Chapter Eleven

Growing Pains

If you own a hundred percent of the business that cannot operate, you own a hundred percent of zero.
—Joe Tsai

When eBay exited the China market in 2006, Taobao's users were 30 million. Within three years they were 170 million, and sales on the Taobao's platform had grown from $2 billion to $30 billion. With no obvious competitor on the horizon, the outlook for Alibaba looked rosy. The Chinese economy was growing at an unprecedented rate, topping 14 percent in 2007. Anticipation about the 2008 Olympic Games in Beijing set off a massive stock market rally at home. Western capital poured into China and the share prices of the country's leading Internet players took off. Baidu's stock trebled in 2007, valuing the company at over $13 billion. Tencent, with more than 740 million QQ instant messaging users and a growing games business, climbed to $13.5 billion. A new wave of China Internet companies prepared to go public. Speculation turned to Alibaba. When would it IPO?

Before raising fresh capital, Alibaba reshaped its management[1] in preparation for a new phase, beefing up its team with new executives from Pepsi, Walmart, and KPMG[2] and a new head of strategy, Dr. Zeng Ming. Alibaba also appointed a Shanghai-born executive, David Wei (Wei Zhe), with experience in finance and retail, as CEO of the B2B business Alibaba.com. He would serve as CEO of Alibaba.com for more than four years,[3] including overseeing Alibaba's first IPO.

Taobao was wildly popular with consumers, but a commitment to free listings ensured that the business was still loss-making. So, instead, Alibaba decided to list only its original B2B business: Alibaba.com.[4] Founded in 1999, these companies were now eight years old. Alibaba.com had more than 25 million registered users in China and overseas. It was a stable and profitable, if unexciting, business.

IPO 1.0

Yet such was the buzz around Jack that the November 2007 IPO of Alibaba.com in Hong Kong generated a frenzy of interest in the stock not seen since the dot-com boom. One analyst slammed the psychology of Hong Kong investors who "trade stocks like they're playing at the baccarat table." That was an accurate description of many of the individuals who lined up to buy the shares, such as sixty-five-year-old Lai Ah-yung, who told the Associated Press: "People said buy, so I buy."

Although the B2B business of Alibaba.com was really a sideshow, excitement about China's booming Internet—now numbering more than 160 million users—and its vibrant economy meant that few people bothered to make the distinction.

Jack described Alibaba's business in language that resonated well in Hong Kong, a market obsessed with property speculation: "We're almost like a real estate developer," he explained. "We make sure the space is cleared, the pipes are laid, the utilities work. People can come in and put up their buildings on our site." But there was much more to come, he said, adding that if Alibaba did things right "we have the chance to build a platform that could become the Internet ecosystem for all of China."

The bulk of the shares were sold to institutional investors in an exhausting, ten-day global road show that finished up in San Francisco. The schedule was so packed that David Wei had no time to eat. Jack unexpectedly ducked out of their last investor meeting, calling David soon after to invite him to an airport restaurant where he'd ordered all the noodle dishes on the menu.

When they landed back in Hong Kong, they already knew from their road show that the offering would be a blowout success. The stock market there had already rallied 40 percent in the previous three months, but to ensure a strong start Yahoo had committed to buy[5] 10 percent of the offering, along with seven other “cornerstone” investors, including local real estate tycoons.[6]

The offering of Alibaba.com, listing under the lucky number stock ticker “1688,” sold 19 percent of the company for $1.7 billion. It was the largest Internet IPO since Google in 2004, and valued[7] the company at almost $9 billion.

Demand from individual investors, who were allocated 25 percent of the total, outstripped supply by 257 to 1. Those lucky enough to secure an allocation of shares saw them triple on the first day from the HK$13.5 offer price, closing at HK$39.5. Alibaba’s B2B business was valued at $26 billion, a multiple of 300 times its earnings.

But the luckiest investors were those who sold right away, since the share price fell 17 percent the next day.

