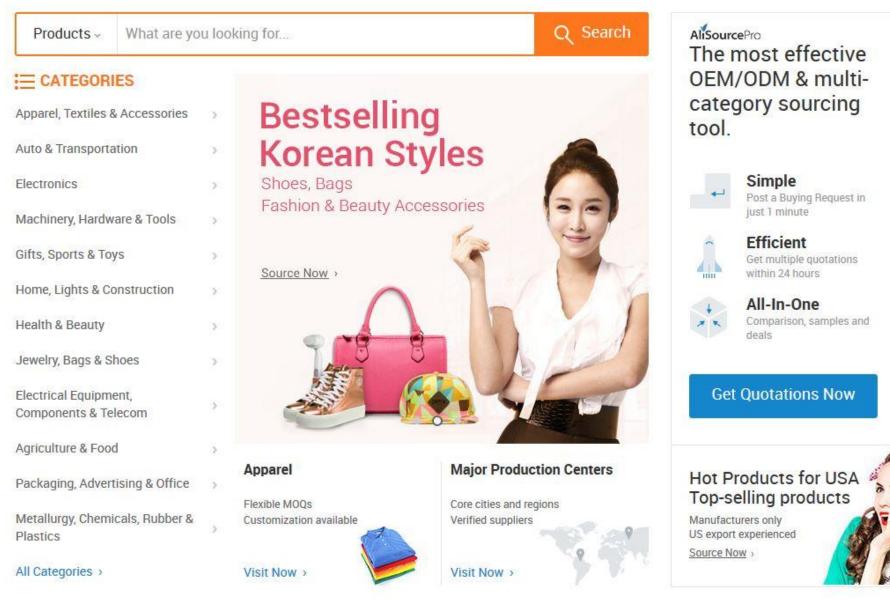
Alibaba and Corporate Governance

Alibaba

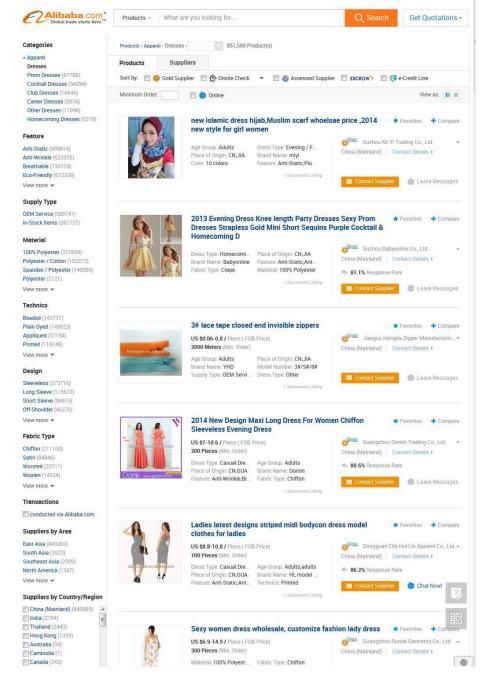
- Founded in 1999
- Consumer-to-consumer (Taobao), business-toconsumer (Tmall), business-to-business portals
- Also have payment services (Alipay), search engines, cloud computing
- Operates mostly in China, accounting for 80% of country's online sales (60% of parcels delivered!)
- 279 million active users

