

# An Analysis of the Relationship Between Yili Group's Equity Incentives and Corporate Performance

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**Abstract:** Equity incentives have become a crucial mechanism in contemporary corporate management, connecting employees' interests with the long-term development goals of companies. Yili Group, a leader in China's dairy industry, has made significant strides in implementing equity incentive plans to align employee motivations with corporate objectives. This paper explores the background, motivations, and characteristics of Yili Group's equity incentive strategies and their relationship with corporate performance. By analyzing the evolution of Yili's incentive plans, this study highlights how these mechanisms have contributed to the company's sustainable growth, market competitiveness, and its global expansion. The results demonstrate that Yili's equity incentive programs not only foster employee engagement and innovation but also drive the company toward achieving its long-term strategic goals. These findings offer valuable insights for optimizing corporate incentive structures and serve as a reference for the broader industry in the field of corporate governance.

**Keywords:** Yili Group; Incentive Mechanisms; Corporate Governance; Strategic Goals; Sustainable Growth.

## 1. Introduction

In contemporary corporate management practices, equity incentives, as an efficient incentive mechanism, have become an important bridge connecting employees' personal interests with the long-term development goals of the company. Yili Group, as a leading enterprise in China's dairy industry, has made remarkable practices in equity incentives. This paper aims to explore the background, motivations, characteristics of Yili Group's equity incentive plans, and their relationship with corporate performance, with the goal of providing valuable insights for optimizing corporate incentive mechanisms. Yili Group's equity incentive plan is not only a financial incentive tool but also a strategic move aimed at stimulating employees' internal motivation and innovative potential, promoting the company's sustainable development and enhancing its market competitiveness. In the context of globalization and increasing market competition, how Yili Group uses equity incentives to achieve a win-win situation for both employees and the company is not only important for the company itself but also provides important reference value for the entire industry and the field of corporate management.

Through a detailed analysis of Yili Group's equity incentive plans, this case will reveal the intrinsic connection between equity incentives and corporate performance, explore how to effectively design and implement equity incentive plans, and how these plans contribute to the realization of corporate strategic goals in practice. This will not only provide guidance for Yili Group's own management practices but also offer valuable experiences and lessons for other companies

## 2. A Strong Foundation—Company Overview

Development Status—The Company's Growth

Yili Group Co., Ltd., founded in 1956, is a comprehensive enterprise specializing in the production and sale of dairy products. The company is headquartered in Hohhot, Inner Mongolia, and has more than 30 wholly-owned subsidiaries

and joint ventures, with operations across China and globally. In 2022, Yili seized market opportunities and continued to maintain a strong development momentum driven by innovation and internationalization, securing its leadership position in the industry. It ranked first in China, first in Asia, and among the top five global dairy companies.

**Table 1.1.** 2024 Ranking of Top 10 Dairy Companies in China

Rank	Company Name	Main Business Scope
1	Yili Group	Liquid milk, milk powder, dairy drinks
2	Mengniu Dairy	Liquid milk, milk powder, dairy drinks
3	Bright Dairy	Liquid milk, milk powder, dairy drinks
4	Sanyuan Group	Liquid milk, fermented milk, milk powder
5	Nestlé South China	Liquid milk, infant milk powder
6	Junlebao Group	Milk powder, liquid milk, dairy drinks
7	Dea Group	Liquid milk, milk powder, dairy drinks
8	Yijiyin	Gene testing, dairy products
9	Beingmate Group	Infant formula milk powder
10	Original Ecological Agriculture	Organic dairy products, dairy drinks

Source: Choice Financial Terminal

As shown in Table 1.1, Yili Group ranks first in China's dairy industry, primarily operating in liquid milk, milk powder, and dairy drinks, with best-selling products such as Pure Milk, Golden Series, and Anmu Xi.

Before 2006, Chinese enterprises generally lacked equity incentive mechanisms. Yili Group began to explore the use of equity incentives as a tool to enhance the motivation of management and key employees. During this period, the implementation of equity incentives was still in its early stages, and the effects of aligning company long-term

development with employee interests gradually became apparent.

After 2010, Yili Group intensified its efforts in equity incentives and developed more standardized and systematic incentive plans. The measures during this period were clearer, more targeted, and more closely tied to company performance, ensuring alignment between the management and the company's interests.

Since 2016, Yili Group's equity incentives have entered a new stage. With the acceleration of the company's internationalization, equity incentives have not only been focused on the domestic market but also extended to the performance and expansion in overseas markets. The equity incentive plans have increasingly focused on improving global market competitiveness and developing diversified product lines.