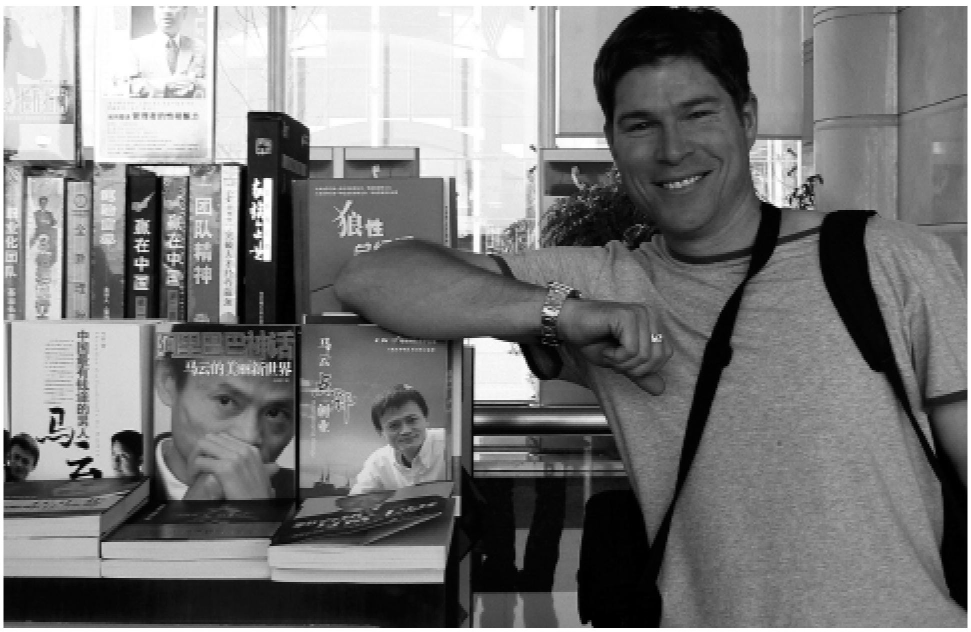
The buzz around Alibaba was focused on Jack and the other high-growth businesses like Taobao and Alipay. But these assets weren’t part of the IPO; in fact most of the shares released in the IPO were from Alibaba.com’s parent, Alibaba Group, which needed to raise cash to support them.

David Wei later looked back on the IPO and said, “Taobao was still burning money.” From Yahoo’s 2005 investment, Alibaba still had “maybe $300 to $400 million, but that was not enough. We still didn’t know how to monetize Taobao.” Of the $1.7 billion raised in Hong Kong, only $300 million went to the B2B business. Alibaba had topped up its coffers with the remaining $1.4 billion, giving it reserves of almost $1.8 billion. “That’s an enormous war chest,” David recalled, “and would last us a very long time to support Taobao. At that time Alipay was still burning money as well.”

The former Alibaba.com CEO added that the 2007 IPO gave him two insights into Jack’s approach. The first was something that Jack had often told him: “Raise money when we don’t need it. When you need it don’t go out to raise money, it’s too late.” The second was that the IPO allowed Alibaba to take care of its employees: “Jack understands people more than any business. He knows business well, but if you ask me the three skills Jack has amongst people, business, or IT? IT is the worst. Business second. First is people.” Alibaba’s B2B business was eight years old. Jack knew that he needed to give his employees an opportunity to cash in their shares. David remembers Jack telling his employees, “You need to buy a house.

You need to buy a car. You can't wait to sell the stock to get married, to have a baby. Selling the stock doesn't mean you don't like the business. I encourage you to sell some, to build your life, to give a reward to your family. Because you have been working too hard, you've been away from your family. They need some reward."

Jack himself didn't sell shares for the first two years. But when he did sell, some $35 million worth, he explained to his colleagues he wanted to give his family "a little sense of accomplishment." But Jack didn't wait to buy himself a $36 million home[8] in Hong Kong.



Jack's fame was cemented with the Alibaba.com IPO: Jack's Australian pen pal, David Morley, at the Hangzhou Airport, 2008. *David Morley and Grit Kaeding*

The IPO prospectus listed Jack's home address as the small Lakeside Gardens apartment where it had all started. But now he would trade up to deluxe apartment in the sky, atop the Mid-Levels district on the hillside of Hong Kong's famous Victoria Peak.

Jack had become a billionaire (based on the value of his stock), but the IPO prospectus illustrated—thanks to the three big investment rounds led by Goldman Sachs, then SoftBank and Yahoo—how much smaller a stake he held in his company than many of his peers. At their IPOs, William Ding held a 59 percent stake in NetEase and Robin Li a 25 percent stake in Baidu.

Global Financial Crisis: Silver Lining

But storm clouds were gathering that would send the company's shares into a tailspin. Alibaba.com depended on foreign trade, but the U.S. economy was weakening, hitting the business of the China exporters who made up the backbone of the B2B business. Alibaba's shares started to slide, dipping below the IPO price in March. When the global financial crisis gathered pace in September 2008, triggering the collapse of Lehman Brothers, Alibaba's shares plummeted, hitting a low of only one-third of its IPO price the following month. Only weeks after Beijing had staged the Olympic Games, it was facing a crisis as global trade volumes plummeted by 40 percent.