About Alibaba Group

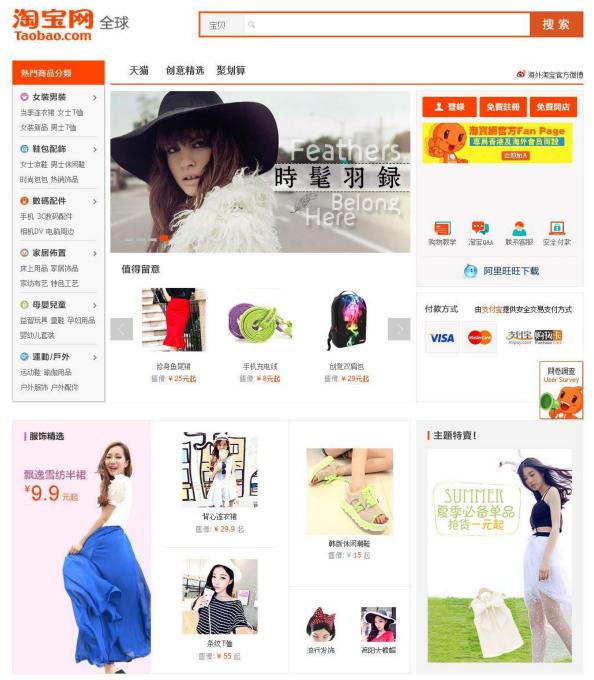




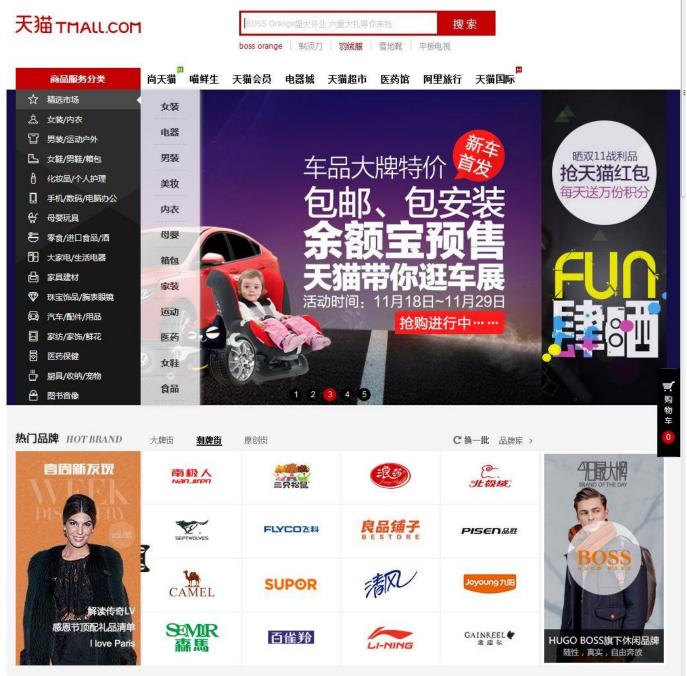
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Alibaba's IPO

- September 18, 2014: shares were initially offered at \$68, raising \$21.8 billion
- September 19, 2014: shares (BABA) started trading on the NYSE at an opening price of \$92.70
- Largest IPO in US history
- China forbids foreign ownership, so shares are in a shell corporation in the Cayman Islands, which has a contractual claim on Alibaba's profits

Issues

- What kinds of investor protections exist in the Cayman Islands?
- What is the nature of the contract between Alibaba and the shell corporation?
- Is that contract legally enforceable?

What is a corporation?

- Lawyers: a corporation is a legal business structure that establishes the business as being a separate entity from the owners.
- Economists: a corporation is a bundle of contracts.
- Essential characteristics: limited liability for investors, free transferability of investor interests, legal personality, centralized management
- Important legal form starting, especially, in 19th century (technological advances brought economies of scale and need for capital investment)

- Corporate governance deals with the mechanisms for aligning the interests of managers with those of (controlling) shareholders while protecting the interests of minority shareholders, debt holders, financial markets, employees, customers, supplier, and society at large.
- In short, good corporate governance prevents expropriation of outside investors.

Lots of ways to steal

- Excessive executive perks
- Excessive executive pay
- Empire building
- Risk-shifting
- Self-dealing
- "CEO and COO Disappeared, Most of the Company's Cash Missing." Ultrasonic. September 12, 2014.

How is stealing prevented?

- Enforcement of accounting laws, conflict of interest laws, reporting regulations
- Power of shareholders to replace directors
- A functioning legal system that allows shareholders to file lawsuits against directors for breach of fiduciary duty
- Legal structure (common versus civil law) and financial structure (market versus bank-based) have been shown to be important in protecting investor rights

Alibaba

- According to the Alibaba perspectus:
 - The "Partnership" will nominate a simple majority of the board of directors.
 - The board of directors will make decisions on compensation, management succession, acquisition strategy, business and financial strategy.
 - If our contractual arrangement is found to violate current or future laws of the PRC, PRC authorities would have broad discretion to amend or discontinue the arrangement.
 - Conflicts of interest may arise.

SEC

 These "contracts are only binding and enforceable if Chinese courts are willing to uphold them. For US investors, a major risk is that the Chinese shareholder...will steal the entity, ignoring the legal arrangements on which the system is based."

Additional issue with Alibaba

 Crovitz, L. Gordon. "Alibaba: Too Big to Expropriate?" The Wall Street Journal. September 21, 2014. MIT OpenCourseWare http://ocw.mit.edu

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