

# The Impact of Vanke Equity Incentive on Business Management

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**Abstract.** The problem of internal governance in modern enterprises is prominent. In order to stimulate the vitality of company organizations and managers, improve company performance, establish a hub between managers and shareholders, implementing equity incentive systems can help to achieve long-term value improvement and reduce agency costs. This article takes the current situation of Vanke Group from the first implementation of the equity incentive plan in 1993 to the present situation of Vanke Group, and the changes that have occurred in Vanke as the object of this article's case study. Combined with the perspective of corporate management, this article summarizes the role and impact of the equity incentive system on Vanke corporate governance, obtains inspiration from it, and puts forward suggestions for improvement, providing reference for the design and improvement of the equity incentive system for listed companies in China.

**Keywords:** Equity incentive; operating management; Vanke group.

## 1. Background Introduction

China's equity incentive system research and implementation in enterprises are relatively late. Vanke Group, which first used the stock option incentive system in 1993, is the first enterprise in China to adopt equity incentive. This system produces a special equity structure of split share structure, which is restricted by China's planned economic system and affected by imperfect relevant laws. With the successive improvement of the Company Law and the Securities Law in 2006, a security system has been established for the trading rules of stock options. Currently, more and more listed companies adopt equity incentive systems to motivate senior executives and technical personnel, closely linking their own interests with the development of the enterprise, It not only effectively promotes the executive's business model, but also avoids the business risks under the principal-agent model as much as possible.

## 2. Equity Incentive and Principal-Agent Theory

### 2.1. Equity incentive system

#### 2.1.1 Basic concepts

Equity incentive refers to the dual role of supervision and incentive provided by enterprises to senior managers and core employees through equity instruments such as stocks and bonds. Equity incentives firmly bind the interests of employees and enterprises, achieving unity of objectives and power checks and balances, thereby promoting the sustainable and stable development of enterprises. Enterprises transfer a certain amount of stock options to senior managers and core employees. The smooth implementation of the equity incentive system is based on contracts between both parties, and under the influence of market mechanisms, it constantly updates resources and transmits information, completes the optimization of human capital and the allocation of social resources, weakens the issue of goal differences and management conflicts between shareholders and managers, and realizes value increment for the enterprise, Finally, achieve the constraint goal of equity incentive.

#### 2.1.2 Four main modes of equity incentive

The first is option incentive, which is a non cash incentive with low cost; It can bring a large amount of working capital to enterprises. However, in this mode, the company's equity will be diluted,

resulting in a decline in management power, which affects the value of equity. Option incentive is widely implemented in China and is one of the common distribution tools for science and technology innovation board enterprises.

The second is virtual stocks, which are generally held by employees or managers. The first is the company's subsidy policy for employees to purchase corporate stocks; The second is the company's free gift of stock incentives; The third is stock investment purchased by employees themselves. During the period when the stock price of a listed company rises, shareholding employees can obtain shareholding benefits, which increases their enthusiasm for work, and can also prevent managers from taking short-term business performance measures. "Huawei owns 99% of its shares held by employees, but they only enjoy dividends without real rights."

The third is performance target shareholding, performance stock is the most common incentive system for listed enterprises, the main reason is that this incentive form is very flexible. Decision makers will set an expected target for executives. Generally, if the incentive object achieves the target within this specific time, it will be able to obtain funds or corresponding equity that can be used to buy corporate stocks. This way can not only effectively play an incentive role, but also attract external core technical talents, retain internal human capital, and achieve a win-win situation of personal value and enterprise value.

The fourth is restricted shareholding, which refers to the right of enterprises to purchase equity of enterprises by formulating lower prices for specific objectives or specific businesses, locking in specific stocks of enterprises, and granting incentive targets the right to purchase equity of enterprises. Under normal circumstances, employees will be given a certain discount on the purchase of shares according to the cost and source of stock procurement, but the transfer of this part of equity will be limited by specific provisions, and only when the specific business objectives are met can incentive targets transfer, realize and profit. This approach requires employees to invest in their own stocks, which in most cases come from the secondary market.

