Advances in Economics, Business and Management Research, volume 203
Proceedings of the 2021 3rd International Conference on Economic Management and Cultural Industry (ICEMCI 2021)

Research on the Role of Chinese Board of Directors in Anti-hostile Takeover
A Case Study of Vanke Acquisition

Siyi Li[1, *, †] Yixuan Song[2, †] Yuechen Wang[3, †]

[1] *Law school, Shanghai University of International Business and Economics, Shanghai, China*
[2] *Law school, Ningbo University, Ningbo, Zhejiang, China*
[3] *The High School Affiliated to Renmin University of China, Beijing, China*
[*] *Corresponding author. Email: [1]19020036@suibe.edu.cn*
[†] *These authors contributed equally.*

ABSTRACT
This paper discusses the board of directors' position in preventing malicious takeover from the perspective of internal right distribution and institutional structure of Listed Companies in China and compares China's company law with British and American company law. The first part of the article describes the current situation of hostile takeover in China combined with the equity dispute between China Vanke Co., Ltd. and Baoneng Investment Group Co., Ltd., and points out that the board of shareholders is generally superior to the board of directors in China. The second part explains that the occurrence of hostile takeover in China is due to the lag of China's existing laws, the incompatibility of China's transplantation of foreign company law system, and the underdeveloped concept of corporate autonomy. In the third part, this paper puts forward some suggestions on strengthening the function of the board of directors, establishing an anti-hostile takeover committee, and drawing lessons from the British and American board system.

Keywords: *Anti-hostile takeover, Board of directors, Distribution of power*

1. INTRODUCTION

Due to Chinese companies' active restructuring and state-owned enterprise reforming, investment fever in 2021 will be highly possible to continue to heat up. It is therefore very necessary to discuss anti-hostile takeover activities and the role of the board of directors in the face of it. Compared with the United Kingdom and the United States, China's anti-hostile takeovers have emerged later, so there is a corresponding lag in the system designing. China's current regulations on directors' obligations are not yet complete and easily abused, causing chaos in the market for the control rights trading of public companies. In fact, the unusual strategies such as trading suspension, intervention by the Chinese regulators, and the assumption of control by a Chinese state-owned enterprise helped the target stave off a hostile acquirer. These are entirely incongruent with the classic scenarios played out in hostile takeovers in the U.S. and the U.K.

In the research on the role of the board of directors in the acquisition of Chinese companies, various scholars have put forward different suggestions. Yin Tong believed that China's current legislation and legal interpretations of directors' obligations were imperfect. She believed that while strengthening the power of the board of directors against hostile takeover activities and some shareholders who harmed the company's interests, the rights, and interests of small and medium shareholders should be guaranteed at the same time [1]. Varottil U., Wan WY believed that in Asian countries, especially China, with a relatively concentrated shareholding structure, it was unrealistic to copy the existing regimes in either the U.K. or the U.S. The authors suggested that Asian countries should be in light of the specific conditions of their own country and accordingly make respective improvements to the Chinese director system [2].

This paper aims to put forward more suggestions on the countermeasures that the Chinese company's board of directors can take in the face of hostile takeovers and find solutions that combine the advantages of the existing U.S. and U.K. model, thus improving the Chinese director system.

This article adopts the literature research method, qualitative analysis method, and case analysis method as the basic research methodology. This article first finds out the current situation and background of the research problem. It then analyzes the reasons for the insufficient power of the Chinese board of directors in anti-hostile takeover activities. To overcome some of the existing problems, this article then proposes corresponding solutions that can be used as a reference from the perspective of system construction and finally summarizes the entire article.