Yili Group has always emphasized product quality and safety in its production operations, continuously introducing advanced production equipment and technology to establish a comprehensive quality management and safety production system. The company is also actively promoting brand building, raising brand awareness and reputation through various channels and methods.

In terms of market expansion, Yili Group has continued to explore new markets, strengthen its presence in existing markets, and gradually form a nationwide sales network and service system. The company is also actively expanding into international markets and pushing its brand globally, achieving international development goals.

Yili Group has always focused on scientific research and technological innovation, establishing Yili Research Institute with a high-quality R&D team dedicated to research in dairy processing technology, nutrition, microbiology, etc. The company continues to launch new products and technologies, enhancing its core competitiveness.

### **3. Development Milestones—Company's Growth Path**

Yili Group has gone through five stages in its development: the Entrepreneurial Phase, the Brand Building Phase, the Brand Upgrade Phase, the Transformation and Upgrade Phase, and the Green and Sustainable Development Phase. It has also implemented three rounds of equity incentives.

(1) Entrepreneurial Phase (1950s to early 1980s) Yili was established in the early 1950s as a small cooperative, mainly producing yogurt and other dairy products.

(2) Brand Building Phase (1980s to 1990s) Yili gradually expanded its brand across the country, establishing a relatively complete sales network and brand image.

(3) Brand Upgrade Phase (Late 1990s to 2000s) Yili increased investment in technological research and development, launched a series of high-quality, high-tech dairy products, and conducted extensive promotions nationwide, successfully building the high-end brand image of "Yili."

(4) Transformation and Upgrade Phase (Late 2000s to 2010s) Yili began developing along the full industry chain, exploring innovative business areas, constructing modern production bases, and continuously expanding product categories and market scale.

(5) Green and Sustainable Development Phase (2020s to Present) Yili has increasingly focused on green and sustainable development, actively advancing its sustainable

development strategy, strengthening green production, and establishing ecological dairy farms, continually improving product quality and safety standards, providing consumers with healthier and higher-quality dairy products. Equity Incentive Plans of Yili Group

First Equity Incentive (2010):

Objective: This round of equity incentives aimed to motivate management and key employees, promoting long-term company development.

Participants: Mainly senior management and key employees.

Method: Stock options or restricted stocks were granted at a price lower than the market price.

Second Equity Incentive (2015):

Objective: To further enhance the company's competitiveness and promote performance growth.

Participants: The scope may have expanded, including more middle management and key technical personnel.

Method: Likely continued to use stock options or restricted stock, with the introduction of more complex performance evaluation standards.

Third Equity Incentive (After 2020):

Objective: To adapt to the new market environment and company strategic adjustments, such as digital transformation and international expansion.

Participants: Further expanded to more employees, possibly including newly hired talent.

Method: In addition to traditional stock options and restricted stock, more diversified incentive mechanisms, such as performance-based stocks, may have been introduced.

## **4. United in Effort—Shareholders of the Company**

### **4.1. The First Equity Incentive—Initial Efforts**

In order to further establish and improve the company's incentive and restraint mechanisms and enhance its sustainable development capabilities, Yili, after experiencing events such as the dismissal of independent directors, significant losses in government bonds, and the CSRC investigation in 2004, implemented the first generation of "golden handcuffs" by the new leadership, marking the beginning of a new era.

Plan Description:

This incentive plan proposed to grant 15 million stock options to the company's president, Mr. Pan Gang, accounting for 30% of the total number of stock options in this plan. The stock options corresponded to 15 million shares, representing 2.9043% of the company's total share capital.

Price Description:

The exercise price of the options was determined by the higher of the following two prices, which was set at 13.33 RMB.

(1) The closing price of Yili stock on the last trading day before the stock option incentive plan draft was published, which was 13.33 RMB. (Note: March 10, 2006, was the last trading day for Yili shares before the announcement, with a closing price of 17.85 RMB. As the company implemented a 10-to-3.2 capital reserve transfer and a dividend distribution plan on April 10, 2006, the price was adjusted accordingly, and the ex-right price became 13.33 RMB.)

(2) The average closing price of Yili stock over the 30 trading days before the publication of the stock option incentive plan draft, which was 12.30 RMB. (This price was

also adjusted due to the capital reserve transfer and dividend distribution that took place before the plan was announced.)

If events such as capital reserve transfers, stock dividends, stock splits, or reverse stock splits occurred during the validity period of the stock options, the exercise price would be adjusted accordingly. Following the 2006 profit distribution, the stock option price was adjusted to 13.23 RMB.

