A STUDY ON THE DUAL-CLASS SHARE STRUCTURES OF OVERSEAS LISTED COMPANIES-- TAKING ALIBABA GROUP AS AN EXAMPLE

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ABSTRACT

At present, more and more Internet technology companies in China have chosen to go public overseas. Most of them have adopted the Dual-Class Share Structure, while Chinese mainland and Hong Kong laws temporarily do not allow companies to adopt such equity structure arrangements. Compared with the "one share one vote" structure, the dual-class share structure can guarantee the founder and his team's control over the company, which is beneficial to the company's continuous operation and long-term development, but it also brings some problems to corporate governance. Alibaba has successfully listed in the United States with the help of the atypical dual-class share structure ownership "partner system", which has aroused people's thinking about the dual-class share structure. This article takes Alibaba as an example to analyze the advantages and risks of the dual-equity structure in corporate governance, and put forward corresponding suggestions for the "landing" of dual-class share structure in China.

Keywords: Dual-Class Share Structure; Partner System; Suggestions.

INTRODUCTION

In recent years, many outstanding enterprises in China have gone out of the market on overseas capital markets and a large number of high-quality resources have been lost to foreign capital markets. Many of these companies adopted the capital structure model of dual-class share structure in the first IPO. As the self-governance demand of Chinese enterprises, especially scientific and technological innovation enterprises is further limited, the contradiction between self-governance and the system of "one share one vote" will become more severe. It is necessary for regulatory authorities to make appropriate institutional reforms timely and innovation in accordance with the governance needs of enterprises. When Baidu landed on the Nasdaq in the United States in August 2005, it issued Class A shares and Class B shares. The voting rights of the latter were 10 times that of the former. Jingdong was listed on Nasdaq in the United States in May 2014. The Class A shares and Class B shares were issued. The latter had 20 times the voting power of the former. In September of the same year, Alibaba was listed on the New York Stock Exchange of the United States and used its own "Lakeside Partner System", which have 28parters. The nomination of the majority of directors in the board of directors is to give the company's founder "super-voting power," which is still essentially a dual-class share structure. The dual equity system is a product of the demand for corporate governance system innovation, and it is a breakthrough to the system of "same shares and same rights". Under this system, common stocks are usually divided into A and B types. Among them, Class A ordinary shares have one voting right per share, and Class B ordinary shares have multiple voting rights per share, which usually have ten or more. There are two ways to realize the dual-class

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share structure. One is to issue two types of voting rights in the IPO; the other is based on the one-for-one equity structure, and through the split share structure, which becomes a dual-class share structure. The dual-class share structure system design better solutions of the contradiction between the maintenance of control rights and equity financing. In accordance with the principle of the same shares and the same rights, the equity financing method will inevitably dilute the control rights of the founder of shareholders, and there is even the risk of transfer of control rights. The implementation of the company's business policy strategy has a negative impact. This article combines the events of Alibaba's listing on the New York Stock Exchange of the United States to analyze how Alibaba's partner system is realized. Then we discusses the advantages and disadvantages of the dual-class share structure and proposes corresponding recommendations and measures for implementing this structure in China.