2. THE CURRENT SITUATION OF THE BOARD OF DIRECTORS IN ANTI-HOSTILE TAKEOVER

2.1. Case background

In 2015, a large amount of funds from insurance companies entered the stock market, which made the Chinese capital market continue to show a banner trend [3]. Two typical cases were Baoneng's insurance fund raising placards for CSG and Vanke. The reasons why the two companies have been repeatedly invaded by "barbarians" [4] are not only the good performance of the company and the undervalued stock price during the stock market crash, but also a very important reason lies in the internal structure of the company. Firstly, the majority shareholder held a low proportion of shares, and the company's shareholding structure was dispersed [5]. Secondly, the articles of association of the two companies gave shareholders the right to nominate corporate directors and at the same time remove the company's directors whose term of office did not expire. But also, after bannering in a short time and increasing the shareholding to become the largest shareholder, CSG and Vanke ended up completely different, which was inseparable from the two boards of directors. CSG used the board of directors meeting to amend a large number of company articles of association, shareholders, and directors' work system proposals to fight against Baoneng, and such obvious targeting was strongly opposed by Baoneng. Baoneng took advantage of the failure of the CSG bill to pass and found an opportunity to insert new managers. On the contrary, Vanke's board of directors knows how to "use others strength against the force" throughout the process, such as seeking the original first shareholder or putting forward the "white knight" plan. The reason why Vanke's board of directors did this is inseparable from its "business Partnership system." They put the company's interests at the center [6]. When barbarians invade, the board of directors will think that they can run the company better than Baoneng and resist Baoneng's Invasion. So, as far as the current situation in China is concerned, do the boards of all listed companies have the power or need to guard their domain like Vanke?

2.2. The characteristics of the board of directors in Chinese listed companies

Before studying the actions of the board of directors, I would like to discuss the characteristics of the board of directors among listed companies in China.

In China, although the board of directors has a relatively high position in the company, it has always served the company's operation rather than the company's master. Only the shareholders' meeting that owns the company's equity and property can determine the company's future and business direction. The board of directors needs to be accountable to the shareholders' meeting, and the latter is superior to the former.

Secondly, in the face of company acquisitions, the board's space for action is limited. The governance structure of Chinese companies is a typical triangular structure. In terms of legislation, the shareholders' meeting is clearly defined as the highest authority to make decisions on major company issues and has the power to appoint and dismiss directors. The board of directors is elected by the shareholders meeting and is a business executive body [7].

Furthermore, the personal professionalism and communicative competence within the board of directors will determine its status. In Vanke's case, although there are only 11 people on the board of directors, its founders have actual control rights, and the senior management team still has certain knowledge reserves and technical means for reverse takeovers. So, it only relies on the "business Partnership system" to let the board of directors win the situation. But not all boards have such status and capabilities. Often the board of directors does not have a "helper" who has obtained a position in the company's articles of association to assist in acquisitions or reverse takeovers. This allows the "barbarians" to avoid encountering the company's management to obtain the company's decision-making power.

The status gap between the board of directors and the shareholder meeting itself and the deliberate avoidance of "barbarians" have created a situation of information misalignment, making the board of directors play a far less important role in the specific operation of the company.

3. CAUSES

3.1. Historical causes

One of the main causes of hostile takeover in China is the lag of China's existing laws and regulations. Since the 1960s, western developed countries began to carry out legal practices against a hostile takeover. The Williams Act passed by the United States in 1968 is an amendment to the Securities Exchange Act of 1934,

which refers to section 3 (d) and section 14 (d) (e) (f) of the Securities Exchange Act of 1934 [8]. The act sets strict information disclosure obligations and sanctions for breach of obligations for a hostile takeover. It stipulates the shareholding disclosure obligations of major shareholders holding 5% and the shareholding change disclosure obligations of major shareholders, etc. While China gradually began to take place in the 1990s because of its historical and political background. The lag of legislation time and the few cases of hostile takeover make China's laws against hostile takeover lack foresight. Under the background of the rapid development of society and the continuous expansion of the market, China's existing laws and regulations lag. Looking at the regulatory changes after the Measures for the Administration of the Takeover of Listed Companies [9], although it has been revised several times, it has not met the reform needs of interest groups for hostile takeover laws, and the rule supply of regulatory authorities has not achieved the expected goal. For example, compared with the United States, China has not yet accurately defined the disclosure of false information. Most of them are judged by behavior, and there is no clear conclusion.