Alibaba's B2B business was vulnerable. It had an impressive sounding 25 million registered users, but only a handful paid to use the website. Just 22,000 subscribers of its Gold Supplier service accounted for 70 percent of total revenues.[9]

As CEO of Alibaba.com, David Wei was expecting the falling share price would trigger a lot of pressure from Jack. But, he remembers, "Jack never picked up the phone or came to see me about the share price. Never once. He never talked about profit growth." But there was one occasion when he did experience Jack's wrath. "The only time he ever called me after midnight was when our team changed the website a little bit. He was shouting, the only time he ever shouted at me. I had never heard him so angry. 'Are you crazy?'" Jack wasn't yelling at him about the stock price. He was angry about downgrading in prominence a long-standing discussion forum set up for traders to chat with one another. Jack demanded David move it back the next day. David pushed back, saying that Alibaba needed to focus on transactions, not discussions, adding that the space on the home page was very valuable for advertisers. But Jack was emphatic: "We are a B2B marketplace. Nobody comes to trade every day. We are more important a community than our marketplace. The same for Taobao; nobody comes to shop every day. If you downgrade this forum you are focusing too much on profits. Switch it back to a non-revenue-generating entry point to the business community."

Although its share price took a beating, Alibaba would survive the global financial crisis. And, as with SARS five years earlier, the crisis created some unexpected dividends for the company.

First, Jack realized that the downturn gave him a way to increase the loyalty of his paying customers. He initiated a dramatic reduction in the cost of their subscriptions, telling David, “Let’s be responsible to our customers. They are paying fifty thousand yuan; we can give them thirty thousand yuan back.”

“The stock market went crazy,” David recalled, as investors called him up to complain, “What? You’re losing sixty percent of your revenue.” But there was a method to Jack’s madness. Jack was serious about putting the customer first, but David emphasized Jack was not espousing “an ideology of ‘let’s give everything for free.’” Instead, Jack was “always trying to understand how to get the money back later. He’s just not greedy about getting the money first.” Looking back on the price cut, David concluded that the move was well timed. “Revenues didn’t drop at all. Customer volume growth offset the price drop completely. And after the financial crisis was over we didn’t raise the prices. We created an opportunity to sell them more value-added services, more of an Internet-style model. Jack actually told me he wanted to change it anyway. The crisis gave him the opportunity.”

The second dividend was that the collapse in their traditional export markets forced China’s factory owners to prioritize consumers at home instead. Increasingly goods “Made in China” for export would be “Sold in China” too. Taobao was perfectly positioned to benefit from this switch. Jonathan Lu, then president of Taobao, commented, “More and more consumers are flocking to the Internet in search of cheaper goods amid the economic slowdown, while many others choose to open online shops as secondary jobs.” By the end of 2009, Taobao’s market share had climbed to nearly 80 percent.

Finally, Taobao started to generate meaningful revenues, selling merchants advertising space[10] to help them promote their goods to the surging number of online shoppers.[11]

By September 2009, Alibaba was on a roll. At Alibaba’s tenth anniversary celebration Bill Clinton was back in Hangzhou as a keynote speaker, but this time with iconic figures for China’s new consumer wave, such as Nike-wearing NBA player Kobe Bryant and the CEO of Starbucks, Howard Schultz. At the celebration, Alibaba also launched its new cloud computing subsidiary, Aliyun.

As Taobao gained momentum, it was becoming Alibaba's main focus. Consumer e-commerce was outshining the company's legacy B2B business—which Alibaba was to later delist[12] from the Hong Kong stock market—and the fading Yahoo China portal asset.

Kobe Bryant presents Jack with a pair of his Nike sneakers in Hangzhou, September 2009. *Alibaba*

Since the 2005 deal, as Taobao grew in strength Alibaba and Yahoo enjoyed a long honeymoon. But a surprise event in early 2008 brought that to a dramatic end. On January 31, 2008, Microsoft made an unsolicited offer to buy Yahoo for $44.6 billion.[13] If the deal went through, Jack realized, Microsoft would become his biggest shareholder. Although he had a good relationship with Bill Gates, Jack realized that in Microsoft he would have a very different partner to contend with, one known to get much more involved in the companies it invested in than Yahoo did. There was another risk: The Chinese government had contacted Alibaba for comment about the possible change in ownership.

Control Concerns

Microsoft and the Chinese government have long enjoyed an unpredictable, love/hate relationship. High points include the red carpet treatment President Jiang Zemin gave to Bill Gates on his visit to China in 2003 and the return favor Bill Gates gave to newly minted president Hu Jintao at a dinner hosted by Bill Gates at his home on Mercer Island, Washington, in

2006. But there had been tensions, too, with Microsoft expressing its exasperation at the rampant piracy[14] of its products and the Chinese government accusing Microsoft of monopolistic behavior.