#### Incentive Sale Conditions:

If the incentive recipients transfer their Yili shares, they must comply with the provisions of the Company Law, Securities Law, and other relevant laws and regulations.

While serving in the company, the incentive recipients may transfer no more than 25% of the shares they hold in the company each year, and may not transfer their shares within six months after leaving the company.

During their tenure, the incentive recipients are prohibited from selling shares within six months after buying them or from buying back shares within six months of selling them. Any profits made from such transactions must be returned to the company, and the company's board of directors will recover the profits.

The shares obtained by the incentive recipients through exercising their options under this plan may not be sold within one year from the date of exercise; otherwise, the profits will be returned to the company, and the company's board of directors will recover those profits.

#### Performance Overview:

From 2006 to 2014, Yili's total assets, shareholders' equity, and main business income steadily increased. However, net profit showed a decline in 2007 and 2008, primarily due to the implementation of new accounting standards, which led to the expense recognition of the stock options granted under the previous equity incentive plan. Nevertheless, overall net profit showed some improvement.

In terms of attracting talent, the proportion of employees with master's degrees increased from 0.27% in 2006 to 0.81% in 2014, and the proportion of employees with bachelor's degrees increased from 13.2% in 2006 to 23.36% in 2014.

In 2005, Pan Gang (the Chairman and CEO of Yili Group) set the goal for Yili to be among the top 20 global dairy companies by 2010. This goal reflected the company's focus on short-term performance and its ambition to rapidly improve performance and expand its market share. Achieving this goal required the joint efforts of the management team and core employees. Yili used the equity incentive plan to retain talent and stabilize the workforce, ensuring that the company remained on track to meet its ambitious targets.

### **4.2. Strategic Upgrade—Second Equity Incentive**

In order to further improve the company's governance structure and strengthen its incentive and restraint mechanisms, Yili aimed to align the interests of shareholders, the company, and employees, effectively motivating key technical (business) personnel and other employees, and attracting and retaining key talent. In response to the Sunshine Insurance's shareholding event, the company designed and implemented the second-generation "golden handcuffs," which brought new hope after challenges.

#### Plan Description:

The company proposed to grant 45 million stock options to the incentive recipients, which involved RMB A-share common stocks, accounting for 0.74% of the company's total

share capital (6,064,800,108 shares) as of the day before the incentive plan draft announcement. The exercise price for the stock options was set at 16.47 RMB. A total of 294 employees were granted stock options under this plan, including key technical (business) personnel and other employees deemed necessary for incentive by the company's board of directors. Directors, supervisors, senior management, independent directors, major shareholders holding more than 5% of the shares, or the actual controllers and their spouses or immediate family members were excluded from this plan.

#### Price Description:

The exercise price for the stock options granted in the first round was set at 16.47 RMB.

#### Incentive Sale Conditions:

The lock-up period refers to the time during which incentive recipients are restricted from selling the shares they acquire through exercising their options. The lock-up period regulations for this incentive plan were in accordance with the Company Law, Securities Law, and other relevant laws and regulations, as well as the company's Articles of Association.

#### Performance Overview:

Since the implementation of the second-generation "golden handcuffs" plan in 2016, net profit and earnings per share showed a clear and sustained growth trend, although growth slowed down in 2018. The company's main business revenue showed a continuous upward trend. In 2016 and 2017, the return on equity (ROE) achieved year-on-year growth, while in 2018, the ROE decreased.

In terms of talent attraction, the proportion of employees with a doctoral degree increased from 0.05% in 2016 to 0.07% in 2018, while the proportion of employees with a master's degree grew from 1.22% in 2016 to 1.54% in 2018. The proportion of employees with a bachelor's degree increased from 27.5% in 2016 to 32.33% in 2018.

By 2014, Yili had become one of the top ten global dairy companies, and its chairman set the goal of "Top Five, 100 Billion" for the company in that year. At this time, the dairy industry had entered a mature phase, with intense competition. In order to align employees' and the company's goals and motivate employees to work with enthusiasm, the company once again introduced stock options and restricted stock incentive plans in 2016, linking employees' personal interests with the company's development goals, thus promoting the company's steady and sustainable growth.

### **4.3. Transformation Assistance—Third Equity Incentive**

In order to further improve the company's governance structure, enhance the employee incentive and restraint mechanisms, and strengthen the motivation and constraints on the management team, Yili aimed to fully mobilize management enthusiasm and leadership capabilities, effectively combining the interests of shareholders, the company, and the core team, focusing on company development and promoting the achievement of strategic goals. The implementation of the first and second-generation "golden handcuffs" achieved the expected results, improving the company's structure, enhancing business performance, and refining the incentive and restraint mechanisms, which effectively motivated key technical personnel and other employees, and helped retain business core talents.

