

# SHAREHOLDER ACTIVISM IN CHINA

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## **1. HISTORY AND DEVELOPMENT OF SHAREHOLDER ACTIVISM**

Shareholder activism has not been a familiar topic to Mainland China market until recently. There are two reasons will explain this phenomenon, and one comes from regulatory side. Under PRC laws framework, shareholders rather than the board of directors play the most important role in the corporate governance. Shareholders meeting is the ultimate authority to approve all material matters of the company, including appointing and dismissing board members. Most major transactions, for example, any transaction with an amount exceeding 50% of the company net asset value, is subject to approval from shareholders meeting. In general speaking, shareholders entitle to actively engage in decision making process of major corporate operation. Another reason lays in shareholder structure of listed companies. As of September 16, 2019, there are 4,670 companies listed in both Shanghai Stock Exchange and Shenzhen Stock Exchange. More than 90% of these listed company are controlled by their controlling shareholders respectively. There is less room for activist investors to play compared to US market. It is not a surprise that we have not seen too much shareholder activism in China.

However, the landscape of shareholder activism has been slowly changed in recent years due to appearance of activist investors and the establishment of China Securities Investor Services Center (ISC). In the last 5 years, a few activist investors initiated a couple of hostile takeover campaigns in the market with the goal of acquiring the controlling shareholder position, which is so called the "fight for control right". ISC is a finance service institute set up in 2014 by its shareholders including Shanghai Stock Exchange, Shenzhen Stock Exchange, Shanghai Future Exchange, China Financial Future Exchange and China Securities Depository and Clearing Corporation Limited. The mission of ISC is to provide education, legal, information and technology services to medium-small investors. ISC usually become a shareholder of a listed company by holding one hundred shares of the company and acts as the representative of minority shareholders to excise its rights. Until now, ISC has held shares in more than 3,000 listed companies. In practice, ISC takes multiple actions to protect minority shareholders' interests. ISC may attend shareholders meeting to speak, inquiry and vote. ISC will send statements and shareholder letters to listed companies urging the improvement of corporate governance. In certain cases, ISC may bring lawsuits against majority shareholders or listed companies. As of March 31, 2019, there are 20 lawsuits filed

or backed by ISC. ISC also can act as mediator to settle disputes between investors and listed companies or other related parties.

## **2. RECENT CASES**

### **2.1. Baoneng / Vanke**

The case of Baoneng / Vanke was viewed as the Chinese version of *Barbarians at the Gate*. Baoneng is an activist investor based in Shenzhen. Qianhai Life Insurance Company (the "Qianhai Life") is a subsidiary of Baoneng. On July 11, 2015, Qianhai Life informed Vanke that it had held 5% of Vanke shares. As of July 24, 2015, Qianhai Life, together with other parties acting in concert held by Baoneng, increased their stake in Vanke to 10%. After that, Baoneng still did not stop its step to buy. As of November 27, 2015, Baoneng held 15.25% stake in Vanke, which had topped the stake held by China Resource, the largest shareholder of Vanke at that time. To block Baoneng's takeover, Vanke brought in Shenzhen Metro Group, a state owned entity of Shenzhen government, as the white knight. Vanke proposed to issue new shares to Shenzhen Metro Group to make Shenzhen Metro Group the largest shareholder of Vanke. Baoneng made a public statement criticizing Vanke's plan immediately after Vanke's announcement.

On June 26, 2016, Baoneng submitted a proposal to the board of directors of Vanke suggesting convening a shareholders meeting to remove all board members and supervisory board members of Vanke, which climaxed the one year long takeover fight. The board of directors rejected Baoneng's proposal. In 2017, Shenzhen Metro bought 29.38% shares from other existing shareholders and became Vanke's largest shareholder. Following this, Baoneng withdrew from the battle and divested part of its holding in Vanke.

### **2.2. Baoneng / Nanbo**

Nanbo is a glass producer listed on Shenzhen Stock Exchange. In February 2015, Baoneng took an initial position in Nanbo. In March 2015, the board of directors of Nanbo passed a resolution to amend its articles of association adding certain anti-takeover clauses such as shark repellants terms to defend Baoneng's attack. Such resolution was subject to approval from the shareholders meeting in accordance with PRC laws. Baoneng filed a counter-motion suggesting the shareholders meeting

to veto such board resolution. As a result, the shareholders meeting was forced to be postponed.

Within 9 months period, Baoneng continued increasing its holding to 25.05%. Under pressure from Baoneng, the majority of board members and management closed to resign from office in November and December 2015. In January 2016, Baoneng successfully gained 3 seats in the board and replaced the management.

### **3. Relevant features in local law facilitating or discouraging activism**

The PRC Company Law, Securities Law and Listing Rules grant certain rights to minority shareholders, depending on their overall stake in the company, which include but not limit to

- Holding any share, entitles a shareholder to (i) attend, speak, inquiry and vote at shareholder meetings and (ii) file a lawsuit with the court to repeal any resolution approved by board meeting or shareholders meeting if such resolution violates the laws or the articles of association.
- Holding stake representing 1% of the total amount of shares with a period not less than 180 days, entitles a shareholder to sue any director or management for breach of fiduciary duty.
- Holding Shares representing 3% of the total amount of shares, entitles a shareholder to submit a proposal to shareholders meeting for vote.
- Holding Shares representing 10% of the total amount of shares, entitles a shareholder to convene a board meeting or a shareholders' meeting.
- Holding shares representing one third of the total amount of shares, entitles a shareholders to block all resolutions that by PRC law must be passed by a two thirds majority (such as capital increase or reduction, dissolution, merger of the company and any amendment of the Articles of Association).

To protect the interest of minority shareholders, CSRC established independent director system as part of corporate governance of listed company. Every listed company must keep at least one third of the board of directors independent from its shareholder and the company. Any related party transaction and certain material

resolutions to be passed by board meeting or shareholders meeting are subject to consent from all independent directors of the company.

#### **4. Thoughts about future developments**

We can expect that shareholder activism will surge on Mainland China market in the near future due to the following factors

- As a consequence of crash of stock market since June 2015, more and more companies have being traded at undervalued prices. Which makes these undervalued companies very attractive for activist investors.
- On the other hand, the group of activist investors is continuing to grow, not only in term of amount but also in size. Many Activist investors managing more than 10 billion RMB funds are very active player in the market.
- ISC has become more and more influential in the market. More and more listed companies have to take into account ISC's recommendation or opinion on corporate governance and protection of minority investors very seriously.
- On September 10, 2019, the State Administration of Foreign Exchange (SAFE) announced that it had decided to cancel the investment quota restrictions for qualified foreign institutional investors (QFII) and RMB qualified foreign institutional investors (RQFII) (the "qualified foreign investors"), together with the lift of the limitations on the pilot countries and regions of RQFII. Qualified foreign investor scheme is one of the main channels for foreign investors to invest in domestic financial markets including securities market, which was first established by SAFE in 2002. By the end of August 2019, the market value of A shares held by qualified foreign investors is about RMB 682.2 billion, which is around 1.5% of the total market value. Following the abolishment of the investment quota restrictions, foreign institutional investors with corresponding qualifications will only need to go through registration procedure, so as to remit funds independently to make securities investment in accordance with the regulations. Therefore, China stock market will be more open and welcome for international investors. It seems very likely that international activist

investors will find more opportunities and take more actions in the near future.