## **2.2. Principal agent theory**

### **2.2.1 Basic concepts**

The principal-agent theory advocates that the owner of an enterprise should be separated from the operator, and the owner should only retain his residual claim and transfer the right to operate the enterprise to other people. The owner of the enterprise is the principal, and the operator hired to implement management is the agent. The main mode of principal-agent relationship is that at least one behavioral entity hires other entities to provide business management services according to specific agreements, transfers decision-making power, and pays remuneration based on the results of business management. The reason for the emergence of principal-agent relationships in enterprises is that the productivity of enterprises continues to improve, and the production model significantly expands, so the division of labor among various positions is more detailed, Taking responsibility for the management and operation of an enterprise can further improve its operational efficiency and strive for greater operating profits for the enterprise.

### **2.2.2 Institutional mechanism and impact**

Principal agent theory holds that linking executive compensation to performance can encourage managers to work harder and improve corporate performance. In the short run, standard performance based compensation contracts can alleviate the agency conflict between shareholders and managers and achieve the convergence of their interests. In the long run, shareholders and managers have different risk preferences, shareholders can achieve business benefits through long-term investment, and managers often choose short-term profitable business projects for career and reputation considerations. In this relationship, there may be contradictions and conflicts due to the differences in identity and interest needs between enterprise managers and operators.

Therefore, the principal agent theory will lead to different behavior of enterprise management to a certain extent. In order to solve the possible problems in the principal agent model as far as possible,

it is necessary to restrict the agents within the enterprise, which requires the establishment of corresponding salary incentive system and other measures.

### **3. Case Introduction**

#### **3.1. Case corporate governance structure and development strategy**

##### **3.1.1 Corporate governance structure**

As one of the earliest listed companies, China Vanke has long recognized the important role of corporate governance mechanisms in establishing modern enterprise systems. Vanke has gradually formed a standardized operating system and established a realistic corporate organizational system and corporate governance structure. The General Meeting of Shareholders, the Board of Directors, and the Board of Supervisors shall exercise decision-making, executive, and supervisory powers in accordance with their respective responsibilities. The Board of Directors has established three professional committees, namely, audit, investment and decision-making, compensation and nomination, to improve the operational efficiency of the Board of Directors. Among the 11 directors on the board of directors, there are 4 independent directors.

##### **3.1.2 Company development strategy**

"*Strategic matching*" is the core factor in creating competitive advantage. While creating core advantages, enterprises will generate target positioning and different positioning. In Vanke, all management is serving the business. Vanke Group's choice of real estate as its core business is an inevitable reflection of the group's decision-maker value system. In 1990, the company initially formed four business frameworks: commerce, industry, real estate, and cultural communication. At the beginning of 1991, the company established a "comprehensive trading house" development model that integrates information, trading, financing, and manufacturing. In 1993, Vanke ran into a wall in front of an investment institution. Coupled with the "Jun'an incident" that followed, Vanke decided to take the path of specialization and make real estate its main business. Since its establishment, Vanke has gone through three stages of development: diversification, specialization, and refinement.

#### **3.2. The impact of equity incentive on company operation and management**

##### **3.2.1 The role of equity incentive in company operation**

Vanke Group has successfully implemented a total of three equity incentive schemes, and added a business partner mechanism and a joint venture mechanism in 2014, closely tying the interests of project leaders with the interests of the enterprise, greatly enhancing management efficiency and profit quality. In 2020, under the leadership of the new Chairman Yu Liang, we consolidated our main business, diversified our development, and successfully issued bonds, raising a total of 1.981 billion yuan. For Vanke Group, equity incentive is not only a long-term incentive mechanism, but more importantly, it conveys the cultural concept of win-win cooperation. Vanke Group explored and innovated in its previous three equity incentive experiences, releasing bullish news in the stock circulation market, directly causing stock price changes; Utilize financial leverage to create greater benefits for the enterprise; Establish limited partnership enterprises, attract more investors, consolidate the actual power of management, display company performance on stock prices, and enhance social influence.

##### **3.2.2 The role of equity incentive in management**

Real estate management enterprises have the characteristics of large scale engineering development and a large number of projects, with branches throughout the country. During the process of large-scale expansion of Vanke's business, it was also faced with a situation where enterprise control costs continued to increase and management efficiency decreased. While shifting from diversification to specialization, Vanke has taken a series of "subtraction" measures: major divestitures of business - real estate as the main business, and residential housing as the core; Regional

concentration - focusing on key cities and dividing areas for management; Large release of authority - gradually delegate authority based on the maturity of the subsidiary; Group management and control - Group companies are still the "brain" of the entire management system. It has been proved afterwards that this series of major adjustments has led to a "qualitative" breakthrough in enterprise management. In 2018, Vanke proposed a new flexible organizational model with strategic inspection, organizational reconstruction, business facilitation, and personnel matching to enhance the main line, transforming the traditional rigid organization with functions and levels as the skeleton into a main task and partnerships as the hub.

