

## Feature Report e-Commerce

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### China e-Commerce – Paradigm Shift

#### China e-Commerce Booms Yet Healthcare Mutual Aid in Hardship

e-Commerce prospers in China and takes lead in the world, yet new initiatives, such as sharing bicycles and mutual aid in healthcare, are facing hard time. Just counting more people in may not work and well-conceived products and targeted market focus can help differentiate from the rest of the pack.

#### Fake Goods Versus Conduction Business with Good Faith

Bad practices are going viral with some KOLs flooding the market with purposely misleading information and fake goods. This is an area that government regulations should be enforced and the market should promote conscientious in conduction business with good faith, not high credit score.

#### Personal Credit Operations License – the Litmus Test

China government's regulatory scrutiny on Alibaba's credit related business operations may be the first step in reigning the e-Commerce market. The personal credit operations license may be the litmus test on how far Chinese regulators will pursuit in this direction.

#### Worst-case Scenario – Alipay First, Then WeChat Pay

In the worst-case scenario, both Alipay and WeChat Pay will be subject to antitrust rulings, on ground of market share concentration. The break-up of Alipay in the case of most severe action is likely to trigger the same action on WeChat Pay. In our view, antitrust ruling will dislodge the linchpin of e-Commerce ecosystem and Chinese characteristics e-Commerce may revert to what it is around the world as a consequence.

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FEB 26, 2021	Closing Prices (HK\$)	Mkt Cap (HK\$ bn)
0700 HK Tencent 騰訊控股	662.50	6,356.4
9988 HK Alibaba - SW 阿里巴巴-SW	232.40	5,030.3
9618 HK JD.com - SW 京東集團-SW	360.00	1,126.7

## Overview

China is leapfrogging the rest of the world in e-Commerce with truly innovative technologies and practices in multiple dimensions and revolutionizes the B2B, B2C, and C2C in the 2000 dotcom bubble era. Alibaba (阿里巴巴) plays a key role in the development of e-Commerce in China and together with other major players in the value chain, such as JD.com (京東) and Weixin / WeChat of Tencent (騰訊微信), create a new paradigm that is different from the U.S. model at the turn of millennium and today. The model is so successful in China, and it is exporting to the rest of the world and become a show case story for China.

Starting with taobao.com (淘寶網) and expanding to Tmall (天貓), Alibaba put forth a platform for millions of small pop-up stalls and line up with delivery operators in the front end, while building an empire with payment system, credit rating, and credit extension at the back end.

In addition to the usual click advertising, China e-Commerce operators invite internet celebrities for both hard and soft advertisements in mass scale. Scores of internet celebrities / key opinion leaders (KOL) with fame in talent shows are brewed up and sustained via the Chinese characteristic red packet award scheme under the easy-to-use payment systems, and they help create a mutually beneficial ecosystem for e-Commerce.

Going a step further, e-Commerce operators venture into market of fresh goods, such as meats and vegetables, and leveraging on their sheer mass to acquire off-line shops to bridge the gap in delivery. All these culminate in the 11.11 Global Shopping Festival (雙十一全球狂歡季) on November 11.

Yet the good old days may be over. Though it may not be an all-out battle against e-Commerce in general, foundations under some key pillars are facing the risks of erosion. The key ones are restrictions on credit extension, capital adequacy requirement, and credit rating services that help mitigate e-Commerce counter party risks.

## Alibaba, JD.com, and Pinduoduo Domination

A rough division of the Chinese e-Commerce market is that half goes to Alibaba, quarter to JD.com, one-eighth to Pinduoduo (拼多多), and the rest sharing the remaining. By far, Alibaba is dominating this market with host of innovations and taking strong leadership across the whole value chain, while others are following its steps. Barring the extreme case that an antitrust crack down initiated by the Chinese government, which will reshuffle the whole e-Commerce market and may have dire consequences

on the Chinese economy, a glimpse on actions taken on Alibaba will be a good indication on the direction of e-Commerce development in China.

Of course, misconducts, or just negative news reports on such, by key persons of major e-Commerce players, such as the one on JD.com founder two years ago and the one on Alibaba founder few months ago, will have detrimental effects on the whole industry, given the high concentration of market shares.

### Alibaba Too Big to be Ignored

In just over 10 years, Alibaba has built up an empire with 711mn Alipay APP monthly active users and 729mn Alipay APP digital finance annual active users. Its famous 11.11 Global Shopping Festival generated RMB498.2bn in GMV in November 2020.

#### Exhibit 1: Alibaba Record GMV in 11.11 Global Shopping Festival 2020



Source: alibabagroup.com

While banks are trying hard to squeeze into the too big to fail category, Alibaba has ventured into the too big to be ignored territory, be it good or bad, and may see back fire on it and other e-Commerce players as well.

