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*Article*

# The Advantages and Challenges of Dual-Class Share Structure: A Case Study of Alibaba IPO

Wan Chong Choi <sup>1,2,\*</sup>, Lai Chu Lam <sup>3</sup>, Nani Cui <sup>4</sup>, Fan Xiao Jie <sup>5</sup> and Chi In Chang <sup>6</sup>

<sup>1</sup> Department of Business Administration, Golden Gate University, U.S.

<sup>2</sup> Department of Computer Science, Illinois Institute of Technology, U.S.

<sup>3</sup> Department of Business Administration, Golden Gate University, U.S.; llam170@my.ggu.edu

<sup>4</sup> Department of Business Administration, Golden Gate University, U.S.; ncui974@my.ggu.edu

<sup>5</sup> Department of Business Administration, Golden Gate University, U.S.; xfan@my.ggu.edu

<sup>6</sup> Department of Psychology, Golden Gate University, U.S.; cchang@my.ggu.edu

\* Correspondence: wchoi@my.ggu.edu

**Abstract:** This study explored the advantages and challenges of the dual-class share structure in initial public offerings (IPO). It used Alibaba's 2014 IPO as a key case study. Alibaba benefited from this structure in multiple ways. It enabled long-term strategic decision-making by insulating management from short-term market pressures, preserved the company's founder-driven culture to maintain its entrepreneurial vision, attracted patient investors aligned with its growth strategy, and protected against hostile takeovers. These advantages contributed to Alibaba's sustained innovation and market leadership. However, challenges associated with the dual-class share structure were observed in other companies. Key concerns included excessive managerial entrenchment, which limited shareholder influence, increased agency costs due to the separation of voting rights from financial ownership, and reduced transparency in corporate governance. Additionally, controlling minority structures amplified governance risks, allowing insiders to wield significant control despite holding a minimal economic stake, leading to potential conflicts of interest. While the dual-class share structure provided strategic advantages, its risks highlighted the need for investor protection and regulatory oversight. Potential reforms, such as sunset provisions, increased transparency, and stricter board independence, could have helped balance founder control with shareholder interests. Our study contributed to the ongoing debate on corporate governance by assessing the tradeoffs between long-term strategic autonomy and investor accountability.

**Keywords:** Dual-Class Share Structure; Advantage; Challenge; Initial Public Offering; IPO; Alibaba; Partnership

## 1. Introduction

On September 19, 2014, Chinese e-commerce giant Alibaba Group Holding Limited (Alibaba) made history by completing the largest initial public offering (IPO) ever, raising US\$25 billion on the New York Stock Exchange (Shao, 2023). A key feature of Alibaba's IPO was its dual-class share structure, which allowed the founder and the company's management to retain majority control of the board and company despite holding a minority economic stake.

Under Alibaba's governance structure, the Alibaba Partnership, a group of founders and executives, had the exclusive right to nominate a majority of the board of directors. This was seen as essential for Alibaba to "set the company's strategic course without being influenced by the fluctuating attitudes of the capital markets so as to protect the long-term interests of Alibaba's customers, the company itself and all shareholders" (Tsai, 2013).

Dual-class share structures like Alibaba, which provided disproportionate voting power to certain shareholders, became increasingly popular among technology companies pursuing IPOs,

including Google and Facebook (McKinnon, 2015). However, critics argued that such structures entrenched management and disenfranchised public shareholders (Gong, 2024). Hong Kong's stock exchange prohibited dual-class shares, leading Alibaba to list in the U.S. instead (Nishizawa & Frost, 2014).

This paper uses Alibaba's IPO as a case study to analyze the advantages of its dual-class share structure and examines the challenges faced by other firms with similar structures, which were not specific to Alibaba. This study aims to address the following research questions:

RQ1: What are the advantages of Alibaba's dual-class share structure in its IPO?

RQ2: What challenges are posed by dual-class share structures in IPOs for other firms?

By analyzing the benefits and challenges of dual-class shares, this paper seeks to contribute to the ongoing debate regarding the suitability of such structures and how they can be improved to balance the interests of various corporate stakeholders.

