An Analysis of Factors Affecting IPO Performance Based on Alibaba IPO

Bishan Zhang*
Shenzhen College of International Education, Shenzhen, 518043, China
*Corresponding author: s23800.zhang@stu.scie.com.cn

Abstract. In this dynamic era of technological innovation and information flow, an increasing number of internet companies and e-commerce platforms emerge endlessly. The level of capital injection is a crucial consideration for companies who desire to expand or innovate, especially for internet companies during the period of rapid development. As a result, going public will be a plausible solution for firms as they are not only able to get sufficient financial support, but also to gain competitiveness. However, companies always need to make some choices when going public: Which and how many underwriters do they need? Which stock exchange do they want to be listed? How should shares issued by a company be priced? Companies need to develop a far-sighted mind to look at this event, along with an innovation strategy that enable businesses to gain a firm foothold in the international market. This paper explains the factors that companies have to take into account in their IPO processes. The IPO event of Alibaba, which shows double-edged effects, is discussed in detail.

Keywords: Initial Public Offering; Share Structure; Pricing Strategy.

1. Introduction

Chinese e-commerce has been ahead of the world for many years. At the same time, China has been the world’s largest online retail market. Many internet enterprises like Alibaba Group Holding, JD.com and PDD Holdings are all accelerating their expansions towards a wider range of services with the purpose of innovating traditional corporate governance in industries other than internet one. All of them were listed in stock exchanges in the United States and proved a right decision. An successful IPO also illustrates the company’s growth potential in the future. Taking Alibaba Group Holding as an example, this paper aims to explore a wide range of factors influencing the successfulness of an IPO. This company is chosen as the subject of this paper’s case study because of its great popularity and influence. As a successful example of U.S.-listed, Alibaba becomes a representative of China’s emerging enterprises, it also sets a typical paradigm for other unlisted companies among online retailer market worldwide. In the first stage, the success of Alibaba will be examined by displaying statistics of its performance in terms of revenue earned, market cap and international trading, along with reasons why the company could make such a good deal and potential problems arose from its IPO. In addition, instead of the traditional ‘one share, one right’ shareholding system, Alibaba Group chooses to maintain the dual-class share structure for its partnership system, following impact will be discussed in both short run and long run. The company decided to give up doing IPO in the Hong Kong Stock Exchange and move to the New York Stock Exchange in the United States, which conducts particular significance for the analysis of the dual-class share structure. In the second stage, the determinants are then assessed to see if they apply equally to other target companies, including interpretation of failure cases.

2. Alibaba Development History and IPO

Alibaba was founded on 28th June 1999, with the idea of connecting Chinese companies with international buyers by the co-founder Jack Ma in his Hangzhou apartment, with 17 friends and students. Its first website was Alibaba.com is a China-based B2B marketplace website. Ma seized the opportunity to venture beyond the confines of traditional industries and established the site, during a
time when China’s Internet economy had yet to emerge. Nowadays, the growth of Alibaba has propelled it to become one of the global leaders in the e-commerce industry. On 19th September 2014, the company were listed on the New York Stock Exchange, officially became Alibaba Group Holding. It raised about 25 billion dollars, such huge amount of money made the deal the largest IPO in the history at that time. This IPO event received a great attention and demand from global investors, exceeding the supply of shares offered. The IPO was reportedly more than 17 times oversubscribed, and the underwriters exercised their over-allotment rights, raising the opening price from the initial offering price of 68USD per share to 92.7USD per share (an increase of more than 38% from the offering price). Within a year, the share price had more than doubled. Despite some volatility, there was an overall upward trend in the three years following the IPO [1]. Alibaba Group now becomes the largest retail commerce business in the world, progress is seen in its expansion into global markets. Its main businesses are comprised of China commerce, international commerce, local consumer services, Cainiao, cloud, digital media and entertainment.

3. Alibaba IPO Success

3.1. Venture Capital

The overall development of Alibaba underwent a start-up phase, followed by rapid growth, an initial public offering stage, and finally reached a stage of stable operation. Venture capital has played a key role in Alibaba’s start-up stage. In 1999, when Alibaba was only a startup, the internet industry in China was under the risk of bubble burst as a nascent high-tech industry. A lot of companies within the industry were facing bankruptcy. Goldman Sachs and several venture capital investment institutions conducted the first round of angel investment of US$ 5 million at start-up stage in 1999. In the following year 2000, SoftBank, which is a Japanese multinational investment holding company, saw the future growth potential of Alibaba and invested US$ 20 million in it. These venture capital introduction ensured Ali’s survival and further development. Other institutional investors like Yahoo! and Fidelity also provided financial support to infuse in Ali’s further expansion, including the new customer website Taobao.com, Ali Mom and Ali Cloud. These rounds of investment had an ultimate goal to promote Alibaba to go public in order to obtain substantial returns.

