

Harvard Law School Forum on Corporate Governance

Alibaba: A Case Study of Synthetic Control

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Editor's Note: [Jesse M. Fried](#) is Dane Professor of Law at Harvard Law School and [Ehud Kamar](#) is Professor of Law at Tel Aviv University Buchmann Faculty of Law. This post is based on their recent [paper](#). Related research from the Program on Corporate Governance includes [The Perils of Small-Minority Controllers](#) by Lucian Bebchuk and Kobi Kastiel (discussed on the Forum [here](#)).

Alibaba conducted a record-breaking IPO six years ago on the New York Stock Exchange and is now valued at over \$500 billion. The firm, founded by Jack Ma and others, is now the most valuable Asian public company, as well as the world's largest ecommerce company and seventh most valuable firm. In a paper recently posted on SSRN, [Alibaba: A Case Study of Synthetic Control](#), we explain how this giant firm is controlled.

Alibaba is known for its unique governance structure: a majority of Alibaba's board is nominated or appointed by the so-called Alibaba Partnership, which consists of several dozen individuals. Thus, the Partnership controls Alibaba. However, as Lin and Mehaffy (2016) show, the Partnership itself is effectively controlled by a much smaller Partnership Committee that includes Ma as a perpetual member. Control of Alibaba is therefore in much fewer hands than might first appear.

Our paper digs even deeper into Alibaba's control arrangements and reveals a surprising fact: Ma, who owns less than 5% of Alibaba, effectively controls Alibaba by himself—control that would persist even if his equity stake declined further. The reason is that Ma's control over Alibaba is not based on his equity but rather on his control of a different firm, Ant Group.

We show that Ma's control of Ant Group gives him two sources of power over Alibaba.

First, Ma can effectively control the Partnership Committee, and thus the Partnership, and ultimately a majority of Alibaba's board. Lin and Mehaffy (2016) have already demonstrated that the Committee controls the Partnership, which in turn controls Alibaba's board. We show that Ma controls the Committee because several of its members are employed by Ma-controlled Ant Group, and thus Ma can cause them to be terminated (from Ant Group, the Partnership, and the Committee).

Second, Ma can use individuals he dominates to at least temporarily cut off (if not permanently seize) licenses that are critical for Alibaba's business but are held by other firms. The ability to seize these licenses gives Ma substantial holdup leverage over Alibaba. The reason Alibaba's key assets are held by other firms is that Chinese regulations prohibit foreign entities like Cayman-domiciled Alibaba from possessing business licenses in sensitive sectors, like the internet and media. To get around this prohibition, Alibaba keeps these licenses in so-called variable-interest entities (VIEs) that are 100%-owned by Chinese nationals and that, via a set of contracts, purport to give Alibaba effective control and ownership over these assets.

The ten individuals who own Alibaba's VIEs include nine Alibaba executives (all but one of whom are partners in the Alibaba Partnership) and one Ant Group executive (who is also a partner in the Alibaba Partnership). Because Ma's position as the controller of Ant Group enables him to dominate not only Ant Group executives but also any member of the Alibaba Partnership and any Alibaba executive who is not a partner, Ma dominates all of the individuals who own the VIEs.

The enforceability of the VIE arrangement in China is uncertain, as Chinese contract law invalidates contracts that seek to achieve an illegal objective under the guise of otherwise legal acts. In the past, government officials have occasionally barred the use of VIEs, required them to be dismantled, or found them to be invalid.

We argue that Ma can exploit this legal fragility to gain leverage over Alibaba. In particular, he could have the VIEs' owners threaten to refuse to honor the VIEs' contracts with Alibaba unless his demands were met, knowing that Alibaba would not sue for fear that the VIE arrangements would be declared void and its business would suffer. A Chinese insider has already followed this script to extract value from Nasdaq-listed GigaMedia.

Our study of Alibaba shows that the separation of ownership from control in public firms, which has been at the center of all corporate governance debates in the last few decades, can arise without pyramidal ownership structures or dual-class shares. We show that an entrepreneur can control a firm without any equity, but rather via a combination of charter provisions and arrangements external to the firm and independent of its capital structure.

We do not know how Ma will wield his power in the future and whether public investors will be harmed. But control matters, and given Alibaba's size it is important to understand who controls it.

The complete paper can be found [here](#).

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