Alibaba and the Rise of Law-Proof Insiders

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Praises

- Paper raises three intriguing questions using Alibaba as the reference

  - CG rules seem to emphasize substance without much regard for enforcement when it comes to certain types of firms

  - CG rules have an inherent inequality in the treatment of domestic and foreign firms → with respect to disclosure and compliance requirement → with respect to ability of enforcement

  - Listing may not be a signal for bonding with higher CG standards but an effort to escape them → one needs to be watchful of foreign firms trying to list in domestic markets

- The paper provides a microscopic look
  - into ownership and governance structure of Alibaba
  - of the relevant US corporate and security laws governing listed firms
  - of facts related to enforcement → rules on the ground → lot to learn
Ability and incentives of CS to execute value reducing actions

- Value reducing actions
  - Unending dissipation
  - Rapacious tunnelling

- Ability to execute these actions
  - Action (a) requires controlling shareholders to be non-significant owners
    → thus other shareholders should be able to remove them
  - Action (b) requires pyramidal ownership structures
    → not prevalent in the US, but may be relevant for PRC

- Incentive of controlling shareholders not to execute value reducing actions
  - Large incentives to grow as they can amass more wealth through this than by simple stealing
    → why do these firms survive, why people subscribe to them
  - Reputation, especially for group firms
Law-proof insiders: which events?

- Laws for prosecution → extreme events
  - Misappropriation of assets
  - Frauds
  - Bankruptcy and distribution of assets
  These may be difficult to legally pursue due to dual or multiple jurisdictions

- Laws for “daily” governance
  - Disclosure
    - Accounting rules
    - Listing rules
    - IPO rules
  - Market discipline
    - Voting through the feet
    - No new capital inflows
Troublesome observations of US Laws

- Disclosure and filing laws are diluted for foreign private issuers (FPI) like Alibaba
  - Financial information, Conflict information, Insider information
  - PCAOB requires home country’s (PRC) approval for periodic scrutiny of FPIs (Alibaba)
  - Domestic issuers must file interim quarterly reports (10-Q) in specified formats while and FPI can furnish only a subset of this information → only annual report can be filed
  - Form 20-F exemptions for FPI with respect to declaration of material conflicts, and declaration of share ownership
  - IPO’s rules are same though
How to design “good” laws?: substance vis-à-vis enforcement

- Should we frame the “first-best” laws and then try to enforce them, or

- Should we endogenize enforceability in the framing of the law itself → the “second-best” option
  → will this lead to design of laws which needs to be updated continuously
  → How can we harmonize cross border laws when enforcement varies across countries

- Challenging to design laws for specific structures (Alibaba and PRC),
  ✓ structure evolve in response to laws, so presumably laws have to be designed at an absolute scale
  ✓ laws which can handle specific structures may be in-optimal for others,
  → Type 1 error versus Type 2 errors → why do the Delaware Law and Cayman Law co-exist?

- Does the solution lie in having the “first-best” law, with inter-governmental cooperation, standardized disclosures, investor education, and market discipline
Enjoyed reading the paper and hope to see more debate on this issue