3.2. Policy causes

The second main reason is that China's transplantation of foreign company law system is incompatible with its national conditions. Because China is a socialist country and the particularity of the socialist market economic system with Chinese characteristics, it cannot have the market conditions of decentralized ownership and extremely free and open market environment of British and American companies. Therefore, compared with the relatively tolerant attitude towards hostile takeover in the common law system, which mostly depends on self-discipline, the firm corporate law tradition of the civil law system leads to the strong exclusion of hostile takeover in business ethics in China, and also makes China's current laws and regulations on hostile takeover focus on strict restrictions [10]. Under such a policy background, China shouldn't inherit the foreign company law. At the same time, in China, the power of the board of shareholders is too large, and the problem of overriding the board of directors is also common. Articles 37 and 102 of China's current company law [7] clearly stipulate that the general meeting of shareholders is the organ of power of the company. Articles 46 and 112 require the board of directors to be responsible for the general meeting of shareholders, which leads to the concentration of power of most companies in China in the hands of the general meeting of shareholders. The prevalence of shareholders' meeting centrism makes hostile takeovers occur constantly. For example, the total amount of investment and M&A expenses disclosed by Tencent exceeded 50 billion in 2015. In the first half of 2021, Tencent took shares in a game company every 3.8 days on average. There are many cases of the hostile takeover, but it still does not touch the so-called "restrictions" of the Hong Kong stock exchange. Until 2021, after the people's Bank of China, China Banking and Insurance Regulatory Commission, China Securities Regulatory Commission, foreign exchange bureau, and other financial management departments jointly appointment with the actual controllers or representatives of 13 network platform enterprises such as Tencent, its behavior has converged.

3.3. Company philosophy causes

The third main reason is that the concept of corporate autonomy in China is not mature. Independent operation and self-management are the basic characteristics of corporate governance. Different enterprises have different modes of operation and management. Any mandatory and mechanical legal presupposition will restrict the independent operation and management of enterprises, lead to the loss of due competitiveness, and finally lead to the inability of enterprises to resist hostile takeover and be eliminated by the market. In the corporate governance standards of European and American countries, we attach great importance to improving the concept of board autonomy. For example, the UKCG standards have more comprehensive provisions on the composition of the board of directors, the appointment of directors, the Executive Committee of the board of directors, the promotion of directors themselves, the evaluation of the board of directors, etc. The diversity and independence of the composition of the board of directors are the two issues it attaches most importance to. In China, the compulsion of company law and the supervision of state organs such as the tax bureau interfere with the autonomy of the board of directors, which is very necessary to improve China's company law. For example, the independent director system can well enhance the autonomy of the company's board of directors. In the case of the equity dispute between China Vanke Co., Ltd. and Baoneng Investment Group Co., Ltd., in the face of Baoneng's hostile takeover, Vanke's board of directors could only resist it by extreme means such as collective resignation. Still, in fact, there should be a better way to deal with the hostile takeover. The concept of corporate autonomy is underdeveloped, and it is difficult for the board of directors to produce an effective internal restraint mechanism to deal with a hostile takeover. If necessary, restructuring the director system may be one of the powerful solutions. Generally speaking, the difficulty of changing the company's concept is one of the problems left over from Chinese history, and it is also the main reason why the general meeting of shareholders is superior to the board of directors. It is very important to untie the shackles of this thought and policy.

4. POSSIBLE SOLUTIONS

4.1. General principles for strengthening the function of the board of directors in anti-hostile takeovers

Public companies should authorize the right of acquisition defence to the behaviour of the board of directors, including judging whether a hostile takeover occurs and taking corresponding measures when it occurs [4]. This principle enables the board of directors to balance with the power of the general meeting of shareholders, avoiding direct decision-making by major shareholders and further make the company more cautious in accepting and rejecting takeover offers.

