

Analysis on the Possibility of Gree Company Resisting "Barbarians at the Door" After the Mixed Ownership Reform

Junshen Lin^{1,*}

¹ School of Management, Jinan University, Guangzhou, Guangdong 510632, the People's Republic of China

*Corresponding author. Email: 1298204986@qq.com

ABSTRACT

In 2019, Gree Electric Appliances, Inc. of Zhuhai (Gree Inc.) carried out a new round of mixed-ownership reform. The main purposes of this reform are to introduce new strategic investors into the company and, at the same time, provide the management of Gree Inc with unprecedented power. And this paper will discuss the significance of the mixed-ownership reform of Gree Inc from the perspective of the ability to resist barbarians in the capital market, which is groundbreaking. In the analysis, the shareholding structure of Gree at present will be compared with that of China Vanke Co., Ltd (Vanke) in 2014 which once suffered from hostile takeover to demonstrate how the management of Gree Inc can defend against barbarians by taking the advantage of shares. After a comprehensive analysis, it can be concluded that after the reform, Gree Inc has more advantages in resisting the barbarians of the capital market than Vanke in 2014. Specifically, the management of Gree Inc is able to utilize more than 30% of shares, including the shares of the largest shareholder, when faced with a hostile takeover. And this is strong enough to prevent barbarians from making any material resolutions in the general meeting of shareholders, which ensures the normal running of Gree Inc and the original board of directors.

Keywords: *Gree Inc, Mixed-ownership reform, Barbarians, Management.*

1. INTRODUCTION

As is widely known, a multitude of enterprises is owned by State Owned Assets Supervision and Administration Commission (SASAC) in China. But after the promotion of the share-trading reform, the shareholding structure of many state-owned enterprises gradually became dispersed. Merits as such reform have, it also provided barbarians in the capital market with opportunities to attack the stated-owned enterprises by purchasing their stocks in the opening market.[1] The hostile takeover of Vanke by Shenzhen Baoneng Investment Group Co., Ltd (Baoneng Group) in 2015 is a case in point.

On the other hand, in 2019, Gree Inc carried out a new mixed-ownership reform. The 2 main purposes of this reform are to introduce a new strategic investor, Hillhouse Capital, and expand the power of Gree's management. At the same time, the shareholding structure of Gree Inc has become highly dispersed.[2]

Since 2019, there were many papers on the mixed-ownership reform of Gree Inc. But instead of talking about the ability to resist barbarians, some papers explained the significance of this reform from the aspects of governance structure, incentive mechanism of management, and future performance of Gree Inc[2]. Although there are still some papers discussing about the strategies of Gree Inc on defending against barbarians, their research is set in the context in which the mixed-ownership reform had not taken place[3][4].

And this paper is going to discuss whether or not Gree Inc will be able to resist barbarians even when the shareholding structure of Gree Inc is highly dispersed after the mixed-ownership reform. Based on the similarities between Gree Inc and Vanke, the shareholding structures of Gree Inc will be compared to that of Vanke in the following parts. As well as that, the analysis of the power given to the management of Gree Inc will also be considered to discuss whether the company is capable of resisting attack from barbarians after the reform.

The purpose of this paper is to let more state-owned enterprises see the value of this brilliant reform. Although after the mixed-ownership reform, the shareholding structure of Gree Inc has become more dispersed, but its ability to resist barbarians has not been weakened, which means that there is no absolute correlation between equity diversification and the risks of controlling rights. Therefore, other companies can also learn the way of Gree Inc to carry out mixed-ownership reform. However, because of the expanding power of the management, this mixed-ownership reform method may breed agency problem in Gree Inc. Thus, other companies should pay attention to it while learning.

2. OVERVIEW

2.1 Gree Electric Appliances, Inc. of Zhuhai

Gree Electric Appliances, Inc. of Zhuhai was established in 1989 and listed on the Shenzhen Stock Exchange in 1996. Its products cover two major areas including household appliances like air conditioners and industrial equipment like advanced manufacturing equipment.