LITERATURE REVIEW

(A)Agency Theory

The traditional principal-agent theory (Jensen and Meckling, 1976) aims to solve the conflict of interests between the shareholders and the managers under the conditions of the separation of the two rights. Under the condition of asymmetric information, operators as agents may use information advantages to seek their own interests. As an agent, managers advocate individualism and opportunism, which pursue higher job rights and material rewards, and thus increase agency costs. As we all know, the relative concentration of equity in China, and even the phenomenon of "only one share" is extremely common,which leading to more prominent second-type agency problems. In the dual-class share system, the founders tend to dominate the control of the company by holding a majority of voting shares, which resulting in a significant increase in the separation of powers. At this point, the internal shareholders have the vast majority of capital operation rights, but they pay very little capital, the rights and responsibilities,which are highly mismatched. This may lead to more serious agency problems and higher agency costs. Masuliset al. (2009) Take the example of a dual-class share structure firm in the United States. It is found that the greater percentage of managers who have overtaken cash flow rights and control the residual control rights, the greater motive for them to pursue private income, the excess demand for remuneration, and the reduction in the value of capital expenditure. It is an important channel for private income. This confirms the intensification of the agent contradictions in the dual-class share structure, and the traditional principal-agent theory opposes the dual equity structure with different shares of the same shares. However, in the dual-class share structure, the theory is more specific. Operators are usually formed by the founding shareholders of the company, which forming a typical insider control, and benefit convergence coexist. Different from the first type of agency problem, the control rights of the managers in the dual-class share structure are statutory in nature. Shareholders cannot restrict the behavior of the managers through equity incentives and power constraints. The replacement of board members is difficult and costly, which may lead the hard work for the managers to decline (Chen Yuxi and Shi Fang, 2014). On the contrary, the statutory power of control may also bring advantages. When the company faces an acquisition, the dual-class share equity can greatly enhance the advantages of management negotiation and help maintain or increase the value of the company. Moreover, when the founder, who as the operator, leading the development of the enterprise.It usually expects the company to develop rapidly and permanently. This is the interest of the shareholders on line. At this time, the operator's innovation and investment motivation are stronger, which will benefit the creation of sustainable growth value. The dual-class share system stabilizes the control of the enterprise from the institutional level,which provides the guarantee for the above development motivation, and the interest convergence effect is enhanced.

(B) Stewardship Theory

The stewardship theory was proposed by Donaldson (1990) is based on the two mutual exclusion theories which generated by the static principal-agent relationship. The conflict lies in the manager's role. The basic assumption of the stewardship theory is that managers are social people and tend to be collectivism and cooperativeism; the interests and goals of the operators are in line with the shareholders, that is the value of the company (shareholders) is maximized. There are obvious differences between the stewardship theory and the principal-agent theory. First, the managerial theory is based on psychology and sociology. He believes that managers, as housekeepers, use self-realization as their internal incentive motive,which pursue high-level spiritual satisfaction and have a stronger sense of organizational identity, who tend to use expert authority and influence. To influence the behavior of management organizations, rather than through the mandatory control of position power; Second, the managerial theory is based on the collectivist values of participation-oriented mutual trust. It is believed that the power distance in the organizational environment is relatively small and the organizational members ,which are united and harmonious to create value. The realization of value is a common goal. Third, in the time dimension, enterprises in the early stages of development are more dependent on the intellectual capital of the operators. There is no significant conflict of interest between the shareholders and the managers. At the same time, the leadership and power of the managers are at the beginning of their careers Low and high work enthusiasm.Therefore, in the early stage of business development or the beginning of the manager's tenure, butler theory has a stronger explanatory power. As a result, the stewardship theory holds that managers often assume the role of stewards, pay scarce intellectual capital, use personal authority and influence to lead the development of the enterprise,Also they have achieved self-realization through the achievement of enterprises and creation of value, which provides strong support for dual-class share equity.

(C) Human capital theory

The American economist Schults (1960) made a speech on "human capital investment" at the annual meeting of the Economic Association,who was one of the founders of the human capital theory. He suggested that human capital is the capital that is formed by investing in the laborers, including all kinds of knowledge, management techniques, and their physical qualities that they possess. This kind of capital can enable them to benefit from economic activities and value. ,which is an important driving force for economic growth. Zhou Qiren (1996) regards enterprises as a special contract between human capital and non-human capital, and analyzes the differences between the two, who were pointing out that human capital cannot be separated from its carrier, and there are features that cannot be oppressed but can only be stimulated. Therefore, human capital Share ownership should get together with non-human capital. Fang Zhulan (2013) also advocates that human capital shares the ownership of enterprises. He believes that human capital is specific and corporate, and that it is more difficult to withdraw from enterprises than non-human capital. Therefore, it assumes that they have the business risks of the company and creates human capital. Add the ability of corporate wealth, which point out the share of corporate ownership will become a trend.