### Chinese Government Intervention on Ant Group IPO

The first shot by the Chinese government may be marked by the suspension of the dual Hong Kong and Shanghai initial public offering of Ant Group (蚂蚁科技集团). The ground for suspension is that Ant Group may not meet listing qualifications or disclosure requirements under recent changes in the Fintech regulatory environment. Amid the failures of various micro-

financing companies in recent years, Ant Group has been operating for years under regulatory scrutiny. Yet the government decision prevails.

Needless to say, Alipay (支付寶) and Tencent's WeChat Pay (微信支付) dominates the e-Commerce payment market. Even the state-owned China UnionPay (中國銀聯), who beats the Visa and Mastercard in the global credit card market and taking 90% market share in China, has seen its QuickPass (雲閃付) mobile payments service fallen behind by wide margin to the two giants. Neither Digital Currency Electronic Payment (DCEP), the digital currency promoted by the Chinese government, materialized after some testing in Shenzhen in October 2020. Stickiness is in the DNA of e-Commerce.

## **PBoC Eyeing on Antitrust Measures for Non-Bank Payment**

China's central bank, the People's Bank of China (PBoC), has issued a consultation paper in January to seek stepping up antitrust measures for companies in the non-bank payments industry, such as Ant Group's Alipay and Tencent's WeChat Pay. Under the draft rules proposed, PBoC can advise the State Council's antitrust committee to stop companies abusing their dominant position or even break up a non-bank institution if it severely hinders the healthy development of the payment service market.

### **Alipay and WeChat Pay Taking Lion's Share**

Out of the 233 licensed players, the market is dominated by Alipay and WeChat Pay in terms of online transactions, according to data from research firm Analysys. Alipay had 55.39% of the third-party mobile payment market as of the second quarter of 2020, while WeChat Pay held a 38.47% share. Alipay is obviously on the cross hair by market share measurement and see if other criteria, such as exclusion clauses with merchants, are counted in defining monopoly.

### **Ease of Payment Incubates Internet Celebrities**

Yet payment is a key pillar in the development of e-Commerce in China. Offering anonymity to protect the true identities of both sides and ease of use via QR merchant code scanning, a new generation of internet celebrities, or KOL, emerged. By just taking red packet awards from audiences, some internet celebrities can earn their livings. The bright side is that some are promoting local cultures and sharing their life style, while the dark side is that some are just doing something extraordinary, form gluttony to explicit sexual acts, in order to attract eyeballs.

### **KOL Positive Feed Back to e-Commerce**

Those successful ones also grasp the opportunity to do online advertising for merchants and, few even build their own brands and sell goods in the

mean-time. This provides a positive feed-back to e-Commerce players like Alibaba and JD.com, and all parties benefit from this scheme.

**Exhibit 2: Li Relaxed After Making a Table with Bamboo in Her Style**



Source: bilibili.com Li's page

Li is among the one on the top. By showing herself at works in natural scenery, she posts as ordinary girl and offers a fresh look in contrast to those showing luxury handbags and dining expensive foods.

**Exhibit 3: Li Selling Canned Foods Under Her Own Brand**



Source: jd.com

Yet not all internet celebrities are good guys. Some are offering fake or poor quality goods and conducting business in bad practices, that tarnish the

image of all participants. Chinese government is saying that it will take actions to rectify the situation.

### **Chinese Characteristics Red Packet Good for Business Promotion**

Ease of payment makes it an ideal channel for handing out red packets, both by platform operators such as taobao.com and Tmall, and by the individual stores, to do advertising and product promotion. And this practice has extended to offline shops as well, since almost everyone targeted will have such digital wallet to grab these lucky monies.

In all, Alipay and WeChat Pay have been developed to serve much more than just on-line payment. If Chinese government imposes severe restriction on them, the way of doing business, not only e-commerce alone, in China may see sea changes.

### **Alibaba Empire Building in Banking and Credit**

In addition to offering simple payment services, Alibaba also provides credits to its customers and establish Huabei (花呗) as the preferred funding option in Alipay for both online and offline purchases due to its accessibility and convenience. Huabei charges a daily interest rate at 0.04% or below, effective for the majority of its users. The average Huabei outstanding balance was about RMB2,000 as disclosed in Ant Group IPO prospectus. Not a big sum by itself, yet it becomes a trillion-dollar business for 500mn users with enabled credit balances.

If Huabei is for facilitating Alibaba's platform operations, Jiebei (借呗) is a bank loan in essence. It is a short-term digital unsecured consumer credit product for users with a credit history on its platform. Alibaba develops the Zhima Credit (芝麻信用) to screen customers with its intelligent decisioning systems for credit line approval. The daily interest rate for the majority of Jiebei users was 0.04% or below, and borrowers can repay outstanding balances at any time typically without penalty.