The directors should abide by the principle of protecting the company's interests to the greatest extent in the company's anti-hostile takeover activities and do their best to work diligently to balance the interests of all parties, especially in the company's anti-hostile takeover activities the process of its confrontation with shareholders. In the face of the hostile takeover, the company's stakeholders will inevitably have conflicts. Most of this conflict of interests occurs between major shareholders, the company's actual controllers, operating managers, and the company itself. To reduce the excessive concentration of shareholder structure in a situation where major shareholders are arbitrary in decision-making, the voting rights of directors should be strengthened. Independent directors have the function of indirectly protecting the rights and interests of small and medium shareholders [11]. Therefore, directors should be more active in anti-hostile takeover activities to include the rights and interests of small and medium shareholders into the scope that affects the final decision.

Outside investors must pass the consent of the board of directors before negotiating with individual or minority shareholders to decide on takeover activities. On the one hand, the directors should have the right to know the company's decisions. On the other hand, as the actual operator of the company, it has a deeper and more professional understanding of the company. The structure of the company system should make full use of this attribute of directors to make it account for a greater proportion in the anti-hostile takeover decision-making process.

4.2. Possible solution1: the anti-hostile takeover committee system

Chinese enterprises may refer to the anti-hostile takeover committee system adopted by the U.S. and clarify the role of directors in China's anti-hostile takeover activities to some extent, thus forming a characteristic Chinese regime. Similar to the insolvency committee established during the insolvency process, the anti-acquisition committee consists of shareholders, directors, company supervisors, and the company's stakeholders, which can integrate the interests of all parties to balance the efficiency of the solution of the problem and the protection of the interests of shareholders. The directors of all public companies can also form a public organization to protect their right to participate in the voting against the company's takeover activities to better perform their duties of care and diligence.

A phased board system can be taken into consideration. Under such a regime, the board can be divided into several different groups, each group consisting of different terms of office, with a group annually expired, and only the term of the office of the directors will be re-elected. Such a system enables enterprises to improve their existing equity structure problems and prevent the acquirer through abnormal changes in the director's personnel to quickly control the board of directors.

There is no double-layer voting in China so far. Even if double-layer voting rights are introduced in the future, unless all shareholders unanimously agree, it should not be allowed to set up double-layer voting rights through a capital majority voting mechanism. The company can force major shareholders to join the board of directors to balance the relationship between the board of directors and shareholders so that directors with voting rights can participate in voting on company takeovers. The board should also fully discuss the shareholder's decisions first. When more than two-thirds of the members present agree, it should be regarded as the board's approval of the shareholders' resolution.

4.3. Possible solution2: make reference to the reasonable factors of the U.S. and U.K. board of directors' system

In U.S. federal law, the board of directors of American companies is granted the decision-making power against hostile takeovers. State regulations tend to be consistent with MBCA regulations, especially in Delaware, known for its Delaware General Corporation Law. This kind of model is called board centralism, in which the decision-making power in the acquisition of a company falls on the board of directors based on the principle that the board's obligation is to maximize the company's interests. Besides, the U.K. places the centrality of decision-making power in a hostile takeover context around the shareholders. The general shareholder meeting enjoys extremely high powers under such a regime. In 1985, the United Kingdom introduced the City Code on Takeover and Mergers and provided the specific rights of shareholders in hostile takeover activities. The authority of the general meeting of shareholders has been legally supported.

The U.S. model enjoys higher efficiency in decision-making, which seems to be more adaptable to the current situation of the rapidly developing market [12]. In contrast, the centralism of the shareholders meeting protects the rights and interests of shareholders as the owners of the company since the decision-making power of ownership transactions is handed over to the owners.