The remainder of the paper is organized as follows. Section 2 examines the advantages of dual-class share structures, including their role in enabling long-term decision-making, preserving founder control, attracting patient capital, and defending against hostile takeovers. Section 3 explores the challenges associated with dual-class structures by other firms, such as management entrenchment, increased agency costs, reduced transparency, and governance risks linked to controlling minority structures. Section 4 concludes by evaluating the overall impact of dual-class shares, weighing their benefits against their governance concerns, and considering potential reforms to balance founder autonomy with shareholder protection.

## **2. RQ1: What Are the Advantages of Alibaba's Dual-Class Share Structure in Its IPO?**

Alibaba's dual-class share structure in its IPO was a strategic decision to balance corporate control with market access. Unlike single-class structures, this model granted enhanced voting rights to founders and key executives, ensuring managerial autonomy. Common in technology firms, dual-class shares helped maintain strategic focus while raising capital. For Alibaba, this structure supported long-term decision-making, preserved entrepreneurial vision, attracted aligned investors, and protected against hostile takeovers. This section analyzes these advantages in detail.

### *2.1. Enabling Long-Term Focus Over Short-Term Market Pressures*

A key rationale for Alibaba's dual-class structure was to insulate the company from short-term market pressures and allow management to focus on long-term strategic priorities. As stated in Alibaba's IPO prospectus (Alibaba Group Holding Limited, 2014), "Our management team's clear sense of mission, long-term focus and commitment to the values that define the Alibaba culture have been central to our successful track record." Furthermore, the company emphasized that "Our management team is organized as a partnership and we believe this partnership culture, as well as substantial long-term equity ownership, encourage our business leaders to think like owners rather than agents."

Dual-class structures shielded management from activist investors and hostile takeovers, allowing them to invest in long-term initiatives that might have been unpopular in the short run but beneficial in the longer term. This was especially important for technology companies like Alibaba, which required upfront investments and a long-term horizon to fulfill their innovative potential (Shao, 2023). The guaranteed control provided by dual-class shares allowed management to execute their unique vision without unnecessary interference from the market (Gong, 2024).

As the Sahoo Committee Report (Saha & Srikant, 2015) noted, dual-class structures could mitigate systemic short-termism, often leading to value-destroying behaviors like delaying worthwhile investments to meet quarterly earnings targets or manipulating accounting to pull forward revenues and defer expenses.

## 2.2. Preserving Founder Control and Entrepreneurial Culture

Another reason for Alibaba's dual-class structure was to preserve the influence of its founders and partnership system to drive future success. The Alibaba Partnership comprises founders and other longtime executives who have contributed to the company's entrepreneurial culture and accomplishments (Alibaba Group Holding Limited, 2014).

By ensuring the Partnership retained majority board control, the dual-class structure aimed to protect Alibaba's unique culture and strategic direction as it transitioned to a public company (Gong, 2024). Public markets tend to undervalue intangible assets like corporate culture. However, for innovative companies, preserving founders' entrepreneurial spirit and influence was critical for maintaining competitiveness (Shao, 2023). Dual-class shares allowed key leaders to keep shaping Alibaba's future.

Entrepreneurial founders were often most incentivized to maximize long-term value given their large ownership stakes, long investment horizons, and strong emotional connection to their companies (McKinnon, 2015). As Alibaba stated, the dual-class structure allows the Partnership to "set the company's strategic course without being influenced by the fluctuating attitudes of the capital markets" (Tsai, 2013). Founder control could counteract short-term biases of public markets.

## 2.3. Attracting Patient Capital and Visionary Investors

Adopting a dual-class share structure served as a mechanism for attracting patient, long-term investors whose strategic objectives and investment horizons aligned with those of the company's management. By explicitly institutionalizing insider control, dual-class structures tended to attract shareholders who were not only aware of but also supportive of the company's long-term strategic vision and leadership (Shao, 2023). This alignment between ownership and governance enhanced corporate stability by reducing the influence of short-term market pressures.