In public, Jack insisted that Alibaba would remain independent regardless of what happened with the bid. “Alibaba has been independent for nine years. . . . No matter what happens, we will go in our own way.”

But in private, he was alarmed. Alibaba wanted to trigger the “right of first offer” clause in the 2005 deal, which allowed it to buy back Yahoo’s stake in the event of a change of ownership, as now appeared likely. Alibaba hired Deutsche Bank and legal advisers to prepare. But in early 2008, as the global economy weakened, raising finance would be difficult, and Alibaba was a company with many moving parts. Taobao and Alipay were growing rapidly but still losing money. The listed company, Alibaba.com, was dropping in value. But if Alibaba couldn’t raise the money or agree on a price with Yahoo to buy back its stake, the 2005 deal stipulated that the price would be determined by arbitration instead—a long and unpredictable process.

In the end, in May 2008, Jerry Yang—now Yahoo CEO since the departure of Terry Semel the previous year—rejected Microsoft’s offer. Investors in Yahoo were furious, as management had turned down an offer that valued the company at a 70 percent premium. Yahoo’s share price started to drop, losing 20 percent in one day. Shareholder activists[15] built up stakes in the company in an effort to force through the deal, but to no avail. When the global financial crisis hit a few months later, Jerry’s decision to reject the Microsoft bid looked like the height of folly. Investors called for his head. In November 17, 2008, Jerry announced he was stepping down as CEO, handing the reins over to Carol Bartz, the former CEO of software firm Autodesk.

Yahoo’s decision to reject Microsoft had cost Jerry Yang his job and dented his pride. Yet Alibaba had dodged a bullet, the uncertainty of an interloper intruding on its relationship with Yahoo, which, now on the back foot with investors, would continue to be its largest shareholder.

Any sense of relief, though, would evaporate a few months later when Jerry’s replacement, Carol Bartz, took up her position as CEO of Yahoo.

Bartz was in many ways the opposite of Yang. Jerry Yang was known as well mannered, amicable, even deferential. But Bartz was infamous for her aggressive style, frequently dropping the F-bomb in meetings.

When Jack and a delegation of his senior Alibaba executives traveled to Yahoo's headquarters in Sunnyvale in March 2009 he was met at the entrance by Jerry.[16] He welcomed them, then walked them to their meeting with Bartz. But on arriving Jerry made his excuses and left the room: Bartz was in charge now.

Alibaba proceeded to give Yahoo an update on the progress of the company, including the runaway growth of Taobao. But rather than congratulating them, Bartz lambasted Alibaba for the dwindling market presence of Yahoo in China under their watch, reportedly telling them, "I'm going to be blunt because that's my reputation. . . . I want you to take our name off that site." Jack later told a journalist,[17] "If you cannot make the business cool, you have no right to be angry with me."

The relationship between Jack and Bartz had instantly become frosty. Soon there were long periods when the two had no contact with each other at all.

Alibaba's efforts to buy back Yahoo's stake would increasingly take place in public, as did their ongoing disputes.

In September 2009, at the same time as Alibaba was celebrating its tenth anniversary, in a public vote of no confidence Yahoo sold[18] the shares it had purchased in the Alibaba.com IPO. Then, in January 2010, as Google faced off with the Chinese government in a bitter spat over censorship and hacking, Yahoo came out in support of Google: "We condemn any attempts to infiltrate company networks to obtain user information. . . . We stand aligned with Google that these kind of attacks are deeply disturbing and strongly believe that the violation of user privacy is something that we as Internet pioneers must all oppose."

Alibaba was livid to see its biggest shareholder square off against the Chinese government. Through a spokesman, John Spelich, Alibaba fired back, "Alibaba Group has communicated to Yahoo that Yahoo's statement that it is 'aligned' with the position Google took last week was reckless given the lack of facts in evidence. . . . Alibaba doesn't share this view."

Worse was yet to come. In September 2010, Yahoo's Hong Kong managing director said he was seeking mainland Chinese advertisers for the site, putting Yahoo in competition with Alibaba, which responded that they would reevaluate their relationship with Yahoo.

Alibaba.com CEO David Wei publicly questioned the relationship with Yahoo: "Why do we need a financial investor with no business synergy or technology?" He added, "The biggest thing that has changed is Yahoo lost its own search engine technology. The biggest reason for a partnership doesn't exist."