## **4. Data Analysis of Equity Incentive on Company Performance**

### **4.1. Analysis of the impact on business performance**

#### **4.1.1 The impact on corporate profitability**

Return on Net Assets (ROE) reflects the utilization rate of a company's own capital and the return rate of variable capital. It is an important indicator to measure the profitability of a listed company. It mainly reflects the profitability of the company's owners, meeting our requirements for research elements. The calculation formula for the return on net assets is: Return on net assets (r)=Earnings per share or net profit of the company (e)/Net assets per share or shareholder's equity of the company (a)×100%. We analyze the impact of equity incentives on the profitability of Vanke Group by extracting the return on equity.

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**Table 1.** Return on net assets of Vanke in 2010-2019 (%)

Reporting period	ROE	Change rate
2019.12.31	20.67	-1.01
2018.12.31	21.68	0.54
2017.12.31	21.14	2.61
2016.12.31	18.53	0.44
2015.12.31	18.09	0.23
2014.12.31	17.86	-2.2
2013.12.31	19.66	0
2012.12.31	19.66	0.49
2011.12.31	18.17	1.7
2010.12.31	16.47	/

This table lists the return on net assets of Vanke Group from 2010 to 2019. It can be seen from the table that the company's return on net assets reached 18.17% in 2011, an increase of 1.7% compared to the previous year, and an increase of 19.66% in 2012. This reflects the stimulating effect of the equity incentive system adjustment carried out by Vanke Group in 2011 on the company's operations, improving the company's profitability. However, after 2013, the company's return on net assets is facing a significant decline, and the annual increase in earnings is relatively small. At this time, the equity incentive plan of Vanke Group has adjusted the company's strategy, mainly the expansion of the company's business and business scale. Although it has enabled enterprises to obtain more operating profits, it has increased the company's management costs and operational risks. Therefore, the profitability of enterprises has correspondingly decreased. In 2016, Vanke Group carried out equity integration. With the centralized development of the company's operations, the profitability of the company has been rapidly improved in recent years. The three comprehensive profitability indicators on the chart also show that at each equity incentive system change node of Vanke Group, with the positive or negative adjustment of the company's equity system and the impact of market and policy, the company's profitability also changes, reflecting the correlation between the two.

#### 4.2.2 Correlation Analysis of Equity Incentive and Profitability

Data analysis based on spss: Pearson correlation is used to measure the linear correlation between two data. The closer the absolute value of the correlation coefficient is to 1, the stronger the correlation. Kendall coefficients rank statistical objects by specific attributes. If two attribute coefficients are close to 1, the stronger the positive correlation is. The Spearman coefficient measures the degree of correlation between hierarchical and ordered variables.

**Table 2.** Return on net assets of Vanke in 2010-2019 (%)

Reporting period	ROE	Change rate	Change rate
2019.12.31	20.67	19.997	14.93
2018.12.31	21.68	17.4	15.23
2017.12.31	21.14	15.1	28.29
2016.12.31	18.53	11.77	20.47
2015.12.31	18.09	9.77	21.83
2014.12.31	17.86	7.637	36.62
2013.12.31	19.66	5.59	27.92
2012.12.31	19.66	4.37	67.43
2011.12.31	18.17	2.61	105.71
2010.12.31	16.47	1.05	/

Extract the basic data for each year in the financial statements of Vanke Group for the past ten years: return on equity (ROE) and the economic profit bonus accrued this year. The economic profit bonus is mainly awarded to senior management personnel of the company. The EP (economic profit) achieved by the company in the current year and calculated by an independent third party is used as a performance evaluation indicator. Each year, 10% of the economic profit bonus is withdrawn as a collective bonus, and a third party is entrusted to conduct investment management and obtain investment income, including various securities, representing the company's equity incentive system indicators. Based on these two basic data, data analysis is conducted, and correlation analysis is conducted using SPSS to further test whether the impact and role of equity incentives on Vanke's operating performance has scientific proof or explanation. Input the extracted two sets of data into the variables for correlation analysis for two-way detection.