The shareholding structure of Gree Inc has undergone three stages. During the first stage, more

than 50% of shares in Gree Inc was controlled by Gree Group which is 100% controlled by SASAC of Zhuhai. But during the second stage, only 18% of total shares were held by Gree Group thanks to the share-trading reform. During the last stage, Gree Inc became a company without controlling shareholders and actual controllers due to the mixed-ownership reform. The proportion of shares held by Gree Group was reduced to 3.22%. Instead, Zhuhai Mingjun has become the largest shareholder, holding 15% of shares. In addition, in order to optimize the incentive mechanism, Gree Inc also set up a new incentive plan providing the management with 4% of shares. As is shown, the shareholding structure of Gree Inc has become highly dispersed.

When it comes to the performance, the net profit of Gree Inc ("Figure 1") has maintained a high growth rate since 2006. After Dong Mingzhu became the chairman of the board in 2012, the net profit of Gree Inc even transcended that of its rival, Midea Group. In addition, the dividend payout rate of Gree Inc ("Figure 2") always ranks the first among all A-share listed companies standing at more than 40%. With a highly dispersed sharing structure and impressive performances, Gree Inc is an ideal target for barbarians in capital market.

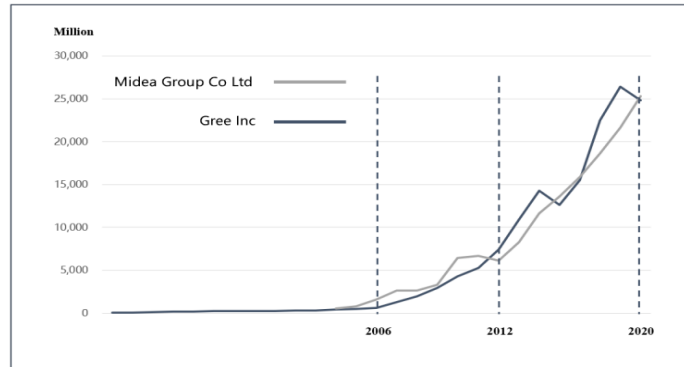


Figure 1 Net profit of Gree Inc.

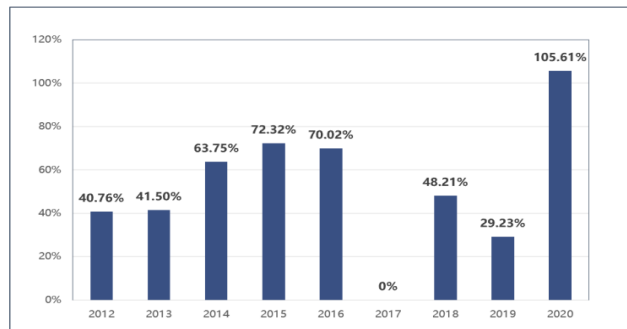


Figure 2 Dividend payout rate of Gree Inc.

2.2 Barbarians

'Barbarians' is borrowed from the title of "Barbarians at the gate" which is a book depicting the story of the largest and most notable LBO of the decade, the hostile takeover of R. J. Nabisco in 1988 by Kolberg Kravis Roberts[4]. Barbarians are actually acquiring firms that make hostile acquisition by using small amount of funds. And those companies with highly dispersed shareholding structure and relatively low share prices are more likely to become the target. Also, the target companies acquired are often in another industry, so the barbarians are unfamiliar with the business model of the target companies[1]. However, the purpose of their acquisition is not to run the target company, but to obtain short-term benefits. Thus, many decisions they make after acquisitions are acting against the companies and other shareholders. (Liu Ruoqiao, 2019)

2.3 Scramble for Control over Vanke

Scramble for Control over Vanke is considered as the "decade of the deal" in China. During this battle, the private company Baoneng Group played the role of barbarian, while Vanke, the leading brand of real estate in China, was the target company. Baoneng used more than 40 billion yuan of funds to acquire 25% of shares of Vanke from 2015 to 2016 and became the largest shareholder of Vanke. During this period, the management of Vanke turned to China Resources Co. Limited, its former largest shareholder, for help, requesting them to increase their holdings of shares and

cooperate with Vanke in implementing a private placement plan. However, China Resources did neither of them, which made the situation worse. Fortunately, the battle came to an end when Baoneng Group was punished by Chinese insurance regulator due to their violation of Chinese insurance regulator and China Resources finally gave in, transferring all their shares to Shenzhen Metro Group Co., Ltd[5].

