

# GOME: A Boardroom Fight from Prison

---

## Case Overview

Founder and former chairman of GOME Electrical Appliance Holdings (GOME), Huang Guangyu, was sentenced to 14 years' jail on 18 May 2010<sup>1</sup>. This was a huge fall from grace for one of the richest men in China. After Huang's arrest in late 2008, the then CEO Chen Xiao replaced him as Chairman of GOME's board in January 2009. Under Chen, GOME began deviating from the company's original strategies, whilst external investors such as Bain Capital LLC were invited to invest in the firm. From Huang's perspective, these developments threatened his control of the company<sup>2</sup>. Huang then waged a boardroom fight from prison. The objective of this case is to allow a discussion of issues such as corporate governance in founder-managed companies; business practices and corporate governance in Chinese companies; bribery, insider trading and market manipulation; and board composition and control.

## The Growth of GOME

Founded in 1987, the success of GOME could be largely attributed to its 'best price' strategy. According to Huang Guangyu, the founder and former Chairman, "by offering lower prices, customers are happy and support you, (and) tell other people about you."<sup>3</sup> Under Huang's management, GOME gradually became known as the electrical appliance store that

---

This is an abridged version of a case initially prepared by Teo Chun Peng Justin, Khong Xiang Zheng, Ker Wanling, Chiu Weiqi, and Abdul Hakeem under the supervision of Professor Mak Yuen Teen. The case was developed from published sources solely for class discussion and is not intended to serve as illustrations of effective or ineffective management. Consequently, the interpretations and perspectives in this case are not necessarily those of the organisations named in the case, or any of their directors or employees. This abridged version was prepared by Amanda Seah Jia Hui under the supervision of Professor Mak Yuen Teen.

Copyright © 2012 Mak Yuen Teen and CPA Australia

---

sold its goods at the lowest price. Huang was then known as the “Price Butcher”<sup>4</sup> and the “Sam Walton of China”<sup>5</sup>.

With the rapid growth of the company, Huang opted to list the GOME Group on the Hong Kong Stock Exchange (HKSE) in 2004. Approximately 90 of GOME’s highest grossing stores were included in the listed GOME Group, while the remaining unlisted stores were under Huang’s personal control<sup>6</sup>. The unlisted stores were managed by the company via a management memorandum agreement. When this agreement expired, control would return to Huang. GOME experienced tremendous growth, surging to a market leadership position in China’s electronics retail industry<sup>7</sup>. The ultimate measure of Huang’s success came in 2005 when he was ranked the richest man in China by Time Magazine<sup>8</sup>, a title he held until his arrest in November 2008. At that time, Huang’s estimated personal wealth stood at US\$6.3 billion<sup>9</sup>.

## **The Arrest of Huang**

In 2008, under the Chinese government’s enforcement actions against corporate corruption<sup>10</sup>, Huang was arrested and placed “under investigation”<sup>11</sup> for suspicion of bribery, insider trading and money laundering, among other breaches. Trading of GOME’s shares was suspended on the HKSE on 24 November 2008 following the news of Huang’s 18-month detention<sup>12</sup>. GOME’s share price plummeted to a low of HK\$1.12 on 25 November 2008<sup>13</sup>.

## **The Bribery Scandal**

The investigations revealed that Huang had engaged in both direct bribery and indirect instigation of bribery of five government officials<sup>14</sup>, involving a total of RMB 4.56 million worth of cash and properties in return for special consideration and business favours<sup>15</sup>.

In June 2006, the Beijing Municipal State Taxation Bureau had ordered six provincial taxation bureaus to investigate GOME over tax evasion issues<sup>16</sup>. Two of the key members of the assigned team, Liang Conglin

and Ling Wei, were approached by Jing Hongli, a senior officer with the Economic Crime Investigation Department of the Beijing police, with a request for them to be “lenient” in reporting their findings on GOME<sup>17</sup>. The pair subsequently had dinner with Huang and his key business partner, Xu Zhongmin, the former chairman of Beijing Centergate<sup>18</sup>.