A Comparative Analysis Of The Dual-Class Share Structure And Equal Shareholder-Right

(A) Concept definition

The dual-class share structure are also known as the dual-class structure and the dual-system equity structure, which refers to the company's issuance of two shares with different voting rights for public shareholders and founders, thus realizing the founder and Management's effective control over the company's ownership structure. The voting rights of shareholders in the equal shareholder-right structure are entirely determined by the proportion of shares held, and it is not allowed for one share to enjoy multiple voting rights. This principle is considered to be a manifestation of capital democracy. It is also an effective restraint mechanism that is conducive to maximizing the interests of shareholders. Under the dual ownership structure, companies generally issue two types of stocks, A and B. The difference is that the number of shares held by a Class B share is more than (usually 10 times) A shares. Among them, Class A shares are publicly issued, while Class B shares are not publicly traded. They are held only by those who have close interests with the company, such as founders and their families. This design allows B-share holders, represented by the company's founders, to gain a firm grip on control and avoid the company's major transactional decisions being overly interfered with by outside investors.

(B) Revenue claim and control

Under the equal shareholder-right structure, the shareholding ratio of shareholders determines the voting rights they have.From another perspective, the claims for proceeds are consistent with the control rights of the company. Shareholders are not only bring cash flow to the company, but also affect the company's decision-making to a certain extent, and obtain dividends from the company. Under the dual-class share structure, these rights began to separate. Obtaining a stock does not necessarily mean that you will gain control. In this situation, shareholders are more likely to have a cash flow impact on the company, which greatly diminishes the role of shareholders in corporate decision-making. The dual-class share structure refers to the company's issuance of two types of shares, of which one type of shares is mainly held by public shareholders and has limited voting rights. The second type of shares are mainly held by founders and management, which have enhanced or "super" voting rights .The effect of voting rights is the corporate governance,which separated from economic participation.

(C)Agency costs

The equal shareholder-right structure can protect better in the interests of shareholders. Shareholders can exercise restraint on the board of directors and management through their voting rights. When there are serious problems in corporate governance, they can even remove the existing board and management to protect their own rights and interests. The majority of shareholders of the company are speculative and investment shareholders. They are only paying attention to short-term interests, and do not pay attention to the long-term development of the company, which lack the passion and motivation.They have participated in the general meeting of shareholders to exercise their voting rights, and the phenomenon of “free-riding” is prone to occur. The dual-class share structure usually allows the voting power to be concentrated in the company’s founders or senior executives. They are likely to exercise the responsibility of managing the company because they do not have the risk of losing control. They will lead to a significant increase in the company's operating risk, and it is very likely that the interests of the rest of the shareholders will be damaged. The dual-class share structure can enable companies to change from short-term commitments to long-term guidance, which create a good and stable environment for the management of the company.They can achieve business objectives whch based on long-term planning, and reduce the short-sighted behavior that caused by the market supervision of external control rights.

(D)Range of application

There is no specific scope of application of the equal shareholder-right structure. All industries companies can adopt traditional ownership structures;and companies that adopt dual-class share structures are mostly from emerging technology industries and family-owned companies. Their common features are founders or the core of shareholders hope to firmly hold the company's control in their own hands. For family businesses or hi-tech industries, super-voting rights that can be inherited means that control over the company does not fall into the hands of family members or shareholders outside the founder. For emerging technology industries such as the Internet industry, companies often have huge external financing needs in the early days of their businesses. Due to the dilution of shares ,the dual-class share structure can prevent loss of control, and can also prevent competitors from hostile takeovers.