### **Alibaba's Zhima Credit and WeChat Pay Score Binding Pieces Together**

By checking Alibaba platform users' payment history and integrating users' other auxiliary information in big data system, Zhima Credit serves as the linchpin binding its e-Commerce platform and banking credit operation.

Tencent is not moving as fast and far as Alibaba and it launched its own credit WeChat Pay Score (微信支付分) last June. And similar to Zhima Credit, it offers deposit waiver on power bank rental, hotel check out without checking room, among other benefits that relate to the credit worthiness of the users.

### **Claiming Deposits on Sharing Bicycle – Lack of Mutual Trust**

Though sharing economy is not as hot a topic as in the year of sharing bicycle, news reporting on the difficulties subscribers faced in claiming their deposits highlights the fact that not only vendors care about the credit worthiness of their subscribers, subscribers also cannot trust the vendors in full. Theoretically a credit system can serve both parties well.

### **PBoC Issuing Second Personal Credit Operations License**

Yet the issuance of personal credit operations license by Chinese government is lagging progress. So far, only two licences are issued and the second one was fresh in December 2020. Both Alibaba's Zhima Credit and Tencent's WeChat Pay Score are apparently operating under preparatory stage. They had applied for formal licence to conduct personal credit operations few year ago, but to no avail.

While various e-Commerce operators are shareholders of Baihang Credit (百行征信) and Pudao Credit (朴道征信), the two licenced personal credit operators, few public information are available on the scope of business cooperation. Alibaba is doing business of few thousand dollars with hundreds of million people, from youngster to elderly, and whether conventional personal credit reports can fit this business model is doubtful. RMB10 for each credit report will amount to RMB1bn expenses.

### **Record Penalty to Pengyuan Credit**

Just days after granting the second personal credit operations license to Pudao Credit, PBoC handed out a record penalty, RMB20mn, to Pengyuan Credit (鹏元征信) for operating without a licence. For sure the grip is tightening and the support and suppress tactics may be at work.

### **e-Commerce Seeing Dead End in Mutual Insurance**

While e-Commerce has been booming in China, we have seen bumps around. The sharing bicycle scheme failed miserably and sharing power banks for cellular phone charging is yet to be sure of success. We have seen another troubled segment just around the corner, the mutual insurance sector.

### **Meituan Mutual Aid Closure on Dwindling Subscriber Base**

Meituan Mutual Aid (美團互助) has announced closure of business by end of January as its number of subscribers has fallen from the peak of 34mn to 15mn before making the decision. This is the second one after Baidu's closure of this line of business few months ago. China Banking and

Insurance Regulatory Commission is frank in saying that increasing risk of adverse selection is the culprit.

This leave Alibaba's Xianghubao (相互寶) with over 100mn active members in the market, together with several other much smaller players. See if Xianghubao can retain the good guys to sustain its business model and stay afloat by cross selling Haoyibao (好醫保) health insurance products.



## Conclusion: Paradigm Shift in View

Having seen e-Commerce prospers in China and taking the lead in the world, bumpers may be just around the corner. The conventional e-Commerce business model works but new initiatives, such as sharing bicycles and mutual aid in healthcare, are facing hard time and may undermine innovations in future e-Commerce development. Just counting more people in may not work just as well as before. Well-conceived products and targeted market focus can help differentiate from the rest of the pack, and we are keeping an eye on development in this arena.

Amid the booming e-Commerce market, a few bad practices are going viral. The case of carrying goods by internet celebrities and KOLs may go too far and flooding the market with purposely misleading information and fake goods. This is an area that government regulations should be enforced. Conscientious in conduction business with good faith, which is lacked in general, is what credit means, not a score in number.

The regulatory scrutiny on Alibaba's credit related business operations may be the first step in reigning the too big to ignore e-Commerce market. Whether this is targeting a single entity or the whole market is yet to be seen. However, all e-Commerce players in the China market share very similar practices and the difference is how aggressive it goes. The personal credit operations license may be the litmus test on how far Chinese regulators will pursuit in this direction.

In the worst-case scenario, both Alipay and WeChat Pay will be subject to antitrust rulings, on ground of market share concentration. The break-up of Alipay in the case of most severe action is likely to trigger the same action on WeChat Pay, given its current market share and the likeliness of taking up a few percentage points of market share from the dismantled Alipay. In our view, antitrust ruling will dislodge the linchpin of e-Commerce ecosystem and practices such as red packet award may no longer function as in its good old days. Chinese characteristics e-Commerce may revert to what it is around the world as a consequence.

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