In fact, it is the negative attitude of China Resources that aggravated the conflict between Vanke and Baoneng. And because of it, many scholars believed that the scramble between Baoneng and Vanke had developed into the scramble between China Resources and Vanke by the end of 2015. Therefore, the relationship between the largest shareholder and the management can determine whether a company can defend against barbarians.

3. ANALYSIS

3.1 The Management of Gree Inc Can Utilize the Shares of the Largest Shareholder

After the mixed-ownership reform, the shareholding structures of Gree Inc and Vanke in 2014 have a lot in common ("Table 1" and "Table 2"). For example, both of them have a highly dispersed shareholding structure; both of their largest shareholders hold approximately 15% of total shares.

Table 1. Ownership structure of Gree Inc

Shareholders	Share Proportion
Zhuhai Mingjun Investment Partnership (L.P.)	15.00%
Hebei Jinghai Guarantee Investment Co., Ltd.	8.91%
Zhuhai Gree Group Co., Ltd.	3.22%
Dong Mingzhu	0.74%
Management Stock Incentive Plan	4%

Table 2. Ownership structure of Vanke

Shareholders	Share Proportion
China Resources Co. Limited	14.91%
Ampang Life Insurance Company Limited – Robust Portfolio	2.13%
GIC PRIVATE LIMITED	1.32%
Liu Yuansheng	1.21%
China Construction Bank – Boshi Theme Industry Stock Fund	0.65%

shares can be turned into voting rights. According to the "Shares Transfer Agreement" signed by Zhuhai Mingjun on the day it became the largest shareholder, how to exercise the 15% voting rights at the general meeting of shareholders in Gree Inc is actually decided by board of directors in Zhuhai Yuxiu which comprises of 3 members who are respectively sent by the management, Hillhouse Capital and Beijing MaoYuan. They must vote to decide how to exercise the 15% voting rights, and it must be approved by more than 2 directors. Therefore, if Hillhouse wanted to stop the management from using shares, they could just vote against the management of Gree Inc with Beijing MaoYuan. But is it really necessary for Hillhouse capital do that? Hillhouse Capital is a strategic investor. They pay more attention to the long-term development of Gree Inc. In contrast, barbarians are anxious for short-term benefits. Their objectives contradict with each other. If Barbarians were finally able to control Gree Inc, Hillhouse capital would also suffer from huge losses. Therefore, Hillhouse capital would not risk betraying the management of Gree Inc.

To sum up, after the mixed-ownership reform, the management of Gree Inc is able to proactively utilize the shares of the largest shareholder when facing barbarians, which is huge progress compared with Vanke.

3.2 The Management of Gree Inc Can Utilize the Shares of Their Own and Other Shareholders

Although Vanke and Gree Inc have a lot in common, a careful comparison reveals the fact that more amounts of shares are directly held by the management of Gree Inc. After the mixed-ownership reform, the management was granted with a 4% stocks incentive plan. As well as that, Dong Mingzhu has held 0.74% of shares since 2012. To sum up, the management of Gree Inc directly hold 4.74% of shares in Gree Inc while only 0.2% of shares in Vanke are held by the management of Vanke, according to Vanke's annual report in 2014.

When it comes to the second largest shareholder, Hebei Jinghai Guarantee Investment Co., Ltd was actually initiated and founded by Zhu Jianghong who is also the founder of Gree Inc. It is always considered that Hebei Jinghai is the party acting in concert of Dong Mingzhu. In other words, whatever decisions the management are going to make, Hebei Jinghai will always stand with them.

Based on the 2 paragraphs above, apart from the 15% of shares from Zhuhai Mingjun, the management of Gree Inc are still able to directly utilize 13.65 % (4.74%+8.91%) of the shares. But so far, 3.22% of shares held by Gree Group has never been discussed.