3.2. Dual-Class Share Structure

Issue of two different types of shares, A share and B share, is a typical form dual-class share structure. Normally, B share has more voting rights than A share. Investors from general public or other unrelated institutions can only buy in A share, also known as common shares. Board of directors usually control the circulation of B share. This can be seen easily according to the co-partnership system applied in Alibaba. Its partners are granted over 50 percent of the voting rights despite owning slightly more than 10 percent of the shares. Alibaba has refuted any plans for a dual-class share structure, but this co-partnership still adopted as an unconventional approach. Dual-class share structure is an effective means to control the company in terms of separating shares rights and control rights [2]. In this shareholding structure, Jack Ma and his corporate team can firmly hold the company in their hands.

3.3. Company Size

The size of company is one of the most crucial determinants of an IPO. Evidence shows that there is a positive relationship between firm size and the IPO valuation. The larger the company, the better performance it will achieve after going public. As a bigger firm tends to gain more trust from investors and so investors will be more likely to invest into the company or being involved in the company’s business [3]. Using Alibaba Group as an example, before the IPO, it has expanded the company consistently after establishment in terms of mergers and acquisitions, increase the number of business segments or attracting rounds of investment by other firms or financial institutions. Relevant key events before IPO are shown in Table 1 below.
Table 1. Key moments in the growth of Alibaba (Pre-listing)

<table>
<thead>
<tr>
<th>Year</th>
<th>Events</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>Officially established Taobao.com</td>
</tr>
<tr>
<td>2004</td>
<td>Alipay - a online payment platform launched</td>
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<tr>
<td>2005</td>
<td>Acquired all of Yahoo! China’s assets, got a $1 billion investment and took over Yahoo! China</td>
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<tr>
<td>2009</td>
<td>Establishment of Alibaba Cloud</td>
</tr>
<tr>
<td>2010</td>
<td>Juhuasuan, AliExpress and mobile Taobao client launched</td>
</tr>
</tbody>
</table>

Data source: Internet data and official website from Alibaba

3.4. Strong and Efficient Underwriting Team and Mechanism

Alibaba selected a total of six investment banks as its underwriting team in early preparations, Credit Suisse, Citigroup, Goldman Sachs, Deutsche Bank, Morgan Stanley and JP Morgan Chase respectively. All of them came from the top 30 investment banks in 2014, according to Wall Street Oasis, as shown in Table 2 below.

Table 2. Overall ranking of selected banks in 2014

<table>
<thead>
<tr>
<th>Ranking</th>
<th>Investment Bank</th>
</tr>
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<tbody>
<tr>
<td>4</td>
<td>Goldman Sachs</td>
</tr>
<tr>
<td>7</td>
<td>JP Morgan Chase</td>
</tr>
<tr>
<td>8</td>
<td>Morgan Stanley</td>
</tr>
<tr>
<td>16</td>
<td>Credit Suisse</td>
</tr>
<tr>
<td>22</td>
<td>Citigroup</td>
</tr>
<tr>
<td>23</td>
<td>Deutsche Bank</td>
</tr>
</tbody>
</table>

Data source: WSO official website

Among them, Credit Suisse and Goldman Sachs have had long-term contact with Alibaba. Goldman Sachs was the first bank on Wall Street to invest in Alibaba in 1999, in exchange for 40% of its shares. Then in 2003, Goldman Sachs sold all its shares in Alibaba at a return rate of 7 times. Unexpectedly, Alibaba’s subsequent success exceeded their best expectations. Credit Suisse became the underwriter of Alibaba IPO mainly because Khan, a former JP Morgan analyst, who had early contacts with several internet businesses, including Alibaba, and had a comprehensive understanding of the company, so finally he won the Alibaba IPO [4].

Besides those six banks acting as joint bookrunners and representatives of the underwriters, Alibaba invited other investment banks to be involved in the securities issuance process, including works like writing the prospectus and overseeing the post-IPO lock-up period, specifying the floor price, providing training to all underwriting agency sales staff and coordinating the relationship between all parties during the road show. Alibaba has also negotiated lower underwriting fees. The company only paid 1 percent of the proceeds of up to $25 billion, which was a hard-driven bargain, that was far less than the 7 percent that smaller IPOs typically generate, or the 2 or 3 percent for larger deals [5]. Last but not least, there is another mechanism used that made Alibaba the biggest IPO case at that time, called Greenshoe Option. The company granted the underwriters the right to intervene in the market, to choose whether to oversell 15% of the shares at the issue price during the 30-days stabilization period immediately after listing. All six main underwriters implemented their rights as the IPO shown a positive expectation.