Analysis of Alibaba's dual-class share structure

(A) Background of Alibaba dual-class share structure

Alibaba Group was founded by Ma Yun in 1997,who with 17 other people in Hangzhou, Zhejiang. After nearly 20 years of operation and development, Alibaba has become the top e-commerce giant in China, which ranking first in the world, and its annual net profit exceeded. 200 billion U.S. dollars. However, in this process, Alibaba Group experienced several large-scale financing and dilution of equity, and the resulting control of the company's control also caused strong external concerns. On August 11, 2005, Alibaba, which was in a rapid growth phase, formally acquired Yahoo China's entire assets for entering the search field. As a consideration, Yahoo will hold 40% of Ali's shares and 35% of voting rights, becoming the largest in Alibaba. Shareholders and occupy a seat in the board of four seats. According to the agreement at that time, Yahoo's seat on the board of directors will be increased to two positions from October 2010. Yahoo, Softbank and Alibaba's management will occupy 2:1:2 seats on the board of directors. Investors will occupy a dominant position in the Alibaba Group's board of directors. The "Alibaba Group CEO Ma Yun will not be dismissed" clause will also expire, which means that Ma Yun may face the risk of being "sweeped out". In order to "recapture" control of the company in May 2012, Alibaba repurchased 20% of Yahoo's holdings at a price of US$7.1 billion. In this transaction, Yahoo agreed to give up the right to appoint a second board member and ensure that the original board structure is not changed. However, for Ma Yun, the issue of corporate control has not yet been completely resolved. After the share repurchase, Softbank and Yahoo became the first and second largest shareholders of Alibaba Group, which together accounted for 56% of the shareholdings (Table 1). This shareholding structure means that if Alibaba Group follows the same principle of "rights" is listed on the capital market. The management of Alibaba headed by Ma Yun and Cai Chongxin will lose the nomination advantage on the board of directors and lose control over the board of directors and even the entire company. In order to solve this problem, Alibaba Group began to formally implement the "partner system" in 2013 to ensure that the senior management team can still firmly control the company's control power when the shareholding ratio is low.

Table1: Sharehold Structure of Alibaba Before they have the Partnership System

Shareholder	Shareholding ratio
Softbank	34.4%
Yahoo	22.6%
Jack Ma	8.9%
Joseph	3.6%
Other shareholders	31.5%

(B) Alibaba Group's "Partner System"

The purpose of establishing Alibaba's "partnership system" is to consolidate the existing control rights of the founders and management which setting up a "Alibaba partner" special authority. On February 24, 2017, Alibaba Group announced the addition of four partners. As of now, the total number of Alibaba partners has increased to 36. The core rights of partners include the right to nominate and appoint members of the board of directors. In accordance with the system design, the directors are nominated by partners that they must occupy more than half of the seats in the board of directors. If the partners nominate or appoint a few directors due to special reasons, the partnership has the right to appoint additional directors to ensure that he has more than half of the principle. In addition, if the shareholder disagrees with the candidate nominated by the partner, the partner has the right to appoint a new temporary director and that is valid until the next year's general meeting; if the director leaves the company for any reason, the partner has the right to appoint a temporary director to make up for it. Vacancies are valid until the next year's general meeting of shareholders. Through this mechanism, Alibaba partners has the right to nominate and appoint beyond the general meeting of shareholders in fact, that the most of the candidates on the board of directors under essence controls, thus ensuring the control over the company's operations and management. Alibaba Group's partners are essentially Alibaba's senior management team headed by the founders of Ma Yun and Cai Chongxin, who have made outstanding contributions to the development of the Group. According to the disclosure of the Alibaba Group prospectus, Alibaba's partner's selection criteria are very stringent. He has to serve at Alibaba for at least 5 years and holds shares in the company, and is recommended by existing partners and more than 75% of the partners vote in favor. It can be one of them. In addition, Alibaba partners ,Softbank and Yahoo have reached a matching agreement to further consolidate the partners' control over the company. According to Alibaba's prospectus, the board of directors has a total of 9 members. Alibaba partners have the right to nominate 5 of them. If Softbank's shareholding ratio exceeds 15%, it is entitled to nominate 1 person. The remaining 3 places are nominated by the Board Nominating Committee. The directors will be elected at a simple majority in the general meeting of shareholders. According to the agreement, Alibaba Partners, Softbank and Yahoo will support each other in voting at the general meeting to ensure that Alibaba can not only gains control of the board of directors, but also controls the voting results of the general meeting of shareholders. Under such system design, Alibaba partners achieved control of the board of directors through the nomination and appointment of directors, thus gaining control of the entire company. Through the design of this system, the veto power of shareholders has actually been emptied. The significance of the election of the directors of the shareholders' meeting is essentially to arrange for the shareholders' representatives which have participated in the operation of the board of directors as a minority of directors, and the partners obtained the company through the way of holding majority of the nomination rights of the director's control.

