

Internal governance mechanism failure and control contest: a case study of the "Vanke-Baoneng Dispute"

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Abstract. Against the backdrop of deepening equity dispersion among China's listed companies, control contests triggered by internal governance deficiencies have become increasingly frequent. This paper takes the high-profile control contest between China Vanke Co., Ltd. and Baoneng Group as a typical case, employing both the case study method and the literature review method. It systematically analyzes issues related to corporate internal governance, the operation of the "three meetings and one management layer" structure, ownership structure, and control risks. This paper reveals critical governance failures at Vanke, including an extremely dispersed equity structure, insufficient board independence, weakened supervisory board functions, and an imbalance in management incentive and constraint mechanisms. It further clarifies how these internal governance deficiencies induced and escalated the control contest. The study concludes that perfecting internal governance, optimizing ownership structure, and strengthening the checks and balances within the "three meetings and one management layer" are fundamental to preventing control risks and ensuring stable corporate development.

Keywords: internal governance, control contest, three meetings and one management layer, ownership dispersion, Vanke-Baoneng Dispute

1. Introduction

In the rapid evolution of China's capital market, control contests among listed companies have emerged as significant risks that disrupt corporate governance and operational stability. These contests often stem from vulnerabilities in a firm's internal governance architecture rather than from purely external market forces. The "Vanke-Baoneng Dispute", one of the most landmark events in the history of the A-share market, serves as a paradigmatic example, laying bare the quintessential problems of internal governance mechanism failure under a dispersed ownership structure [1].

Prior academic work has extensively explored corporate governance structures, the market for corporate control, and the implications of different ownership patterns. Agency theory, as articulated by Jensen and Meckling, provides a foundational lens for understanding conflicts between managers and dispersed shareholders [2]. La Porta et al. highlight the global prevalence of ownership structures and their governance consequences [3]. Regarding the Vanke incident specifically, scholars have offered insights from legal and financial perspectives, examining the legitimacy of hostile takeovers and the role of company law [1], or

analyzing how ownership structure interacts with the broader control market [4]. However, a systematic examination that traces the complete transmission mechanism — starting from specific internal governance failures, proceeding through the emergence of control risk, and culminating in an open conflict — remains relatively scarce. This paper directly addresses this gap by focusing on two core research questions: First, what specific deficiencies in Vanke's internal governance mechanisms led to the control contest? Second, how can governance mechanisms be improved to prevent similar risks? Employing a case study methodology, this research holds significance by deepening the theoretical understanding of corporate governance for listed companies while providing practical references for optimizing governance structures, safeguarding the interests of small and medium shareholders, and preventing control-related risks.

The structure of this paper proceeds as follows: Section 2 lays out the relevant theoretical foundation. Section 3 provides a detailed overview of the Vanke-Baoneng Dispute case. Section 4 serves as the core analysis, dissecting the failures in Vanke's internal governance mechanisms. Section 5 discusses the multifaceted impacts of the control contest on the company. Section 6 offers targeted recommendations for improving internal governance. Finally, Section 7 concludes the paper.

2. Relevant theoretical basis

This paper is grounded in several interrelated theoretical frameworks that together form a comprehensive lens for analysis.

2.1. The connotation and functions of internal governance mechanisms

Internal governance mechanisms are the system of institutional arrangements within a company designed to allocate rights and responsibilities among shareholders, the board of directors, the supervisory board, and management, thereby achieving checks and balances and scientific decision-making. Their core functions include mitigating agency costs, supervising managerial behavior, and protecting stakeholder interests [5]. Effective internal governance ensures that a company's operations are aligned with the long-term interests of its owners [6].

2.2. The "three meetings and one management layer" governance structure

Under China's corporate governance framework, the "three meetings and one management layer" (consisting of the shareholders' meeting, the board of directors, the supervisory board, and senior management) form the structural backbone. The shareholders' meeting is the highest authority; the board is the decision-making body; the supervisory board conducts oversight; and the management layer executes operations. A well-functioning structure depends on a clear delineation of power and effective mutual checks among these organs [7].

2.3. Ownership structure and control theory

Ownership structure is the foundation of corporate governance because it determines the distribution of control rights. Concentrated ownership can align the interests of controlling shareholders with those of the company but may lead to the expropriation of minority shareholders. Conversely, dispersed ownership, while increasing stock liquidity, can result in managerial entrenchment and vulnerability to hostile takeovers. Berle and Means's classic thesis on the separation of ownership and control is particularly relevant in such contexts. Control represents the pivotal right to influence a company's operational and strategic decisions, often becoming the prize in contests when governance is weak [4].

