Alibaba's stock market listing a risky prospect as insiders hold all the cards

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Wall Street excited as China's cross between Amazon and eBay prepares for IPO, but investors should be wary

Roll up, roll up, for Wall Street's latest internet spectacular. Alibaba is commonly described as a cross between Amazon and eBay. Throw in the fact that it operates primarily in China, and thus is very big, and you have ingredients for a successful listing with the usual tiresome razzmatazz.

Just in case the great American investor is inclined to worry about Alibaba's unconventional governance and corporate setup, the front page of the flotation prospectus boasts the names of 20 investment banks and brokers, led by Credit Suisse, Deutsche, Goldman Sachs, JP Morgan, Morgan Stanley and Citi. Even at a valuation of $165bn (£100bn), a first-day pop in the share price is likely.

Unconventional? Actually, it's worse than that. Huge potential conflicts of interest run through Alibaba and its related entities. The "risk factors" section of the prospectus should be lit in neon.

The big problem is not simply that founder Jack Ma can load the board with his chums and that shareholders will have zero rights to change management or influence strategy.

Alibaba's breach of the principle of "one share, one vote" is a serious no-no in UK eyes, and the Hong Kong Stock Exchange refused to change its rules to accommodate the company, but US investors seem happy to swallow the idea that pioneering founders should retain ultimate control. Facebook and Google have dual-voting structures, for example.

At Alibaba, Ma's twist is that a 30-strong "Alibaba Partnership" of founders will control a majority of board appointments, even though he and his colleagues will end up with just 13% of the stock. Such tight control is blatantly unfair, but at least it is clear.

The same cannot be said about Alibaba's related-party relationships, which is where the real difficulty lies. In 2011, Alibaba divested Alipay, its mission-critical payment processor, to comply with a new Chinese rule that non-bank payment companies must be owned in China.

The Alibaba Group Holding Limited that is joining the New York Stock Exchange, you see, is registered not in China but in the Cayman Islands.

The owner of Alipay is now a business called Small and Micro Financial Services Company, which is controlled by Ma. What happens if Alibaba and Alipay, or SMFS, have commercial quarrels?

This is what Alibaba's listing prospectus says: "Conflicts of interest may arise due to Jack Ma's role as executive chairman of our company and through his voting control and his economic interest in SMFS, and he may not act to resolve such conflicts in our favour."

That's one hell of a risk factor. Naturally, there is a service agreement between Alibaba and Alipay; it runs for 50 years. But ecommerce is an evolving industry and the nature of operations changes; new agreements may be needed. Lucian Bebchuk, a professor of law, economics and finance at Harvard Law School, put the problem this way in a sharp piece for the New York Times: "With an absolute lock on control and a limited fraction of the equity capital, the Alibaba insiders will have substantial incentives to divert value from Alibaba to other entities in which they own a substantial percentage of the equity. This can be done by placing future profitable opportunities in such entities, or making deals with such entities on terms that favour them at the expense of Alibaba."

Ma plans to reduce his stake in Alipay over three to five years, including via grants to Alibaba employees, to address the problem. Professor Bebchuk is not convinced this makes any difference whatsoever. "Stating such an intention does not represent an irreversible legal commitment," he argues.

"Furthermore, transfers of Alipay ownership stakes from Mr Ma to other members of the Alibaba Partnership would still leave the Partnership's aggregate interest to be decidedly on the side of Alipay rather than Alibaba." Quite.

Ma, it might be argued, seems an upstanding fellow who can be trusted not to exploit opportunities to favour his and his partners' private enterprises over the publicly-owned Alibaba. Let's hope so.

But we're talking about a $165bn company whose shares will be stuffed into many people's pension pots, whether they like it or not. The governance safeguards should be more watertight than a hope that the folksy, smiling boss is as nice as he sounds. Never mind how many well-paid Wall Street banks are on the ticket. Dear Mr Pension Fund Manager, count me out.