It cannot be denied that when Gree Group was still the largest shareholder, management would find it difficult to gain support from Gree Group who represents SASAC of Zhuhai. This is mainly because Gree Group and the management of Gree Inc used to have different objectives towards the development of Gree Inc. While management cared about the sustainable development of Gree Inc, Gree Group emphasized more importance on political performance, hoping that Gree Inc was able to generate huge amount of value in the short-term. But nowadays, only 3.22% of shares was held by Gree Group and Gree Inc has become one of the Fortune 500 Companies. Gree Group would rather act as a state-owned investor and enjoy the "tempting" dividends paid from Gree Inc than act against management which is meaningless. In addition, after the scramble for control over Vanke, our country has become aware of the threats caused by the barbarians. Therefore, as one of the state agencies, SASAC would not turn a blind eye to Gree Inc if it suffered from hostile takeover by barbarians. Instead, SASAC would cooperate with management to defend against barbarians in the capital market.

3.3 Quantitative Analysis

According to the previous 2 sections, the management of Gree Inc is able to utilize 31.78% (15%+8.91%+3.22%+4.74%) of shares which are respectively belong to Zhuhai Mingjun, Hebei Jinghai, Gree Group and the management themselves (the author would like to call it "Alliance" in the following parts.). This part is going to discuss to what extent the management of Gree Inc are able to resist barbarians taking the advantages of these 31.78% of shares.

According to the Articles of Association of Gree Inc, when any SPECIAL resolution is to be made by the shareholders' meeting, it shall be adopted by shareholders representing more than two third of the voting rights of the shareholders IN PRESNECE. "Alliance" has occupied 31.78% of shares which is close to 1/3. In other words, "Alliance" has been able to prevent barbarians from manipulating any special resolution at the

shareholders' meeting, which can ensure the survival of Gree Inc.

However, when it comes to ordinary resolutions, everything seems to be more perplexing. According to the Articles of Association of Gree Inc, when any ORDINARY resolution is to be made by the shareholders' meeting, it shall be adopted by shareholders representing more than half of the voting rights of the shareholders IN PRESNECE. And a rigorous calculation is needed here to test the ability of management to defend against barbarians.

Before calculation, here are some basic assumptions. First of all, every member of "Alliance" would not sell their shares and all of them would present in the general meeting of shareholders. Secondly, the attendance rate of minority shareholders in general meeting of shareholders remains the same. Thirdly, minority shareholders would stand with barbarians.

According to the minutes of general meetings of shareholders, the following ratios can be calculated ("Table 3"). The first ratio is the proportion of the voting shares represented by minority shareholders in presence to the total voting shares of Gree Inc, which is labeled as α . The second ratio is the proportion of voting shares represented by all minority shareholders to the total voting shares of Gree Inc, which is labeled as β . The third ratio is attendance rate which is equal to α/β .

After referring to the past 10 shareholders' meetings, an average attendance rate can be calculated as 23.33% which is subsequently used for calculating to what extent barbarians would outweigh "Alliance" on the shareholders' meetings.

Table 3. Calculation of average attendance rate

	α	β	Attendance Rate = α/β
2020/11/2	22.99%	72.84%	31.56%
2020/6/1	21.74%	72.84%	29.84%
2020/3/7	20.70%	72.84%	28.42%
2019 /11/18	14.50%	72.13%	20.10%
2019 6/26	18.50%	72.13%	25.65%
2019 /1/16	11.63%	72.13%	16.12%
2018 /6/25	9.62%	72.13%	13.34%
2018 /6/25	12.61%	72.13%	17.48%
2017/3/8	9.57%	72.13%	13.27%
2016 /10/28	27.04%	72.13%	37.48%
Average			23.33%

Table 4. Calculation of the extent to which barbarians would outweigh "alliance"

	x	y	z	k = y * Attendance Rate	$\gamma = x/(x+k)$
Before hostile takeover	31.87%	68.13%	0.00%	15.89%	66.73%
When barbarian acquires 10%	31.87%	58.13%	10.00%	13.56%	57.50%
When barbarian acquires 15%	31.87%	53.13%	15.00%	12.39%	53.78%
When barbarian acquires 20%	31.87%	48.13%	20.00%	11.23%	50.51%

Before any further explanation, the introduction of some important ratios in "Table 4" is necessary. The first ratio is the proportion of voting shares represented by "Alliance" to total voting shares of Gree Inc, which is labeled as x. The Second ratio is the proportion of voting shares represented by all minority shareholders to total voting shares of Gree

Inc, which is labeled as y. The third ratio is the proportion of voting shares represented by barbarian to total voting shares of Gree Inc, which is labled as z. The fourth ratio is the proportion of voting shares represented by minority shareholders in presence to total voting shares of Gree Inc,

which can be calculated as $y * \text{attendance rate}$. And the last ratio is γ which can be calculated as $x/(x+k)$.