Alibaba's dual-class structure sent a clear signal to the market regarding the nature of capital it sought to attract through its IPO. By allowing the company to self-select investors committed to the leadership of the founder and his executive team, the structure facilitated the formation of a shareholder base willing to endure market fluctuations in pursuit of Alibaba's long-term growth potential. Given Alibaba's position within China's rapidly expanding e-commerce sector, ensuring a committed investor base was essential to sustaining its competitive trajectory over time.

Moreover, shares with enhanced voting rights and transfer restrictions tended to be held by long-term, strategic investors rather than transient market participants seeking short-term gains. Compared to the dispersed ownership patterns typical of single-class share structures, dual-class models helped to retain a stable group of engaged shareholders who shared a vested interest in the firm's long-term success. This governance framework mirrored the concentrated ownership structures commonly observed in venture capital-backed private firms, where investor commitment and strategic oversight were prioritized to support sustained innovation and growth.

## 2.4. Defending Against Hostile Takeovers

The enhanced voting rights associated with dual-class shares mitigated the risk of hostile takeovers, enabling management to resist coercive or opportunistic acquisition attempts that might not have aligned with the long-term interests of shareholders (Saha & Srikant, 2015). Given that Alibaba's Partnership retained control over director elections, it was difficult for an acquiring entity to secure board control without the cooperation of existing management.

This takeover protection was particularly valuable for rapidly expanding technology firms, which attracted acquisition interest from larger, financially robust competitors or investment entities seeking to appropriate their growth potential. It allowed management to assess takeover proposals based on long-term strategic value rather than short-term financial incentives (Li, 2018).

Dual-class share structures enabled management to negotiate higher acquisition prices for all shareholders and prevented coercive takeovers designed to pressure investors into accepting



undervalued offers. Furthermore, Alibaba's superior voting shares were designed to be non-transferable, reinforcing its defense against hostile acquisition attempts.

Shielding emerging public companies from short-term takeover pressures was critical in fostering innovation and entrepreneurial initiatives. If visionary founders perceived their firms as perpetually vulnerable to acquisition, they might have been reluctant to access public capital markets for expansion, as exemplified by Alibaba's initial preference for listing in Hong Kong. Dual-class structures provided a safeguard that encouraged companies to pursue public offerings while maintaining strategic autonomy (Shao, 2023).

### **3. RQ2: What Challenges Are Posed by Dual-Class Share Structures in IPOs for Other Firms?**

While dual-class share structures offered significant benefits, they also introduced notable governance risks. Critics argued that these structures could lead to managerial entrenchment, misalignment of interests, and reduced accountability. This section discusses the challenges faced by other firms with similar structures, focusing on entrenchment, agency costs, transparency issues, and risks from controlling minority structures.

#### *3.1. Excessive Entrenchment of Management and Weakened Accountability*

The most significant criticism of dual-class structures was that they entrenched management by making them unaccountable to public shareholders and the market for corporate control. With outsize voting power relative to the economic stake, controlling shareholders faced little risk of being voted out of power even if the company underperformed or management acted against shareholder interests (McKinnon, 2015).

In dual-class firms, controlling shareholders had the exclusive right to appoint a majority of board directors, effectively insulating themselves from external oversight (Anand, 2018). This structure diminished the influence of minority shareholders, depriving them of the fundamental right to nominate and elect board representatives to oversee management on their behalf.

The weakening of external accountability and market discipline enabled by dual-class structures risked allowing management to become complacent or pursue imprudent strategies shielded from shareholder opposition and the threat of removal. Regulators and investors challenged the appropriateness of such stark imbalances between ownership and control.

As noted in the Sahoo Committee Report (Saha & Srikant, 2015), the unbundling of control rights from cash-flow rights increased the risk of managerial entrenchment and value destruction since controllers did not undertake the full economic consequences of their decisions. Management with voting control tended to resist value-enhancing takeovers and engage in empire-building. Weakened accountability distorted incentives.

#### *3.2. Increased Agency Costs and Extraction of Private Benefits*

By separating voting rights from cash flow rights, dual-class structures created misaligned incentives and heightened the risks of insiders extracting private benefits to the detriment of public shareholders (Amoako-Adu et al., 2014). With control not proportional to economic interest, dual-class firms were more susceptible to costly agency problems, as controllers sought to divert corporate resources for private gain through related-party transactions or excessive compensation.