(C) Relationship between "Partnership System" and Dual-class share structure

From the specific design of the "partnership system", it can be seen that this system and the traditional dual-class share structure have essentially the same design motivations and operational ideas, there are many improvements and innovations in the specific operation methods. Alibaba's "partnership system" is a "weakened" dual-equity structure in fact. On the one hand, it actually controls the decision-making power of major affairs by controlling the nomination rights of the company's directors and the veto power of the general shareholders' meeting. The right is open to shareholders; on the other hand, it prevents the minority founders from having too many voting rights and super voting rights. The problems that the hereditary problems may bring in the future,which will ensure the quality and vitality of the partner team. Compared with the traditional dual ownership structure, the "partnership system" is a kind of inheritance and innovation. While achieving the purpose of controlling the company, it avoids that the negative problems such as the founder's dictatorship brought about by the traditional dual-class share structure. By comparing the traditional dual-equity structure with Alibaba's "partnership system", it can be seen that the core of both is currently allowing some shareholders to have "privileges" relative to other shareholders ,and to control the general meeting and the board of directors.The former is enabled holders of Class B shares to hold their own decision-making power over the company’s major affairs by taking control of the absolute voting rights in the shareholders’ general meeting, and the “partnership system” is at the board of directors of modern enterprises. "The trend" is a unique way to ensure that the board of directors is placed under the control of the partner by nominating a majority of directors, so that the decision-making power of major affairs and the control of the company are in the hands of partners.

Domestic dual-class share structure proposal

(A) Clarify the legal status of dual-class share structure

Since China has implemented a comprehensive strategy for reform and opening up, it has achieved certain results. During the formation and development of the capital market, the highly concentrated equity structure is gradually shifting into a relatively decentralized direction. This is a dual-class share structure. The establishment of the system in our country offers possibilities. The relative dispersion of equity may allow companies to change from short-term commitments to long-term guidance, which is more conducive to long-term development. Equity is relatively decentralized to effectively implement power checks and balances, so that the behaviors of founding shareholders and managers can be more effectively monitored. At this time, managers are more likely to control the company through strategic implementation rather than just financial means, and which are willing to undertake more. Big risks create maximum value for the company. The cost of a series of corporate governance brought about by the implementation of the single-equity system now restricts the company's management and development. The company's laws should eliminate the existing rigid single-equity structure system design, clarify the status of the "double equity" system in the law, and continuously improve corporate governance. It is also beneficial to the function of the company's external governance mechanism, so that the company can develop steadily and healthily. Listed companies should be allowed to independently choose to classify the company's equity and determine the type of stocks to be issued. This gives the founding shareholders a right and changes China's shareholding structure. Drawing on the practical experience of the United States,which taking into account the gradual nature of the implementation of equity diversification in China, allowing the establishment of a dual-class share structure, the establishment of super-voting stocks. In this way, the founder can control the equity by holding the super-voting shares. However, when setting up the super-voting rights, we must also pay attention to limiting the proportion of voting, not too high to cause the founder to become a monopoly; the same can not be set too low to play the role of the dual-class share structure. At the same time, if founders and senior managers in dual-class share structure enterprises exit or transfer, they must convert the held super-voting shares into ordinary shares, and they must not allow such restrictions on the circulation of shares in the market.

