consulted to hundreds of companies – both headquartered in and outside of China – on all critical aspects of business in China and China for the world. He also consulted to the Chinese government on strategies, state-owned enterprise reform and Chinese companies going overseas. He is the author of over 200 articles and four books including both award-winning *The China Strategy(2010)* and *China's Disruptors (2015)* (Chinese version «创业家精神»).

Alan Chan is a Senior Consultant at Gao Feng Advisory Company based in Shanghai. He specializes in digital strategy, business model transformation and innovation implementation. He has worked in both multinational organizations and start-ups across the Chinese Mainland, Hong Kong and the United Kingdom.

Alexander Loke is a Consultant at Gao Feng Advisory Company based in Hong Kong. He is experienced in automotive, banking, real estate and charity organizations, specializing in market strategy and business model development. He has worked with multinational organizations across the Chinese Mainland, the United States and Hong Kong.