2.4. Principal-agent theory and internal checks-and-balances theory

Jensen and Meckling's principal-agent theory describes the costs arising from the separation of a firm's owners (principals) and its managers (agents) [2]. When ownership is dispersed, the monitoring capacity of individual shareholders weakens, a classic "collective action" problem that empowers managers with de facto control. The theory of internal checks and balances posits that a well-designed governance system can counteract this tendency. Institutional arrangements like independent directors and a supervisory board are mechanisms intended to create a power equilibrium, preventing any single entity from making unilateral decisions that are not in the firm's best interest [5].

3. Case overview of the Vanke-baoneng Dispute

To understand the governance failure, a chronological and structural overview of the conflict is essential.

3.1. Event background and participants

China Vanke Co., Ltd., founded in 1984, grew into a benchmark enterprise in China's real estate industry. Before the dispute, its hallmark governance feature was an extremely dispersed equity structure; for an extended period, the largest shareholder, China Resources, held only around 15% of shares. This made Vanke a prime target for a hostile takeover in the capital market. The primary aggressor, Baoneng Group, led by its chairman Yao Zhenhua, was a rapidly expanding conglomerate with a highly leveraged financing model. Other key players included China Resources (the existing passive major shareholder), Shenzhen Metro Group (which later became the "white knight"), and Vanke's founding management team led by Wang Shi, who exercised significant influence despite negligible personal shareholdings [4].

3.2. Chronology of the control contest

The dispute officially erupted in July 2015 when Baoneng Group initiated its share-buying spree. Through its primary vehicle, Foresea Life Insurance, and a series of coordinated actions with other entities, Baoneng rapidly increased its stake in Vanke. By December 2015, Baoneng's total holdings had surpassed China Resources', making it the new largest shareholder. Vanke's management, however, publicly declared its unequivocal opposition, with Chairman Wang Shi issuing a stark statement that Vanke did not welcome Baoneng as its major shareholder. The confrontation escalated into a protracted, multisided war involving capital market operations, shareholder alliances, public relations campaigns, and legal and regulatory proceedings. The deadlock was eventually resolved in 2017 when Shenzhen Metro Group, a state-owned enterprise, stepped in to acquire a major stake from China Resources and later the controlling stake from Evergrande Group, finally stabilizing Vanke's control structure [1, 8].

3.3. Stakeholder interests and strategies

The strategic objectives and actions of each party were distinct. Baoneng's motive was to acquire control of a high-quality asset to complement its financial empire, using aggressive leverage and policy gray areas as its primary strategy. Vanke's management team, viewing Baoneng as a predatory and incompatible partner, employed a defensive strategy centered on reputation-based confrontation, potential asset restructuring plans, and a search for a state-owned savior. China Resources, initially a silent partner, oscillated between defending its position and ultimately decided to divest for significant profit, acting as the conflict's pivotal swing vote. This complex strategic interplay was a direct consequence of a governance vacuum where no single clear authority could resolve the dispute internally [9].

4. Analysis of Vanke's internal governance mechanism failure

The central argument of this paper is that Vanke's control contest was not an accident of finance but rather the inevitable result of a deeply compromised internal governance system. The failure can be dissected into four interconnected dimensions.

4.1. Extremely dispersed ownership with no stable controlling shareholder

The primary and most fundamental vulnerability was Vanke's fragmented equity structure. A dispersed ownership structure without a core controlling shareholder leads to a severe principal-agent problem: the ownership of the company is separated from its control. As Jensen and Meckling theorized, when individual shareholders hold very small stakes, none have a sufficient economic incentive to engage in intensive monitoring of management [2]. This allowed Vanke's professional management team to exercise de facto control over the company for decades, creating a "strong management, weak owners" paradigm. While this fostered operational autonomy, it also meant there was no stable shareholder pillar to mount a swift and definitive defense when an external aggressor like Baoneng began accumulating shares on the open market [6]. The governance system lacked an ultimate guardian.

4.2. Ineffective board of directors: a deficit of independence and checks

The board of directors, as the key decision-making body between shareholders' meetings, failed in its role of providing strategic oversight and checks and balances. The independent directors, ostensibly appointed to represent the interests of all shareholders, especially minority ones, failed to form an effective unified voice during the early stages of the crisis. The board's paralysis was evident in its inability to quickly assess the threat, evaluate Baoneng's intentions in a systematic manner, and propose a clear set of strategic options for shareholder deliberation. Instead, the conflict was personalized by the management's public declarations, bypassing the board's collective authority. This indicates that the board's composition and procedures did not foster genuine independence or a culture of rigorous deliberation [8].