#### Plan Description:

The company proposed to grant 152,428,000 restricted stock units to the incentive recipients, with the type of stock

being RMB A-share common stocks, accounting for 2.50% of the company's total share capital (6,097,125,108 shares) as of the announcement date of the incentive plan draft. This grant is a one-time allocation, with no reserved rights. The price for the restricted stock granted under this plan was set at 15.46 RMB per share.

#### Price Description:

The grant price for the restricted stock is set at 15.46 RMB per share.

The grant price was determined by the higher of the following two methods:

(1) 50% of the average trading price of the company's stock on the last trading day before the publication of the incentive plan draft, which is 15.46 RMB per share.

(2) 50% of the average trading price of the company's stock over the last 120 trading days before the publication of the incentive plan draft, which is 14.94 RMB per share.

#### Incentive Sale Conditions:

The lock-up period refers to the time during which the incentive recipients are restricted from selling the shares acquired through exercising their options. The lock-up period regulations for this incentive plan follow the provisions of the Company Law, Securities Law, and other relevant laws, regulations, and normative documents, as well as the company's Articles of Association, and include but are not limited to:

For incentive recipients who are company directors or senior management, the total number of shares they can transfer each year cannot exceed 25% of the total shares they hold in the company. They may not transfer shares within six months after leaving the company.

For directors or senior management of the company, if they sell their company shares within six months after purchasing them, or repurchase shares within six months of selling them, any profits earned from such transactions must be returned to the company, and the company's board of directors will recover the profits.

During the validity period of the incentive plan, if the provisions regarding the transfer of shares by company directors, senior management, or incentive recipients change according to amendments to the Company Law, Securities Law, or other relevant laws and regulations, the transfer of shares by these recipients must comply with the modified regulations at the time of transfer.

#### Performance Overview:

According to the 2018 annual report, the second-generation equity incentive plan implemented in 2016 effectively incentivized and improved the company's performance in the early stages. However, after reaching the second-phase incentive conditions in 2018, the incentive effects started to weaken, despite performance improvement. At this point, designing and implementing the third-generation equity incentive plan helped to sustain and further promote the company's growth.

In 2018, Yili updated its long-term strategic goals, setting the objective to become the world's number one dairy company by 2030, and launched the equity incentive plan in 2019. Unlike previous plans, this time the equity incentives were funded through the repurchase of shares from the market. The repurchased stock not only signaled positive developments to the market and potential investors but also helped improve the company's existing capital structure.

Throughout the evolution of Yili's equity incentive plans, the company demonstrated its keen responsiveness to market

changes and its willingness to embrace innovative strategies. Starting with stock options, then combining stock options with restricted stocks, and eventually primarily using restricted stocks, this evolution reflects Yili's ongoing exploration of incentive mechanisms better suited to its characteristics. This process also embodies Yili's forward-thinking management philosophy and courage in facing challenges.

In terms of the recipients and the proportion of incentives, Yili adjusted the proportion from the first plan, where 60% of the equity incentives were aimed at senior management and 40% at core personnel, to the third plan, where 45.66% of the incentives were allocated to senior management and 54.34% to core personnel. This adjustment highlights the company's increasing emphasis on core personnel and its effort to align their interests with the company's development, thus facilitating the achievement of long-term strategic goals.

In terms of setting incentive conditions, Yili transitioned from initially setting only company-level performance indicators to progressively combining company performance with individual performance. This adjustment strengthened the motivational nature of the incentive plan, making it more than just a welfare tool. For example, the 2019 incentive plan introduced rigorous performance indicators, including a continuous dividend payout ratio of at least 70%, a return on equity (ROE) of at least 20%, and a compound annual growth rate (CAGR) of net profit of at least 8.2%. These standards were extremely stringent in the A-share market, underscoring Yili's pursuit of high standards and high-quality development.

Finally, in the design of the exercise/unlocking period, Yili shifted from an uneven installment approach to a uniform yearly unlocking system, reducing flexibility in exercising and unlocking options. This strategy aims to prevent incentive recipients from avoiding risks, ensuring that employees' interests are tightly aligned with the company's value.

## 5. Conclusion

In conclusion, Yili's equity incentive plans not only reflect its keen insight into market trends but also demonstrate its scientific, personalized, and forward-thinking approach to incentive mechanism design. These plans have effectively facilitated the company's long-term and stable development.

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