

Flash Commentary: Corporate Governance

Alibaba: Uniquely Conflicted



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With Alibaba's first annual meeting scheduled for October 8, we conducted an examination of its corporate governance structure. At the time of its IPO last year, we [wrote](#) that what the company calls its "hybrid" corporate governance structure maintains insider control not through a dual-class voting structure but through the director nomination process. Under the company's bylaws, the Alibaba Partnership, an insider group chosen by founder Jack Ma, retains the right to elect a majority of board seats.

The company's 2015 annual report includes the following among dozens of Risk Factors:

- *The Alibaba Partnership and related voting agreements limit the ability of our shareholders to nominate and elect directors.*
- *The interests of the Alibaba Partnership may conflict with the interests of our shareholders.*
- *Our articles of association contain anti-takeover provisions that could adversely affect the rights of holders of our ordinary shares and ADSs.*

We are not aware of another corporation that lists its corporate governance structure as a risk to shareholders. In fact, numerous concerns about the company's corporate governance have been widely cited:

- The board is majority non-independent;
- The board is classified;
- The company lacks independent audit or compensation committees;
- The company provides little information about executive compensation;
- The company has only one woman on its board;
- The company discloses little about sustainability, and lacks robust sustainability oversight at the board or management level.

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Moreover, the company discloses numerous related-party transactions, particularly regarding Jack Ma. For example, regarding Alipay, the company's online payment platform, the annual report notes:

We do not control Alipay or its parent entity, Ant Financial Services, over which Jack Ma effectively controls a majority of the voting interests. Accordingly, if conflicts arise between us and Alipay or Ant Financial Services, including conflicts that could threaten our ability to continue to receive payment services on preferential terms or conflicts relating to commercial opportunities that we or Alipay or Ant Financial Services wish to pursue, such conflicts may not be resolved in our favor and could have a negative effect on our ecosystem and materially and adversely affect our business, financial condition, results of operations and prospects. Moreover, conflicts of interest may arise due to Jack Ma's role as executive chairman of our company and through his voting control over and his economic interest in Ant Financial Services, and he may not act to resolve such conflicts in our favor.

We are particularly concerned that the chairman of the company may have conflicting interests with regard to another entity that provides a key part of the company's service.

Controlled companies commonly employ governance structures designed to entrench insider control. However, as the annual report acknowledges, trust is critical to the success of "sharing economy" and e-commerce companies such as Alibaba. The first Risk Factor identified observes that:

Maintaining the trusted status of our ecosystem is critical to our success, and any failure to do so could severely damage our reputation and brand, which would have a material adverse effect on our business, financial condition and results of operations.

In fact, Alibaba's integrity has been challenged multiple times in the first year of its existence as a public company. As we [reported](#) earlier this year, the Chinese State Administration for Industry and Commerce (SAIC) published a "white paper" alleging that counterfeiting was common on Taobao, the company's peer-to-peer website. After discussions with Jack Ma, SAIC removed the "white paper" from its website without a detailed account of how the issue was resolved.

More recently, an article in *Barron's*¹ argued that the share price of the company was likely to fall substantially. Among other arguments, the article challenged

¹ "Alibaba: Why It Could Fall 50% Further," Jonathan R. Laing, *Barron's* September 12, 2015

the plausibility of the company's growth figures. Following this article, the shares of the company fell more than 10% and currently trade at 38% below the IPO price. The company has published its own report that seeks to refute the arguments made in the *Barron's* piece.

We have no insights into the factual merit of these or any other allegations. However, the company's lack of independent oversight raises questions about whether shareholders can have confidence in the company's reported figures, or in its responses to other questions about the integrity of its businesses.

Shareholders may also ask a more troubling question. If the company's own disclosures raise concerns about its corporate governance structure; if these disclosures also acknowledge that the company's chairman has multiple conflicts; and if no disclosures are made about the incentive structure provided by its executive compensation scheme, then the company is implicitly acknowledging that it is not designed to be managed for shareholder benefit. Jack Ma has explicitly asserted that the company exists first for the benefit of customers, then employees, and finally shareholders. But it is hard to understand how a lack of transparency and accountability promotes the interests of these non-financial stakeholders either. And so, the question remains: if not shareholders, customers or employees, then whom?

Alibaba (BABA): \$57.82 (September 29 closing price)



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