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# WHY WE ARE STILL OPTIMISTIC ON CHINA'S INTERNET COMPANIES

Wisdomtree EU  
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Most of the recent commentary surrounding Ant Group and the antitrust regulations that will impact Chinese companies focuses on party intrigue and palace gossip.

While interesting, this type of commentary does not help us understand the broad Chinese economic system, nor prepare us for the future competitive dynamics between the US and China.

Let's review two timelines—one on the delayed initial public offering (IPO)<sup>1</sup> of Ant Group and the other on the origin of the antitrust regulations.

## TIMELINE 1: ANT'S IPO DELAY

**13 June 2020: Qifan Huang, ex-mayor of Chongqing, gave a speech on "FINTECH Features and Future Development Path under 5G."**

Huang approved two Internet loan businesses that grew into Ant Group. Over time, Chongqing became the centre for Internet loans with 60% national market share.

Regulators were initially ambivalent on fintech loan leverage<sup>2</sup> limits, and Huang described an unnamed entity using 100 times leverage. This suddenly raised concerns.

The People's Bank of China (PBOC) had no regulatory oversight because Ant Group was not regulated as a financial company, but it said the 100-times-leverage ratio was too much and needed to be reduced.

China's banking regulator said the entity used 2-3 times leverage of its bank loans, which is within the current law.

China's securities regulator said the entity used asset-backed securities<sup>3</sup> (ABS) in the capital market to raise capital, which resulted in a leverage ratio closer to 30-50 times. But there is no Chinese law limiting the leverage ratio on ABS.

**24 October 2020: Jack Ma gives a speech.**

Jack Ma, co-founder and former executive chairman of Alibaba Group, gave a speech claiming that Chinese banks "tirelessly gave loans to companies that don't need money" and that there is "conflict between financial innovation and Chinese regulation."

Chinese social media lit up over his audacity to criticize regulators. But sentiment shifted abruptly to the view that Ant Group was taking advantage of regulatory loopholes

and getting away with very high financial leverage.

**2 November 2020: Regulators interview Ant Group, and new regulations on Internet microloans are proposed and seeking comments.**

Four top financial regulators<sup>4</sup> interviewed Jack Ma, Ant Group's controller, as well as executive chairman Eric Jing and CEO Simon Hu. Two regulators (PBOC and the China Banking and Insurance Regulatory Commission, CBIRC) released a new regulation for Internet microloans.

**3 November 2020: Suspension of IPOs are originally scheduled for 5 November.**

Citing "significant issues such as the changes in financial technology regulatory environment," which "may result in your company not meeting the conditions for listing or meeting the information disclosure requirements," the Shanghai Stock Exchange decided to suspend Ant's listing on the Science and Technology Innovation Board, also known as the STAR Market, China's version of the Nasdaq.

Shortly afterward, Ant Group said the listing of its Hong Kong shares would also be suspended.

**9 November 2020: Pfizer and BioNTech announce effective COVID-19 vaccine.**

The market reacted swiftly to the news, leading to a rotation from technology-focused global growth<sup>5</sup> equities to cyclical economic sectors like Energy and Financials.

#### TIMELINE 2: THE ORIGIN OF CHINA'S ANTITRUST REGULATIONS

**1 August 2008: China's antitrust law (the Anti-Monopoly Law) becomes official.**

**March 2016: Car industry antitrust regulation guidance is proposed and seeking comments.**

**March 2017: Intellectual property antitrust regulation guidance is proposed and seeking comments.**

**16 November 2018: In commemoration of the 10th anniversary of the passing of the Anti-Monopoly Law, the Chinese Supreme Court released the 10 most significant cases.**

**January 2019: Car industry antitrust regulation guidance is finalized. August 2020: Intellectual property antitrust regulation guidance is finalized.**

**10 November 2020: Internet platform antitrust regulation guidance is proposed and seeking comments.**

It is intriguing to say Jack Ma tripped on opaque party politics and was punished. But Chinese regulations generally follow a long process that takes 3-5 years.

Our recent Behind the Markets radio interview with Professor Nan Li laid out details for why there was broad sentiment across government regulators, academics and the public to regulate Ant Group long before its IPO was paused.

Chinese consumption historically has been financed with savings. My parents never owned

credit cards or had a mortgage because there was no access to such tools.

In the last 15 years, China has moved toward credit-based consumption. Ant Group marketed itself as using its unique proprietary big data on small businesses to make credit available to these owners who are not getting credit from state-owned banks. This generally is viewed positively by the public as a helping hand.

But 80% of Ant Group's loans are for consumption. It is providing consumer credit like a credit card company without being regulated like a financial intermediary. It usually entices people during online shopping with instant credit with high interest rates. This part of Ant's business could be considered "predatory lending."

In our view, the most likely scenario is that Ant knew the Internet microloan regulations were coming but chose to negotiate in public. Jack Ma of Alibaba has always been more willing to plead his case in public, while Ma Huateng of Tencent is famous for his reticence.

A public listing would have helped Ant's negotiating position, as no one wants to rock the market. A pause in the IPO hurt its negotiating position, which is being reflected in lower valuations. But it would not impact Alibaba's fundamentals (as Ant Group is an affiliate of Alibaba) too much, since its business is much more diversified than Ant Group's.

Professor Li believes Ant Group is likely to be reapproved for public listing in 6-12 months as a financial firm with leverage and lending practice regulations on the A-share main board, instead of listing as a technology firm on the STAR technology board. There is a small but non-zero chance that Ant may not be allowed to re-list until the Internet microloan and Internet platform regulations— both currently in seeking comments phase—are official, which usually takes three years.

Similarly, the major Chinese platform companies likely also already knew the antitrust regulations were coming many months in advance. Yet, they generally have not viewed it as a major threat to their businesses for two reasons.

First, there were few big antitrust legal cases against platform companies in the last 12 years since the first Chinese antitrust law was passed in 2008.

Second is Chinese regulators' prevailing view that antitrust cases do not seem to work, based on observing how antitrust laws have been applied in the US over more than a century.

Encouraging competition is believed to be a better way to combat monopolies. The business world is competitive. We believe China technology companies provide growth opportunities that rival, if not surpass, the growth potential of US technology companies. Indeed, anything could happen in China, as behind-closed-doors politics-driven policies emerge to swiftly and unexpectedly strike individuals and businesses. Having a well-tested legal process is a strength of the US business environment. China or EM equity has a higher political risk valuation discount precisely for this reason. There will always be a regulatory risk here, but so far China has encouraged competition instead of trying to "force" breakups via antitrust cases.

<sup>1</sup> Initial public offering (IPO): The first sale of stock by a private company to the public.

<sup>2</sup> Leverage: Total assets divided by equity. Higher numbers indicate greater borrowing to finance asset purchases; leverage can tend to make positive performance more positive and negative performance more negative.

<sup>3</sup> Asset-backed security: A fixed income security whose value or cash flows depends on the value of another asset, such as a loan, lease or receivable.

<sup>4</sup> People's Bank of China (PBOC), China Banking and Insurance Regulatory Commission (CBIRC), China Securities Regulatory Commission (CSRC) and State Administration of Foreign Exchange (SAFE).

<sup>5</sup> Growth: Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

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