The relationship with Alibaba would never improve under Carol Bartz, who was fired by Yahoo in September 2011. But before she stepped down, Alibaba was buffeted by two crises that threatened to erode the company's most precious commodity: trust.

The first crisis was an internal incident, the discovery of fraud within Alibaba's B2B business, which damaged Alibaba.com's reputation with its customers. The second was the controversy over the transfer of the Alipay asset outside Alibaba ownership, which damaged Alibaba Group's reputation with some of its investors.

The fraud, in which an estimated one hundred Alibaba sales personnel were implicated, involved 2,300 merchant storefronts[19] who were certified as trusted suppliers by the corrupt employees. The merchants then took in $2 million in payments for orders of computers and other goods on alibaba.com—bestselling items that were offered at very low prices—that they never shipped to the customers overseas.

Alibaba outed itself, sending its shares down by 8 percent, but Jack was most angry about the damage it had done to consumers trust. The salespeople were fired, and the accounts of more than 1,200 paying members were terminated. Although an investigation cleared the senior management of any wrongdoing, because the fraud happened on their watch Jack asked for the resignation of CEO David Wei and the company's COO.[20] Jack told the media that Alibaba is "probably the only company in China" where senior management takes responsibility, which prompted *Forbes* to describe Jack as "something of a rare species" in a nation "steeped in corruption." When some accused him that the dismissal of the senior executives was a publicity stunt, Jack responded angrily, "I'm not the guy who created the cancer, I'm the guy curing it!"

David Wei didn't oppose the move, crediting it as helping spur a similar crackdown within Taobao shortly after. "People said, 'Wow it's that serious?'" he told me. "And this triggered other cleanups within the group. It started within B2B, then to consumers. I feel very proud of my resignation. Without cleaning up the business, the IPO in 2014 would not have been so successful."

But the other crisis, impacting its investors, would have a more pernicious and long-lasting impact on Alibaba's reputation. Even though the company insists it did nothing wrong, a position that many investors support, the controversy continues to serve as a lightning rod to the company's critics. This crisis centered on who owned the Alipay business.

Firestorm

Alipay was a critical cog in the Taobao machine, handling more than $700 million a day in transactions, more than half of the total market in China. As it was so integral to Alibaba, it was hard to put a value on the business, but one analyst estimated that Alipay was worth $1 billion.

But on May 10, 2011, it emerged that the Alipay asset had actually been transferred out of Alibaba Group the previous year. The business was now owned by a company, personally controlled by Jack, called Zhejiang Alibaba E-Commerce Company Limited. Jack owned 80 percent of the company, and Alibaba cofounder Simon Xie (Xie Shihuang) held the rest. Investors first got wind of the transfer in a paragraph buried on page eight of the notes to Yahoo's quarterly earnings report. It read:

> To expedite obtaining an essential regulatory license, the ownership of Alibaba Group's online payment business, Alipay, was restructured so that a hundred percent of its outstanding shares are held by a Chinese domestic company which is majority owned by Alibaba Group's chief executive officer. Alibaba Group's management and its principal shareholders, Yahoo and Softbank Corporation, are engaged in ongoing discussions regarding the terms of the restructuring and the appropriate commercial arrangements related to the online payment business.

A business potentially worth $1 billion just went missing? Investors were alarmed. Yahoo's shares dropped like a stone—losing 7 percent on May 11 and 6 percent the day after—wiping $3 billion off its equity market capitalization. That evening, in an effort to limit the damage, Yahoo disclosed that neither it nor SoftBank had been told about the transfer of control until after the fact.

But ignorance wasn't much of a defense. In Yahoo's 2005 investment agreement, any transfer of assets or subsidiaries out of Alibaba Group that were worth more than $10 million required the approval of the company's board of directors or shareholders.

At Alibaba.com's annual general meeting in Hong Kong, Jack defended the transfer, arguing it was "a hundred percent legal and a hundred percent transparent." He added that discussions were ongoing with Yahoo and SoftBank "regarding the appropriate commercial arrangements related to the Alipay business," adding, "if we had not been doing everything aboveboard, we would not be where we are today."

Alibaba also released a statement confirming the transfer and explaining that it was made to comply with regulations from the People's Bank of China (PBOC), China's banking regulator. Specifically the PBOC had issued its "administrative measures for the payment services provided by nonfinancial institutions," which required, Alibaba explained, that "absolute controlling stakes of non-financial institutions must be domestically held."

On May 15, in an attempt to calm the waters after days of turmoil, Alibaba and Yahoo issued a joint statement: "Alibaba Group, and its major stockholders Yahoo Inc. and Softbank Corporation, are engaged in and committed to productive negotiations to resolve the outstanding issues related to Alipay in a manner that serves the interests of all shareholders as soon as possible."

