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COMMENTARY

Alibaba: Governance by corp politburo

Investors might think it necessary to trade off some benefits in order to skirt around the rules. BY LAWRENCE LOH

WHILE the share prices may stagger, Alibaba's record-breaking New York initial public offering (IPO) in September 2014 has left an indelible mark on the global corporate governance landscape. As the largest ever listing, raising over US$25 billion, the Chinese e-commerce giant has been the focus of much attention among investors and regulators across the world.

Alibaba had initially considered listing in several Asian markets, and this was reportedly its preferred choice. But regulators in key regional markets such as Hong Kong and Singapore were unwilling to bend their stringent listing requirements over shareholder voting rights.

From a governance perspective, the scrutiny of Alibaba stems not from the magnitude of the share offering. Rather, it is in the way that shareholders are treated in the listed Alibaba.

The most notable concern is that shareholders do not have the power to elect directors to the board. Instead, this power is vested in the so-called "Alibaba Partnership", which is a group of some 30 of the firm's original founding members and associates.

After finding the path blocked in Asia, it was the New York Stock Exchange (NYSE) that permitted such unique governance mechanisms as Alibaba's.

US stock exchanges are probably some of the toughest in the world for their listing requirements while the broader regulatory environment is also very exacting and elaborate.

Some found it surprising that the New York IPO deal went through and was agreed so readily. But history shows that American exchanges have allowed differentiated voting configurations among shareholders – with several hundred listed firms in the US having multiple share structures with different voting rights.

Nonetheless, Alibaba's listing drew its fair share of distractors and sceptics. Besides the central contention of shareholder power, the crux of the corporate structure is the unique variable interest entity (VIE) that underpins the IPO.

Investors are actually buying into the shares of a shell company in Cayman Islands which has operating agreements with the "real" Alibaba in China for its revenues and profits. There is obviously an array of inherent risks with this arrangement as shareholders do not get access to the actual Alibaba and is solely dependent on veracity of the agreements across international boundaries.

Market acceptance

Yet, the Alibaba IPO stood the market test. On the first day of trade, the price shot up by a hefty premium of 38 per cent. Alibaba's creative mode of IPO with control by a collective body – Alibaba Partnership – is not a new concept in the Chinese way of governance.

As a nation, China is ruled effectively by the Politburo of the Communist Party of China. So it is not too much of a stretch for some to call the Alibaba method as "corporate governance by politburo".

Indeed, this is probably the next big thing in the so-labelled "corporate governance with Chinese characteristics".

The key question in many observers' minds is whether there will be more Alibaba-style IPOs.

Certainly, Alibaba's share price has declined after the high point a few months after the IPO.

However, analysts pointed to uncertainties in the business environment rather than prevailing issues in corporate governance as the cause of the drop.

While there may be purported business problems in product authenticity and trading practices, it appears that no major governance-centric controversies have arisen other than the persistent hounding of regulatory authorities by specific lobbyists.

If anything, the concerns and risks in corporate governance would have been discounted in the trading price just after the IPO.

So, now that the dust has settled, the question is whether Alibaba will be a forerunner for a new era in corporate governance. Will we see more of such types of governance structures particularly at IPOs?

With Alibaba, it seems that the traditional notion of shareholder democracy has taken a back seat. Or is it too early to tell?

Bandwagon effect

Alibaba may indeed be a beginning of a new trend. However, there may be several conditions before Alibaba-style corporate governance in companies can take off on a wider scale.

First, the company must have market power – it must be a potential game-changer in the industry.

Alibaba has wielded considerable supremacy in being a pioneer in creating online trading platforms, especially in the business-to-business domain. Thus, it virtually controls the market in China and has ambitions far beyond.

Second, the company must have deep pockets, with access to plenty of ready cash.

Alibaba had the fortune of capitalising on its first-mover advantage in its various product lines to amass much financial muscle. More recently, it has embarked on a shopping spree, buying up all types of companies before and also after its IPO as it looks to build its own ecosystem or even empire.

Third, there must be a real constraint in the regulatory environment. Investors might then see it necessary to trade off some benefits to skirt around the rules.

In Alibaba's case, there are restrictions under Chinese laws on foreign control and ownership of the Internet. Thus a VIE has been used together with exclusive rights vested with the Alibaba Partnership.

Stock exchange challenge

Perhaps the more crucial question is how exchanges can position themselves with the possible advents of creative forms of corporate governance.

Exchanges must adapt to innovations as every company in any country faces an extremely context-specific set of circumstances driving its corporate decision-making. In an increasingly complex business world, there is no one-size-fits-all solution.

There are probably many pros and cons in the IPO style used by Alibaba, just as dual class share structures have gone through intense debates in the US.

Ultimately, as long as there is full disclosure upfront and those in control do not alter the structures after the IPO, it is perhaps acceptable.

In any case, investors know full well what they are buying into, and they buy with their eyes open.

Alibaba is probably not a one-shot phenomenon. There will be others. Eventually, it will not be China-specific or Asia-specific; it may well be a new global wave, just like any corporate governance innovation can happen anywhere.

There is optimism in seeing more Alibabas coming on to the scene.

As they often allude to in the US, what is good for General Motors is good for the country. In our case, what is good for Alibaba is probably good for China. The debate is whether corporate governance is being altered to serve this good for one country, and less for the world.

For investors looking at corporate governance, it is still the maxim of caution that rules the day – high risk, high return. While on the other side of the coin, there is of course also no risk, no return.

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Alibaba's record-breaking New York IPO in September 2014 has left an indelible mark on the global corporate governance landscape. PHOTO: REUTERS

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