Following Liang and Ling’s official inquiry, GOME’s Beijing branch was fined a very lenient sum of less than RMB 2 million for injecting capital into a shell company for tax evasion purposes. Liang and Ling each received bank cards with RMB 500,000 worth of credit<sup>19</sup>. Xu Zhongmin was also found to have been instigated by Huang to bribe police and tax officials. In addition, senior tax officials Jing Hongli and Sun Haiting received RMB 1.5 million and RMB 1 million<sup>20</sup> respectively from Xu in connection with GOME’s and Huang’s misdeeds.

## **Insider Trading and Other Offences**

Huang was also found to have engaged in insider trading from April to September 2007, involving shares in Shenzhen-listed Beijing Centergate Technologies Holding Company Limited (‘Centergate’), in which he was a major shareholder<sup>21</sup>. Huang instructed others, including Beijing Eagle Investment Co Ltd<sup>22</sup>, a company controlled by Huang himself<sup>23</sup>, to buy substantial quantities of Centergate’s shares amounting to RMB 1.415 billion<sup>24</sup>. This illegal trading was conducted prior to public disclosures concerning the restructuring plans for Centergate. Centergate’s share price soared after these plans were officially announced. Using similar strategies involving restructuring and swaps, Huang also engaged in insider trading in the shares of Sanlian Commercial<sup>25</sup>. By acting on the insider knowledge he had in these two cases, Huang made illegal profits of more than RMB 309 million<sup>26</sup>.

In addition to insider trading, Huang was also found guilty of money laundering. From September to December 2007, Huang channelled RMB 800 million to Hong Kong, where the money was converted to HK\$822 million through illegal channels such as ‘underground banks’<sup>27</sup>.

Huang was found guilty by the Beijing Second Intermediate People's Court with respect to charges of bribery and insider trading and sentenced to 14 years in prison<sup>28</sup>, fined RMB 600 million and had RMB 200 million of his assets frozen<sup>29</sup>.

## Share Repurchase Scandal

Besides the criminal offences committed in China, Huang also engaged in unlawful activities outside Mainland China<sup>30</sup>. Huang had organised a large share repurchase with his wife, Du Juan, to sell their shares in GOME back to the company, so as to repay Huang's personal loan of HK\$2.4 billion. On 28 January 2008, Huang transferred 50 million GOME shares to his wife's wholly owned company. At the same time, he and Shine Group Ltd, which was wholly-owned by Huang, transferred around 900,000<sup>31</sup> and 136 million shares<sup>32</sup> of GOME respectively to other "family members". As Huang's interest in GOME shares decreased by the same amount, this suggested that these "family members" did not, in fact, include his wife and children<sup>33</sup>.

During the period between 22 January 2008 and 5 February 2008, GOME initiated a share buyback from the market. The company bought back 129.8 million of its shares at an average price of HK\$17.23, at an approximate cost of HK\$2.2 billion to the company.<sup>34</sup> This buyback scheme caught the attention of Hong Kong's Securities and Futures Commission (SFC), even though Huang himself did not directly sell any of his personal shares to the company. The SFC regarded this share buyback as having a negative impact on GOME's financial position and not in the best interests of the company and its shareholders<sup>35</sup>. It had resulted in an artificial upward manipulation of GOME's share price, allowing Huang to dispose of his shares at higher prices through indirect means. Indeed, after the last day of buybacks, GOME's share price plummeted by 74.6 per cent from HK\$4.405 to HK\$1.12, resulting in a loss of about HK\$1.6 billion dollars to shareholders<sup>36</sup>.

On 7 August 2009, the SFC applied to the court under Section 213 of the Securities and Futures Ordinance to freeze movement of Huang's stake in GOME, valued at around HK\$1.655 billion<sup>37</sup>. In response to this news,

GOME's share price fell by 7.8 per cent on 7 August 2009 from HK\$2.57 to HK\$2.37<sup>38</sup>. It was a costly ruling for the non-controlling shareholders, despite the ruling's intention to protect minority interests.