3.5. The Effectiveness of Pricing Strategy

Although Alibaba received a price-to-earnings ratio estimated of 24 times and enthusiastic responses from road shows, its pricing was relatively low-key, as can be seen from the comparison
between the increase in the issue price and in the opening price. The purposes for deliberately lowering the stock price in this way are: firstly, to keep the IPO risk as low as possible to ensure a successful listing; secondly, to learn from Facebook’s experience, setting a lower issue price can not only strengthen long-term investment institutions but also attract more potential investors, play the role of motivating the market [6].

3.6. Success in International Trade

After IPO, Alibaba Group had been greatly involved in the international retail and wholesale market. For years, it continued investing in a better customer experience aiming for driving sales across its international retail and B2B e-commerce sites. This strategy creates an untouchable position for Alibaba in overseas trading [7]. Figure 1 shows the growth in revenue earned in both domestic market and overseas market. After listing, there is a consistent and gradual progress in international commerce. Alibaba's strong financial performance and dominant position in the e-commerce market contributed to its successful IPO. Investors were attracted to the company's impressive revenue growth and profitability, as well as its potential for future expansion.

Fig. 1 Alibaba’s China-commerce and International-commerce after acquisition [8].

3.7. Investment Environment in 2014

A key factor affecting Alibaba's IPO performance was market conditions. The timing of an IPO can have a significant impact on its success, as market volatility and investor sentiment can greatly influence the demand for shares. Alibaba went public at a time when global markets were strong and investor appetite for tech stocks was high. This helped to generate significant interest in the offering and drive up the demand [9]. At the same time, some famous technology companies, e-commerce companies were listed in the stock exchanges in United States, such as TrueCar (an automotive pricing and digital retailing website for new and used car buyers), GoPro (an American technology company) and Zendesk (a company which provides software-as-a-service products). These listings represented the trend of growth of innovative industries.

Likewise, investor sentiment towards Chinese companies also played a role in shaping Alibaba's IPO performance. Despite concerns about corporate governance and regulatory risks in China, investors were willing to overlook these issues due to their confidence in Alibaba's business model and management team. as can be seen from the comparison between the increase in the issue price and in the opening price. The purposes for deliberately lowering the stock price in this way are: firstly, to keep the IPO risk as low as possible to ensure a successful listing; secondly, to learn from Facebook’s experience, setting a lower issue price can not only strengthen long-term investment institutions but also attract more potential investors, play the role of motivating the market [6].
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4. Conclusion

A combination of favorable market conditions, strong company fundamentals, and positive investor sentiment all contributed to the successful IPO performance of Alibaba. By analyzing these factors, it can gain valuable insights into what drives the success or failure of IPOs in today's competitive financial markets. Alibaba Group's globalization strategy is also worthy of praise. From the initial Chinese market to the global market, and now to "making it easy to do business around the world", Alibaba has been actively expanding overseas markets and promoting the development of global e-commerce. By establishing close cooperative relationships with partners around the world, Alibaba has successfully entered the global market and provided convenient e-commerce services to consumers and businesses around the world.

Today, Alibaba has gradually expanded from the original B2B e-commerce platform to include B2C, C2C, payment, logistics, cloud computing and other fields, becoming a comprehensive e-commerce ecosystem. Alibaba Group's success is inseparable from its unique corporate culture and innovative spirit. Jack Ma has always emphasized the business philosophy of "customers first, employees second, and shareholders third", which has provided a strong spiritual impetus for Alibaba's development. At the same time, Alibaba always adheres to technological innovation and continues to lead the development trend of the e-commerce industry. Whether it is financial technology products such as Alipay or cutting-edge technologies such as cloud computing and artificial intelligence, Alibaba has demonstrated strong R&D strength and technology accumulation. However, Alibaba also faces some challenges. As competition in the global market intensifies, Alibaba needs to continue to carry out technological innovation and strategic adjustments to maintain its leading position. At the same time, as the Chinese market gradually becomes saturated, Alibaba also needs to find new growth points to maintain its continued development.

In general, Alibaba Group is a banner of Chinese e-commerce and an important driving force for the development of global e-commerce. Its successful experience and innovative spirit not only provide reference and inspiration for the development of China's e-commerce industry, but also point the way for the development of global e-commerce. In the future, it is expected that Alibaba will continue to be a beacon leading the development of the e-commerce industry and bring more convenience and value to consumers and businesses around the world.

References