Since the author assumes that every member of "Alliance" would not sell their shares and all of them would present in the general meeting of shareholders, x would stabilize at 31.87%. As the barbarian increases its shares of Gree Inc, the amounts of shares held by minority shareholders would decline, but their total shares are always equal to 68.13% (100%-31.87%). γ is the ultimate indicator of whether "Alliance" is still able to outweigh barbarian at the general meeting of shareholders. If γ was larger than 50%, "Alliance" might play a dominant role when shareholders' meeting is making ordinary resolution. But if γ was lower than 50%, barbarian might play a dominant role instead.

After calculation, the barbarian must hold at least 20% of Gree's shares in the market. Or it is not able to manipulate ordinary resolutions on shareholders' meeting. In accordance with the current stock price of Gree Inc, Barbarian needs to spend roughly 60 billion to acquire 20% of shares which is much higher than 44.1 billion paid by Baoneng Group to acquire 25% of shares in Vanke. Nowadays, the regulations in our country have become better-rounded. It would be extremely difficult for barbarians to fund 60 billion by using inappropriate method like what Baoneng Group did. In addition, the author also assumes that minority shareholders would stand with barbarians. However, in reality, there are still a certain amount of minority shareholders who would stand with management, which will make it even more challenging for barbarians to dominate the shareholders' meeting.

According to Company Law of the People's Republic of China, ordinary resolutions include the appointment and removal of members of the board of directors and the board of supervisors. Thus, as long as the proportion of shares held by the barbarian is lower than 20%, the original board of directors would remain unchanged. And this offers an opportunity for the original board of directors to come up with strategies such as introducing new strategic investors or a private placement plans to deter the barbarian from any further purchasing.

3.4 Discussion and Summary

In 2019, Gree Inc carried out a mixed-ownership reform and the management of Gree Inc was granted with an unprecedented power. Because

of this power granted to management, Gree Inc has more advantages in resisting the barbarians of the capital market than Vanke. Specifically, the management of Gree Inc is able to utilize more than 30% of shares which are respectively belong to Zhuhai Mingjun, Hebei Jinghai, Gree group and management themselves. After rigorous calculations, it can be concluded that 31.87% of shares is strong enough to prevent barbarians from making any material resolutions at the general meeting of shareholders, which ensures the normal running of Gree Inc and the original board of directors. As long as the original board of directors can function normally, strategies used for defense can be adopted in a timely manner to prevent further hostile takeovers by barbarians.

The mixed-ownership reform of Gree Inc is such a creative method that other state-owned enterprises can learn. But every corn has 2 sides. That the management is granted great power can trigger the principal-agent problem. If the management of a company was diligent and conscientious like the management of Gree Inc, this method for mixed-ownership reform would be ideal. But if the management is self-interested, this method can be Pandora's Box. Therefore, other companies must pay attention to this point when they learn from Gree Inc. And it would be better if they could design an extra mechanism to contain the power of management when necessary.

4. CONCLUSION

After a rigorous analysis, it can be concluded that Gree Inc does have a better defense mechanism than Vanke did when it suffers from a hostile takeover by barbarians. Specifically, Gree's management can more proactively utilize the shares of other shareholders to prevent the barbarian from making decisions that are detrimental to the future development of Gree Inc.

But it cannot be denied that this paper still has some defects. For example, only the shareholding structure is considered to discuss whether Gree Inc is able to defend against barbarians. Research in the future can take more factors into accounts such as the constitution of the board of directors, the corporate culture within Gree Inc, the introduction of new strategic investors and such like. As well as that, in the quantitative analysis, this paper assumes that the future attendance rate of minority shareholders in the meeting is equal to the average amount in the past. This is not always the case in reality since the adoption of online voting will

encourage more minority shareholders to attend the shareholders' meetings. In this case, Gree Inc will have more difficulties in defending barbarians by taking advantage of the shareholding structure. Therefore, consideration on the attitude of minority shareholders should be added in future research.

AUTHORS' CONTRIBUTIONS

This paper is independently completed by Junshen Lin.

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