China should find solutions that combine the advantages of the existing U.S. and U.K. model, thus further clarifying the rights and duties of directors within the company in the face of hostile takeovers. There are two types of directors in the process of director replacement, one is independent directors, and the other is employee directors. Suppose independent directors are expected to act as agents of small and medium shareholders to safeguard their interests in the boards. In that case, the existing appointment and removal mechanism must be reformed according to the basic structure of proxy agent in corporate governance: the main trustees of independent directors are small and medium shareholders, and they should be responsible for the independent directors' selection. At the same time, to prevent frequent changes of the shareholders and unstable equity structure, there must be appropriate reasons for the removal of independent directors. Thus, different conditions are adopted for the appointment and removal of independent directors. The intention of the employee director system has now become an important measure of acquisition defence [13].

In judging whether a takeover activity is hostile, the board of directors has the right to review the matter and form a resolution. The board of directors' resolution is the ultimate basis for judging whether a takeover activity constitutes a hostile one. The company charter should authorize the board of directors to take and implement anti-hostile takeover measures that are not prohibited by relevant laws and regulations. And ensure the act of the directors does not harm the interests of the company and other shareholders when the company is facing a hostile takeover.

5. CONCLUSION

The lagging of historical conditions, the lack of integration of policies, and the immaturity of corporate concepts have made the board of directors of most Chinese listed companies lack the right to speak for decision-making. The future of a company should not avoid the board of directors and place the decision-making power in the hands of the shareholders' meeting. Chinese companies cannot simply pursue the decision-making model of the shareholder meeting but should establish a system that combines the advantages of the American and British models. The author believes that companies should set up an anti-takeover committee system, a phased board system, or double-layer voting at the level of the company's articles of association. It is hoped that these strategies can further clarify the distribution of rights within the company and the specific actions of the board of directors in hostile acquisitions. And our purpose in doing this is to allow potential companies to play their abilities under the premise of having excellent leaders, thereby creating a good financial environment. To be clear, this article does not involve other research aspects of the board of directors and only focuses on anti-hostile takeover activities. In future acquisitions, managers should work hard to grasp the steering wheel to realize the company's initial ideas. The shareholders' meeting also needs to be cautious on the same front as the board of directors for their own interests. The struggle in the financial world is often easier to bring down an enterprise or even a country than a war of weapons and ammunition.

REFERENCES

[1] Yin Tong, (2018), Research on Directors' Obligations in Anti-Hostile Acquisitions of Listed Companies, Doctoral dissertation, Shandong University.

[2] Varottil U., Wan W. Y., (2018), Hostile takeover regimes in Asia: a comparative approach, Social Science Electronic Publishing.

[3] Zhu Nanjun, Han Jiayun, (2016), Investing Traits and Strategies in the Insurance Sector, Financial Market Research, vol.04, 85-91.

[4] Cui Jinzhen, Zhang Miao, (2018), Analyzing the Hostile Takeover of Listed Companies and Its Legal Regulation Through "the Dispute Between Wanke and Baoneng", Journal Of Tianjin University (Social Sciences), vol.20(04), 317-322.

[5] Xu Shoufu, Cheng Qiong, (2020), Financial Capital's Fight for the Control Right of Listed Campanies and Its Economic Consequences: A Comparative Study of Two Cases, Management case studies and reviews, vol.13(04), 444-459.

[6] Hua Tanjie, (2015), Vanke's business partnership system, Tsinghua Business Review, vol.35(10), 21-25.

[7] Company Law of The People's Public of China, 2005.

[8] William Act, 1968.

[9] Measures for the Administration of the Takeover of Listed Companies, 2020.

[10] Lin Shufang, (2012), The development of hostile takeover in China from a legal perspective,

Doctoral dissertation, Fudan University, vol.04, 15-18.

[11] Robert Hanka, (2004), Harbin Brewery's reverse takeover-personal experience of the first hostile takeover case of a Chinese listed company, The Banker, vol.09, 80-83.

[12] Cao Meng, (2013), Research on anti-takeover strategies of listed companies based on hostile takeover, Doctoral dissertation, Henan University.

[13] Chen Yang, (2017), The value of hostile acquisition and its impact on listed companies in my country, Modern Enterprise, vol.10, 61-62.