4.3. Atrophied supervisory function of the supervisory board

Vanke's supervisory board remained completely silent and invisible throughout the entire dispute, rendering its statutory oversight function meaningless. According to Chinese company law, the supervisory board is tasked with supervising directors' and managers' execution of their duties and safeguarding the company's lawful interests. Yet, in the face of a transformative control contest that would profoundly affect all shareholders and stakeholders, the supervisory board did not issue a single substantive investigation report or objection. This silence is the starkest evidence of a profound institutional failure. A robust supervisory board could have served as a neutral internal arbiter, scrutinizing the legality of both the acquirer's tactics and the incumbent management's defensive measures, but this function was entirely absent [10].

4.4. Imbalance in management incentive and constraint mechanisms

The crisis also exposed a deep-seated conflict between the management's operational excellence and the lack of adequate shareholder constraints. The Vanke management team, under the charismatic leadership of Wang Shi, had successfully built the company and developed a strong organizational culture. The external reputation and internal authority of the management were so formidable that they effectively overshadowed the formal governance organs. The incentive mechanism (including the partnership scheme) tied management's interests closely to the company's performance but did not legally equate to ownership control. When a dissonance

emerged between the management's vision of Vanke's future and the potential desires of a new majority shareholder, the lack of a formal constraint mechanism meant the conflict had to be fought in the public and regulatory arenas rather than being resolved through internal governance procedures [1].

4.5. The transmission path from internal governance failure to control risk

These four failures were not isolated; they formed a causal chain. An excessively dispersed ownership structure created a control vacuum. The atrophied board and supervisory board meant this vacuum was filled not by healthy institutional oversight but by the unilateral influence of a powerful management team. The resulting governance regime was stable on the surface but lacked the structural resilience to absorb external shocks. When Baoneng's capital offensive commenced, the absence of a stable controlling shareholder meant there was no first line of defense. The dysfunctional board could not mediate. The silent supervisory board could not investigate. Consequently, the latent governance flaw was activated, transforming a simple share acquisition into a full-blown control crisis. The internal governance defect was the necessary condition that precipitated the conflict.

5. Impact of the control contest on Vanke

The prolonged and high-profile control contest inflicted substantial and multidimensional damage on Vanke.

5.1. Impact on operations and strategy

The persistent uncertainty over the company's controlling owner severely disrupted its operational rhythm. Management attention, which should have been focused on project investments, land acquisitions, and market competition, was instead diverted to corporate defense. Strategic decision-making was paralyzed; long-term planning gave way to short-term crisis management. Employee morale suffered, and the recruitment and retention of top talent became challenging due to the instability.

5.2. Impact on stock price and market value

Financial markets abhor uncertainty, and the Vanke dispute caused significant volatility in its stock price. While the initial share-buying spree drove prices up, the subsequent drawn-out conflict introduced a risk premium that depressed valuations. After the standoff's resolution in mid-2016, when trading resumed, the stock faced immense downward pressure, reflecting investor anxiety about the company's fractured internal governance. The incident demonstrated that a governance crisis directly impairs market confidence and shareholder value [9].

5.3. Impact on shareholders and stakeholders

The conflict created a fragmented and adversarial shareholder base, pitting the aggressor against the incumbent management and the originally largest shareholder against both. Small and medium shareholders, for whose interests all sides claimed to be fighting, were left in the most vulnerable position. Their ability to influence the outcome was marginal, and they bore the brunt of the stock price volatility. For other stakeholders, including banks, creditors, and business partners, Vanke's credit profile and partnership stability were perceived as risky, potentially leading to increased financing costs and stricter contractual terms.

5.4. Impact on corporate governance and industry regulation

On a broader scale, the Vanke-Baoneng dispute served as a harsh stress test for China's corporate governance norms and financial regulation. It exposed ambiguities in regulations concerning the use of universal life insurance funds for hostile takeovers and sparked a nationwide discussion on the functions of independent directors and the rights of corporate founders. In its aftermath, regulatory bodies, including the China Securities Regulatory Commission, tightened rules on the funding sources for corporate acquisitions and issued stronger calls for regulatory compliance. The case underscored the systemic importance of sound internal governance and catalyzed a wave of amendments to governance charters and articles of association among listed companies [11].