But there was a gap between the public statements from Yahoo and Alibaba, opening up a series of troubling questions that were essentially: Who knew what? When?

Alibaba said the Alipay transfer had already happened. But Yahoo hadn't informed its shareholders for months, perhaps even years. How long had Yahoo (and SoftBank) known about the transfer? Alibaba insisted that Yahoo and SoftBank had been told in a July 2009 board meeting that "majority shareholding in Alipay had been transferred[21] into Chinese ownership." The Chinese business publication *Caixin* confirmed, after an investigation, that Alipay was sold in two transactions, in June 2009 and August 2010, to Zhejiang Alibaba E-Commerce Company Limited, the firm controlled by Jack. The total price paid was 330 million yuan ($51 million). Critics argued that Yahoo was either dishonest or incompetent. If Yahoo knew about the transfer, why hadn't they told their investors? If they didn't know about it, why not?

Other troubling questions were also raised by the crisis. Did Alibaba really have no choice but to transfer such an important asset out of the company? Furthermore, did that transfer have to be made to a company under Jack's personal control? And what was going to happen next?

Shareholders in Yahoo were exasperated, with one hedge fund manager telling the media, "It seems like this thing has evolved into a he-said, she-said battle via press releases. It doesn't make Yahoo's board look like they were on top of things."

Critics of the VIE structure, and of investing in Chinese companies in general, were having a field day. But did Alibaba in fact, as it was arguing, have no choice but to make the transfer?

Behind the scenes, when the crisis first broke Jerry Yang was upset, but he remained calm. Masayoshi Son, however, was incensed. What was Jack thinking? To figure out what was going on, Jerry offered to fly to Beijing. Meeting there with a senior official at the PBOC, he was told that it was best he just "accept the situation." When he pressed for an explanation, he was simply informed that the matter was "out of their hands."

It was true that PBOC had introduced new rules, in June 2010, governing domestic third-party payment platforms on the Internet. The rules set out a longer application procedure for foreign-funded companies than for wholly domestically owned applicants. PBOC had been debating the issue of foreign ownership of payment companies since 2005. But the rules did not exclude foreign ownership entirely.

Jack's defenders argue that he was simply first to see which way the regulatory wind was blowing. Parking the Alipay asset into a domestic company that he controlled could insulate Alibaba from the risk that new licenses expected to be issued by PBOC would be denied to foreign-invested companies. In an effort to clear up the matter in 2014 ahead of its IPO, Alibaba justified the transfer by explaining that the "action enabled Alipay to obtain a payment business license in May 2011 without delay and without any detrimental impact to our China retail marketplaces or to Alipay."

Indeed, on May 26, 2011, Alipay, now entirely domestically owned, was the first of twenty-seven companies to be issued licenses[22] and was awarded license number 001. But Jack's critics charge that because PBOC also issued licenses to foreign-invested companies, such as Tencent's Tenpay, and was the number two player in the market, then the argument that

Alibaba had to transfer ownership of Alipay out of foreign hands doesn't hold water. To this, Jack's defenders argue that the comparison with Tenpay and other foreign-invested companies isn't valid: Alipay already had such a dominant share of the market that it could not have expected such leniency. There were thousands of companies active in the third-party payment market, but with the first batch of licenses issued in May, PBOC also issued a deadline—September 1, 2011—for all companies to either obtain their own licenses or merge with an existing license holder. Inevitably this generated a lot of tension. Companies that had operated in a gray area now found themselves being divided into black and white, based on whether they had foreign investment and had obtained a license. Those that had not yet received licenses faced the risk of going out of business, and those that had received licenses but were foreign-invested were concerned that Alipay's move threatened their own ability to have IPOs in the future, damaging the valuation of their business and, many feared, undermining the VIE investment structure on which so many Internet companies relied.

A number of Alipay's rivals described to me a meeting hosted by PBOC soon after the licenses were issued, at which Jack was present. Many vented their unhappiness at Alibaba, but Jack remained silent. Yet even without the licensing issue, the reality was that too many companies were chasing after the oasis of fortunes to be made in payment riches. This turned out to be a mirage: With fees as low as 1 percent of transactions, if licensing hadn't thinned out the field, then competition would have done the job anyway. In this light, the Alipay incident—and the PBOC licensing regime it triggered—merely accelerated the inevitable: Many payment companies found themselves stranded in the desert, soon to run out of funding. One executive summed it up for me: "There were more 'payment solution' companies out there than consumer e-commerce companies. It was like being in a kitchen where there were more chefs than diners in the restaurant."