Empirical research (Baulkaran et al., 2011) documented such risks in dual-class firms, where controlling shareholders engaged in transactions that transferred business opportunities to entities they controlled, often at the expense of minority investors. These governance concerns arose due to the diminished ability of external shareholders to challenge or block such decisions, given the disproportionate voting power of insiders.

While dual-class firms had policies to review and approve related-party transactions, their governance structures often weakened external checks on insiders' ability to bypass or take

advantage of these safeguards. The misalignment between economic ownership and voting rights heightened governance risks and agency costs, ultimately harming long-term shareholder value.

Claessens et al. (2002) conducted an international analysis and found that the wedge between control and cash-flow rights enabled by dual-class shares was linked to increased value destruction, as controllers could pursue private benefits without regard to overall corporate performance. Higher agency costs manifested in depressed valuations as investors price-protected against increased risks.

### *3.3. Restricted Transparency and Hollow Accountability Mechanisms*

Beyond voting rights, dual-class structures also weakened other shareholder protections and accountability mechanisms (Shen, 2016). Because dual-class insiders could retain complete voting control with even a small minority ownership stake, they had less incentive to provide transparency and cultivate investor relations beyond the legal minimum.

Companies with a dual-class structure may face concerns regarding transparency and accountability (Anand, 2018). Their complex web of domestic and offshore holding companies, subsidiaries, and variable interest entities could obscure their actual organizational structure.

While these companies were subject to listing and disclosure requirements, governance experts questioned whether standard accountability tools like independent directors were substantive when dual-class controllers could appoint the board. The divergence between ownership and control enabled by dual-class shares risked insulating insiders from outside monitoring and market discipline. Striking the right balance between transparency and accountability remained an ongoing challenge.

### *3.4. Magnified Risks from Controlling Minority Structures*

The dual-class structure presented unique risks as a Controlling Minority Structure (CMS), where controllers held only a small fraction of cash-flow rights despite wielding majority voting power (Bebchuk & Kastiel, 2019). CMS firms were prone to unique governance challenges relative to traditional dual-class structures.

With a minimal financial stake in the company, CMS controllers faced few direct consequences from actions that destroyed shareholder value since their personal wealth was not relevant to company performance. This weakened natural incentive alignment and heightened moral hazard problems. CMS firms were found to exhibit more significant agency costs and risks of tunneling.

Moreover, in CMS firms, a controlling figure might have held a minimal economic stake while maintaining significant board control, leading to a clear divergence of interests from public shareholders. Controllers sometimes had the discretion to nominate directors and determine their compensation.

While all dual-class firms had embedded principal-agent conflicts, CMS structures represented the most extreme manifestation, as controllers had voting rights far exceeding their fractional economic interests. The exceptional governance risks of CMS firms warranted heightened regulatory and investor scrutiny to protect against abuse.

## **4. Conclusions**

As a governance model favored by many technology firms, dual-class share structures encapsulate both the potential benefits and challenges of modern corporate ownership. While this structure aims to preserve entrepreneurial culture and long-term strategic vision, it raises valid concerns about entrenched control, private benefit extraction, and weakened accountability.

Whether the benefits of dual-class structures outweigh the risks remains hotly debated. However, their attraction to technology company founders is clear. By examining their implementation, this paper highlighted how such structures can enhance stability and long-term thinking in public markets while amplifying principal-agent conflicts and insulating insiders from external checks and balances.

Ultimately, the suitability of dual-class shares depends on company-specific factors such as management quality, business model, and growth stage. While contractual protections and robust disclosure can help mitigate governance risks, dual-class structures are based on outsized trust in corporate insiders. Companies considering dual-class IPOs should assess whether such trust is warranted and carefully weigh the tradeoffs.

As more dual-class firms go public, policymakers and investors will need to consider how to allow companies flexibility to tailor governance arrangements to their unique needs while still providing adequate protections for public shareholders. Potential improvements could include time-based sunset provisions on dual-class structures, greater transparency on insider control, and more substantial board independence requirements. Striking the right balance between founder autonomy and shareholder protection will be key to the long-term viability of dual-class structures.

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