6. Recommendations for improving internal governance and preventing control risks

Based on the preceding analysis, a multi-faceted reform of internal governance is necessary to build corporate resilience.

6.1. Optimizing ownership structure to form rational checks and balances

Companies must design an ownership structure that balances control stability with market vitality. A moderate level of equity concentration, perhaps through strategic long-term investors or employee joint-holding vehicles, can create a core group of shareholders with both the incentive and the capacity to monitor management and defend against hostile raids [3]. This does not advocate returning to a singular dominant shareholder but rather cultivating a set of committed, stabilizing institutional investors.

6.2. Perfecting the "three meetings and one management layer" checks and balances mechanism

The formal division of powers among governance bodies must be strictly implemented. The boundaries of the shareholders' meeting, the board's strategic decision-making authority, the supervisory board's oversight scope, and management's executive power must be clarified in the corporate charter. Regular, well-documented meetings with substantive deliberation are essential to prevent the atrophy of any single organ.

6.3. Strengthening board independence and professionalism

The independent director system must be strengthened. In setting selection criteria, we should move beyond the minimal threshold of eliminating candidates with business ties to the company, and prioritize three critical competencies: demonstrated industry expertise, proven financial acumen, and a verifiable history of independent, sound judgment. Companies should establish an independent directors' committee that can meet without the presence of executive directors, enabling it to form a genuine counterweight in critical strategic issues, including response strategies to hostile takeovers [8].

6.4. Enhancing the oversight effectiveness of the supervisory board

The supervisory board must be revitalized. This can be achieved by expanding its composition to include external supervisors with professional legal and accounting backgrounds. Its formal powers—including the ability to independently hire external auditors and law firms to investigate specific matters—should be explicitly stated and actively exercised. An active supervisory board could have served as a credible, unbiased internal investigator during the dispute, providing a factual and legal basis for shareholder decisions [10].

6.5. Refining management incentive and constraint mechanisms

A balanced approach to management incentives is critical. While equity-linked incentives, such as the partnership model, are effective for aligning interests, they must be designed with transparent conditions and disclosure. Furthermore, a disciplinary constraint mechanism is equally important. This includes performance-based dismissal clauses and a clear articulation in the corporate charter of the board's supreme authority over hiring and firing top managers, preventing the formation of an unassailable management fortress [6].

6.6. Establishing a control risk early warning and response mechanism

Finally, companies should proactively institutionalize their defense against control risks. This involves setting up a governance-focused committee tasked with monitoring share registrations, identifying unusual stock accumulation, and drafting a contingency plan (a form of internal "shark repellent"). This pre-planned response strategy can prevent panic-driven decision-making and ensure that any defensive actions are legally sound, proportionate, and approved through proper governance channels [9].

7. Conclusion

This paper has used the Vanke-Baoneng dispute as a critical case study to systematically investigate the relationship between internal governance mechanism failure and the eruption of control contests. The research confirms that Vanke's crisis was fundamentally caused not by an external capital assault, but by its pre-existing internal governance flaws. Specifically, its highly dispersed ownership structure, an under-empowered board of directors, a functionally invisible supervisory board, and an imbalanced management constraint mechanism collectively created a brittle governance system incapable of absorbing the shock from an external acquirer. The case demonstrates the transmission mechanism: a structural absence of an owner-guardian, compounded by the atrophy of internal oversight organs, invariably transforms a latent ownership vulnerability into a full-scale corporate control crisis. The disruption caused by the contest negatively impacted the company's business operations, market valuation, and the broader regulatory landscape, underscoring the practical significance of governance integrity. The fundamental solution for preventing such risks lies in the deep reform and fortification of internal governance mechanisms, including optimizing equity structure, strengthening board independence, making the supervisory board genuinely functional, and establishing permanent risk response systems.

The primary limitation of this study is its reliance on a single, albeit rich, case. Although this allows for a deep contextual analysis of causal mechanisms, the external validity and generalizability of its specific findings to firms in different industries or with different ownership types are inherently bounded. Furthermore, the analysis is predominantly qualitative. Future research could significantly advance this line of inquiry by conducting multi-case comparative studies across different institutional contexts and ownership structures. Moreover, quantitative empirical research that systematically measures internal governance failures and tests their statistical association with the probability of control contests would be an invaluable contribution, helping to identify more generalizable laws of governance risk and further strengthen the foundations of both corporate practice and capital market regulation.

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