In light of all of this, was Jack justified in making the transfer of Alipay to his control? Or are those who, to this day, criticize the transfer justified? Both sides of the argument relied on their interpretation of what the Chinese government, in the form of PBOC, had in mind. But that was clear as mud. PBOC had never said that foreign-invested entities could own payment platforms. But equally it had never said that they could not. One influential investor I spoke with summed it up: "PBOC were pissed. But Jack was very skilled at playing off different factions. No one could do anything about it because PBOC's rules were so vague to start with."

Was something else going on that drove Jack to take the risky move of transferring Alipay out of Alibaba? The deteriorating relationship between Yahoo and Alibaba certainly didn't help. Under Carol Bartz, relations had become so bad that she and Jack were not even on speaking terms. Instead they started to communicate with each other by issuing statements or in interviews with the media.

Eight months before the Alipay crisis erupted, Bartz stated that she had no interest in selling Yahoo's stake in Alibaba and that Jack was merely trying to get "some of his stock back" ahead of an IPO that would value those shares much higher. Alibaba immediately fired back, via the media, denying any plans to get an IPO and laying out its efforts at good faith negotiations[23] with Yahoo to buy back its stake.

The reality for Alibaba, though, was that if Yahoo didn't like the price Alibaba was prepared to pay there was little Jack could do about it.

Did this frustration play a role? Or was another looming issue the reason? Five years had passed since Yahoo's investment. Part of the investment agreement, conceded to by Alibaba only after intensive negotiations, gave Yahoo the right to appoint a second director to Alibaba's board in 2010. Furthermore, the agreement also stipulated that a majority of the board could replace Alibaba's senior management. If a hostile Bartz gained the support of Jerry Yang, who although no longer CEO still sat on Alibaba's board, and enlisted the support of Masayoshi Son, she could outvote Jack and Joe, imperiling their positions. This was improbable—given Jack's relationship with Jerry and Masayoshi Son, not to mention the difficulty for a foreign company to try to gain control over such an iconic company as Alibaba—but not impossible, especially if Bartz could strengthen her hand in negotiations over a sale of Yahoo's stake. Yet even threatening such a move would have been highly destructive for Yahoo. "Then their investment would be worthless" is how another China Internet founder I spoke with put it.

In any case, the "nuclear option" never happened. As criticism of the transfer mounted Alibaba had little choice but to reach an agreement with Yahoo as quickly as possible. A number of domestic commentators were even harsher than foreign critics. In their eyes, the dispute threatened the interests of other entrepreneurs in China by undermining confidence in the

VIE structure, and foreign investment in the country in general. After first criticizing the government for the vague and lengthy approval process for licensing payment providers, respected local magazine *Caixin* slammed Jack personally for "violating contract principles that support the market economy." Jack had tarnished his international business reputation and diminished Alibaba's long-term growth prospects, Caixin argued, by transferring an asset "to a concern under his name, for a price too low to be fair." One China Internet company founder I spoke with, four years after the controversy, told me that even if that was the motivation, Jack was justified in doing it: "I perfectly understand it. Is it right? If I were Jack, I would have done the same thing. If he hadn't resolved the incentive problem, Alibaba wouldn't be today's Alibaba." Although few Chinese business leaders publicly endorsed that view, a number posted links to the *Caixin* article on social media.

Soon after its publication, Jack communicated with Hu Shuli, *Caixin*'s influential editor-in-chief, through a flurry of mobile text messages to discuss the issues she had raised. Their first texting session lasted two hours. Jack texted her to say he was very disappointed that *Caixin* published the comments without knowing the whole picture. He said that he "had no interest in politics at all," he just wanted "to be himself" and "to be accountable to himself and to others."

Jack said that "today's situation is not designed [by us], but [we are] compelled to do it. The complexity of decision making of shareholders and the board is also a problem of corporate governance in the future." He added, "I have three principles of doing things: first, one hundred percent legal; second, one hundred percent transparent; third, I must let the company develop sustainably and healthily."

Interestingly, Jack revealed to Hu that Alibaba's relationship with Yahoo was stronger at that point than with SoftBank: "The problems between me and Yahoo are easy to solve. They are problems of interests. But the issues between me and Masayoshi Son are not only issues of interests." Beyond the Alipay dispute, at the height of the controversy, Jack disclosed[24] that he had fundamental disagreements with Son on a range of HR issues, including employee incentive schemes and staff training:

> He thinks that employees can be replaced at any time. I believe that we should give opportunities to young people in China, sharing

> the future with them. He thinks that's not the case in Japan: I pay you wages anyway, so if you want to do it that's fine, but if not there will be others. First of all, I don't think [what happens in] Japan is necessarily right; second, this is totally wrong in China. I believe customers first, employees second. We wouldn't have this company without our staff. We have completely different principles on this issue. . . . The issue has been there since day one.