(B) Improve relevant legal systems

The effective implementation of the dual-class share structure system concept also requires the continuous improvement of relevant laws and regulations. This is a key factor in achieving the transformation of equity from centralized to decentralized. It can not only promote the establishment of a sound internal control by listed companies, but also operate according to law, and can also reduce risk of the investment of small and medium shareholders.

a. Improve the constraints on founding shareholders and the protection mechanism for the interests of small and medium shareholders

The most prominent cost of the dual-class share system is the monitoring of costs, and there are also problems with the equal shareholder-right system. The high concentration of control rights makes it impossible for medium and small shareholders to form effective supervision and control over controlling shareholders. With a high degree of separation of control and income rights, the controlling shareholders can easily infiltrate their private interests into the company and damage the interests of small and medium shareholders through the board of directors and management. Under the condition that the supervision mechanism is not sound, there is currently no effective supervision method for controlling shareholders. Therefore, in the absence of effective control of the moral hazard of shareholders,which drawing on the experience of the United States.It is possible to limit the company’s business objectives and manager’s powers through the articles of association, and shareholders can pursue the losses caused by the managers’ excess actions to shareholders and the company in accordance with the law; To prevent or reduce the abuse of power by the directors of the company through legislation that stipulates procedures for penalizing parties who have caused various consequences for violations of rights, so as to protect the interests of shareholders, creditors and the society as a whole, and to balance the high concentration of control rights. To a certain extent,the issue of distribution of shareholder interests under certain circumstances, prevents directors from infringing on the interests of the company and shareholders, which is conducive to the sustainable development of the company.

b. Implement strict information disclosure system

The obligation of information disclosure is one of the important obligations imposed on the company by the securities law, and it is also an important measure to protect the rights of third parties and other investors. Under the strict information disclosure system of the United States, when listed companies issue different shares with the same shares, they must state the relevant facts in written form so that investors can decide whether to purchase; when a major situation occurs, public disclosure must be made to all investors; The company’s founder or management’s abuse of power, which leads to a reduction in company’s performance, that also bears the responsibility of truthful disclosure and even faces the risk of being held accountable for relevant legal liabilities. The strict information disclosure system of the United States has played an important role in preventing fraud and protecting investors, which effectively coordinating the conflicts and conflicts between investor protection and market efficiency.

c. Establish perfect class action system

When the dual-class share structure company violates statutory or contractual obligations to infringe on the rights of non-voting or low-voting holders, the United States has also established a comprehensive system of class actions. Mary Kai Kane, an American scholar, believes that: “A class action lawsuit is a system that allows one or several persons to sue or be sued on behalf of themselves or others who claim to have been similarly infringed or otherwise infringed.” The definition of China’s group lawsuit is: “Legally allow one or several persons to bring suit on behalf of other people who have common interests. The judgment of the lawsuit is valid for all common stakeholders.” This kind of post-relief measures is to protect the market. Many small and medium-sized investors are undoubtedly more effective.

CONCLUSIONS

With the historic advancement of the global economic and financial integration process, the internationalization of corporate governance has also become an inevitable trend. The practice of Alibaba’s dual-class share system shows that the dual equity system is conducive to the development of Internet and other technological enterprises. In fact, the dual-class share structure and the equal shareholder-right structure are all the choices of the company's equity system and should have the same legal status. At the same time, as an economic organization that pursues interests, the company’s dual-class share structure is closer to the company’s essence and can promote the long-term development of the company. Judging from the experience of the dual equity system implemented by the United States, the company’s management and development require relevant laws and regulations to improve the company’s shareholding system, which break through the single design of the same shares and the same rights, and allow the establishment and development of dual equity structures in China. The broadening of the road to development has also injected new vitality into China’s capital market. The dual-class share structure is a double-edged sword. The disadvantage is that it may lead to more serious insider control and intensify agent conflicts. However, its advantages can broaden corporate financing channels; balance the distribution of corporate rights; and maintain the stability of corporate control. Of course, at present, China's market conditions and legal environment are not yet mature, and the risk of fully implementing the dual-class share system is extremely high. We should adopt a step-by-step approach to gradually liberalize the system to avoid excessive market reactions and unnecessary losses.

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