The three detection results of the data are shown in the following table:

**Table 3.** Pearson correlation test

		ROE	Accrued economic profit bonus
ROE	Pearson correlation	1	0.759*
	Significance (bilateral)		.011
	N	10	10
Accrued economic profit bonus	Pearson correlation	.759*	1
	Significance (bilateral)	.011	
	N	10	10

\*. Significant correlation at 0.05 level (bilateral).

Correlation test of Kendall coefficient and Spearman coefficient

			ROE	Accrued economic profit bonus
Tau of Kendall_ b	ROE	correlation coefficient	1.000	.539*
		Sig. (both sides)	.	.031
		N	10	10
	Accrued economic profit bonus	correlation coefficient	.539*	1.000
		Sig. (both sides)	.031	.
		N	10	10
Spearman's rho	ROE	correlation coefficient	1.000	.693*
		Sig. (both sides)	.	.026
		N	10	10
	Accrued economic profit bonus	correlation coefficient	.693*	1.000
		Sig. (both sides)	.026	.
		N	10	10

\*. When the confidence level (double measure) is 0.05, the correlation is significant.

The detection results of the data are positively correlated on the three tests, indicating that the implementation of the equity incentive system has played a positive role in promoting the profitability

of Vanke Group to a certain extent. Although the impact of equity incentives on corporate profitability can improve rapidly in the short term, and the improvement effect is gradual, which can remain stable for 2-3 years after the end of equity incentives, the return on net assets will then tend to stabilize or even decline. The reason for this may be that the benefits of equity incentives and compensation incentives have given management enthusiasm for their work. However, the incentive effect is generally a three-year closed period after the implementation of collective bonuses, and due to the subsequent absence of other forms of incentive measures, senior managers have failed to maintain a high growth trend in net asset growth in order to achieve short-term profitability, thereby affecting the net asset growth rate.

## **5. Enlightenment and Suggestions**

### **5.1. Standardizing the equity incentive system**

In 1993, Vanke Group began preparing to implement the first equity incentive plan and drafted the "Staff Share Plan Rules", which obtained approval documents from the People's Bank of Shenzhen. However, the implementation went through a process of suspension, failure, restart, and final improvement. After the establishment of the China Securities Regulatory Commission in 2006, relevant laws and regulations were improved to address existing issues in China's equity incentive. Vanke Group took the opportunity to launch a three-year equity incentive plan in the same year. Although it ended in failure, the more reason at this time was that the protection system for incentive targets could not be established when the plan was formulated, It is not influenced by market environment and legal norms. Two years later, the China Securities Regulatory Commission issued documents such as the Memorandum on Issues Related to Equity Incentive, while the SASAC also issued relevant regulations, as well as government departments standardized dividend tax payment from the perspective of individuals and enterprises as a whole. The comprehensive establishment of legal protection for equity incentive has helped Vanke Group successfully implement its third equity incentive plan in 2011. Vanke Group established strict requirements and regulations for the equity incentive system, which further standardized and standardized the company's equity incentive system, ensuring the stable operation of the company as a whole.

### **5.2. Establish a matching assessment and incentive mechanism**

When setting evaluation indicators for Vanke Group, two indicators, net profit and return on net assets, are set as the primary objectives. Although they can directly reflect business performance, they are most easily manipulated by management and cannot be compared in long-term evaluations. Assessment results tend to become mere formality. In order to demonstrate the comprehensiveness and practicality of equity incentive effects, Vanke Group's equity incentive plan can start from aspects such as employee creativity, customer satisfaction, and market share, and build a systematic and scientific humanized evaluation mechanism, allowing equity incentive to play a positive collaborative management effect and be better applied to corporate governance. Secondly, Vanke Group has set too high exercise standards for its exercise indicators, which can lead to incentive targets being unable to meet performance requirements regardless of any measures taken, and undermine the work confidence of incentive targets. The lack of a reasonable evaluation mechanism is the biggest problem faced by enterprises when exercising their rights, which is also the root cause of the failure of Vanke Group's equity incentive in 2011; On the contrary, if the exercise standard is set too low, managers can achieve the unlocking standard with only a little effort, and the substantial improvement of operating performance is not achieved, so the equity incentive effect cannot be exerted; If the setting of the evaluation mechanism is too complex, it is likely to lead to an increase in the evaluation cost, and the interests of shareholders will also be violated.

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