Jack revealed that his disagreement with Son was long-standing, that they had been "fighting over it regularly in the past few years." Jack also contrasted his approach to equity ownership. "Seventeen thousand employees at Alibaba all have shares," he said. "You see that from the day that Alibaba was established until today, my share has been getting smaller and smaller." Jack argued that Son, by contrast, had a stake in Alibaba of "thirty percent from day one, and now it is over thirty percent." In a sign of the tension that had erupted between the two men, he invited journalists to look at Son's approach to his own employees at SoftBank: "You can check if he's given anything to his employees. . . . If he [Son] is asked to take out one percent [of his stake], it's like pulling out a tooth from a live tiger."

While Jack professed his admiration for Son's skills of negotiations, he also said Son is the world's number one "iron rooster" (*tie gongji*), a Chinese idiom describing people who are extremely stingy: Meaning, there is no chance whatsoever to pull out even one hair from an iron rooster.

Because many of the facts were disputed, and the stakes were so high, efforts to resolve the dispute dragged on for weeks, then months. Midway through the crisis,[25] Jack described the negotiations over the compensation to be paid for the Alipay transfer as "very complicated," comparing them to "peace talks at the United Nations."

But reaching a settlement was becoming urgent. By the end of July, Yahoo's shares had dropped 22 percent since the dispute began. A few weeks earlier, high-profile investor David Einhorn of Greenlight Capital sold his entire position in Yahoo, which he had built up because of its exposure to China, saying that the dispute "wasn't what we signed up for."

Finally, on July 29, an agreement was reached. The transfer of the assets would stand. But Yahoo, benefiting through its continued stake, would receive compensation of $2 to $6 billion from the proceeds of any future IPO of Alipay. Alibaba, Yahoo, and SoftBank were ready to put the dispute behind them. But investors in Yahoo were underwhelmed, particularly by the cap of $6 billion,[26] and its shares fell 2.6 percent on the news. But in a call explaining the agreement to investors Joe Tsai pushed back vigorously, saying that the transfer was made to stay in line with government regulations: “If you own a hundred percent of the business that cannot operate, you own a hundred percent of zero.”

The Alipay episode left a bitter taste, but the compensation agreement had put an end to months of uncertainty. Now Alibaba could focus on its next priority: buying back as much as possible of Yahoo’s stake.

On September 30, 2011, Jack accepted an invitation to Stanford University to give a keynote speech at the China 2.0 conference series, which I had cofounded with Marguerite Gong Hancock a few years earlier. After I had introduced him onstage, I settled into a seat in the front row to watch what turned out to be a vintage performance of “Jack Magic.” Speaking in English, Jack started by acknowledging the elephant in the room—the company’s relationship with Yahoo. He said he was very tired from the events of the past few months, then, raising his right hand and looking at the audience, he said, “I still don’t know what the VIE is, right?” Of course it was obvious Jack knew all about the investment structure—it had been center stage of the Alipay controversy—but feigning ignorance was his way of winning over the crowd, even if the lawyers in the audience couldn’t contain their incredulity. Jack then ventured onto safer ground using some of his stock stories, before I started to field questions for him from the media. Asked, “Are you going to buy Yahoo?” Jack replied, “Yes, we’re very interested in that.” When Kara Swisher of Dow Jones’s AllThingsD asked him if he wanted to buy back just Yahoo’s stake in Alibaba, or all of Yahoo, Jack replied, in a sound bite that quickly went around the world: “The whole piece. Yahoo China is already ours right?” Then putting his right hand in his pocket he added, “It’s already in my pocket!” He concluded by adding that the situation was complex and would take time.

In the end, it would take nine months before a deal was completed. On May 21, 2012, the terms were made public: Alibaba would pay Yahoo $7.1 billion ($6.3 billion in cash and up to $800 million in preferred stock) to buy back half of Yahoo’s stake, or 20 percent of Alibaba, netting Yahoo some badly needed cash: $4.2 billion after tax. Alibaba also made a commitment to buy back a quarter of Yahoo’s remaining stake by 2015, or let Yahoo sell the stake in a future IPO[27] of Alibaba Group. Yahoo and SoftBank also agreed to cap their voting rights on Alibaba's board below 50 percent. Jack and Joe could feel secure in their seats. They set a course for their IPO (2.0).