## The Boardroom Shuffle

Following Huang's resignation due to his "inability to perform his duties as a director" on 16 January 2009<sup>39</sup>, Huang's successor Chen Xiao started to steer GOME in a different direction, against the wishes of Huang. In 2009, Chen implemented a strategy to transform GOME, through giving priority to network rationalisation and individual store profitability. He built stronger relationships with suppliers to reap economies of scale and also paid more attention to investors. Chen's focus was on cutting down expenses and making GOME a much leaner and more efficient company. Hence, instead of choosing to expand GOME's retail outlets as Huang would have done, Chen decided to close down 189 stores which were deemed to be insufficiently profitable<sup>40</sup>.

Huang's second point of contention, also the more crucial one, was with regard to Chen's intention to "broaden (GOME's) shareholder base and shore up its finances"<sup>41</sup> by scouting for private equity investors to boost GOME's declining financial performance and to solve its debt issues. Chen's intention was to attract investments by reputable investors with an interest in management of the company in order to convince the HK regulators of GOME's recovery and restore investor confidence. Chen therefore invited investments from institutional investors, with Kohlberg Kravis Roberts and Bain Capital coming forward as interested parties<sup>42</sup>.

On 22 June 2009, an agreement with Bain Capital was struck, despite vehement opposition from Huang<sup>43</sup>. As Huang owned just over a third of the shares, he was unable to swing the board resolution which was in favour of Chen's proposal. Bain was hence able to invest up to US\$418 million in GOME, acquiring up to a 23 per cent stake<sup>44</sup>, while also subscribing to 12 per cent of GOME's convertible bonds at a huge discount<sup>45</sup>. As expected, market opinions were bullish following this investment. "The worst is over," declared Merrill Lynch analysts Chen Luo

and Denise Chai<sup>46</sup>. Following the announcement of Bain's investment, GOME shares soared as much as 107 per cent to a peak of HK\$2.32 on 23 June 2009<sup>47</sup>.

The investment gave Bain a foothold in the Chinese equity market that was already paying off richly, with the surge in GOME's share price. Bain also had the option to convert its debt instruments into equity, or to continue holding the debt for a 5 percent coupon that "guaranteed it a return of at least 1.5 times its outlay<sup>48</sup>". In addition, Bain was given the right to nominate three directors to GOME's board<sup>49</sup>, providing it a good buffer against any action by the majority shareholder which may harm Bain's interests.

Huang appeared to be losing control of the company he had founded, with Bain now the second largest shareholder in GOME, after Huang. However, there was not yet any direct confrontation between both parties.

## **Jailed, But Still in the Game**

The peace was broken on 11 May 2010<sup>50</sup> following Huang's sentencing. Through his representatives, Huang acted to veto a move by Bain to nominate its three allotted directorships<sup>51</sup>. This ultimately proved to be a futile attempt, as Bain's rights to appoint its directors were guaranteed through the contractual agreement made in June 2009.

On 5 August 2010<sup>52</sup>, the GOME board filed a lawsuit against Huang for breaches of fiduciary duties as a director and damages for the illegal share repurchase<sup>53</sup>. In response, the convicted Huang launched an attempt to oust Chen using his large shareholding (held by Shinning Crown Holdings Inc)<sup>54</sup>. Yet again, Huang's attempts came to nought, as shareholders voted against this resolution. Huang did, however, succeed in preventing his shareholding from being further diluted, by voting against a mandate to issue new shares "without first offering them to current shareholders"<sup>55</sup>.

With Huang and a Bain-backed Chen cancelling each other out in the boardroom, the battle for control soon evolved into a battle for a majority control. Industry insiders saw the potential for a proxy fight, as Bain was gradually accumulating support from GOME's institutional investors who jointly held almost 45 percent of GOME's shares<sup>56</sup>. Bain further added to its voting power by exercising its convertible debt options, converting the bonds to an additional 9.98 percent stake.<sup>57</sup>

However, Huang considered himself to still have a few bargaining chips on hand. Firstly, he had maintained personal ownership over 300 GOME stores that were not listed in 2004<sup>58</sup>. These stores were only run by the listed entity via a management contract that was expiring soon, and Huang could use the uncertainty surrounding its renewal to his advantage. Secondly, Huang continued to have full ownership over the GOME trademark. Without his approval, GOME would be forced to rebuild its brand from scratch.

A few options were open to Huang. He could simply purchase an outright majority of shares, adding to his existing 32.4 per cent ownership<sup>59</sup> which he shared with his wife. However, this action would prove to be costly especially when GOME's share price peaked after the resumption of trading on 23 June 2009<sup>60</sup>. Huang would have to sell some of his unlisted assets to finance such a move<sup>61</sup>. The last option was a co-operative truce.

## **The End of the Power Struggle**

On 11 November 2010, GOME announced its agreement in allowing two of Huang's representatives onto the board<sup>62</sup>. A memorandum of understanding with Huang-controlled Shinning Crown was signed and GOME's board was enlarged from 11 to 13 directors. Huang's sister, Huang Yanhong, was appointed as a non-executive director, while Huang's associate, Zou Xiaochun, was appointed an executive director on the board. It seemed that the concession made would end the power struggle. This agreement would help remove uncertainty about the future of GOME and allow less disruption by avoiding a vicious boardroom fight.

Huang's initial fruitless attempt to oust Chen saw a sudden turn of events when Chairman Chen tendered his resignation on 9 March 2011<sup>63</sup>. The founder of Beijing Dazhong Electrical Appliances Co., Zhang Dazhong, succeeded Chen as Chairman, effective on 10 March 2011<sup>64</sup>. For Huang, Chen's departure meant a removal of a bone of contention and could probably mean a return to GOME's original direction<sup>65</sup>.

Under Zhang, a five-year plan for GOME was developed to expand the company's presence to tier-two and tier-three cities in China, with 60 per cent of new shop openings in those cities<sup>66</sup>. In a recent announcement, GOME appears poised to embrace a series of internal reforms, which include a new share option plan. It appears that these plans would see a shift from the "Chen-plan" to the "Huang-plan", marking a personal victory for Huang against Chen<sup>67</sup>. Bain Capital, with a 10 per cent stake in GOME, also announced its long-term commitment in the Beijing-based retailer<sup>68</sup>.

## Discussion Questions

1. For a family-controlled company seeking capital, the pros of a public listing would likely outweigh the cons. Do you agree with this statement?
2. Under the OECD Principles of corporate governance, the board of directors should be able to exercise objective judgement independently, especially from management. This outlines the importance of having a clear separation between board and management. To what extent can Huang's actions in relation to GOME be attributed to the lack of such a separation?
3. "This fight has no winners ... GOME is undervalued and its share price will reflect how quickly they remove uncertainties,"<sup>69</sup> remarked BNP Paribas analyst Charlie Chen in response to GOME's boardroom battle. How were minority shareholders hurt in the entire GOME saga? Would any of GOME's existing shareholders be considered "winners" in this leadership struggle?

4. Huang vehemently opposed Bain's investment in GOME in June 2009, a stark contrast to his receptiveness to institutional investors a few years ago. Taking into account the roles played by private equity investors and institutional investors in a company, explain possible reasons for Huang's strong opposition to Bain's investment. Were Huang's motivations in the best interests of the company?
5. Identify the regulatory parties involved in the GOME scandal. Do you think these regulators played effective roles in monitoring and enforcement?
6. At the end of the case, several options were open to Huang. In your opinion, which of these options would be in the best interests of GOME's shareholders?
7. What are the risks for minority shareholders investing in a company like GOME? Given the recent developments, would you be prepared to invest in GOME?