May 31, 2021

Feature Report

e-Commerce

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Industry Research

China e-Commerce – Pounds of Flesh, Far from the Heart

Alibaba Paid the Record RMB18.2bn Fines

Having paid the record RMB18.2bn fines, Alibaba is apparently doing business as usual for now. Uncertainties remain ahead yet standstill situation works for Alibaba. In our view, other fines should be expected in near future and the good news is that investors' sentiment is resilient.

e-Commerce Contributing to Economy and Pandemic Control

e-Commerce has been a strong pillar in China economy and it is a brag point amid the sluggish global economy. Especially at a time when the manufacturing sector is facing a surge in commodity prices and shortage of key components, such as ICs. e-Commerce performs well in helping minimize people flow and interactions in the pandemic environment.

Internet Celebrity Promotion Backfires

Yet to tighten regulations in internet celebrity promotion is imminent. Too many of these internet celebrities retort to extravaganza acts to attract eye balls, though general public are quite attached to such acts and fans are fervent to their idols. To e-Commerce merchants, products sell well with internet celebrities carrying goods. Yet it backfires sometimes, as in the Mengniu case.

Killing Two Birds with One Stone

Fast track in breaking the oligopoly of incumbents by grooming another e-Commerce platform via taking a core component from each incumbent, handicapping their capabilities in the process, is unlikely. We buy the more moderate way in tightening grip via regulatory actions and administrative orders.

Strengthen regulation maims, doesn't kill e-Commerce.

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MAY 31, 2021	Closing Prices (HK$)	Mkt Cap (HK$ bn)
0700 HK Tencent 騰訊控股	619.000	5,939.3
9988 HK Alibaba – SW 阿里巴巴–SW	211.000	4,576.3
3690 HK Meituan – W 美團–W	294.000	1,796.6
9618 HK JD.com – SW 京東集團–SW	291.200	911.3

Overview

After the first shot in targeting the e-Commerce players, which was marked by the suspension of the dual Hong Kong and Shanghai initial public offering of Ant Group (螞蟻科技集團), we saw salvoes fired by China government in quick succession. The most notable one is of course the record RMB18.228bn fines on Alibaba imposed by the State Administration for Market Regulation (SAMR) upon its quick conclusion of anti-monopoly investigation.

Major e-Commerce players, such as Meituan (美團), DiDi Group (滴滴出行), Pinduoduo (拼多多), vip.com (唯品會), Tencent (騰訊), and yet other smaller players, were fined in the millions of dollars range, more or less under similar charges to that of Alibaba. That scratches the skin.

The stock market responded calmly towards these fines and we saw tens of billions of dollars shares placement and disposal deals proceeded as usual. Music doesn’t stop.

Yet there are under current underneath. This is evident in the apparently harmless quoting of a thousand-years-old poem by Meituan founder and CEO and the insightful interpretation of its underlying meanings by some key opinion leaders (KOL) that prolonged a losing streak over multiple days for the stock.

Aside from the monetary fines, e-Commerce players are all committed to review their own operations and undertake remedies to rectify wrong doings, in one way or the other. Yet the key cornerstones underlying the China e-Commerce industry are yet to be touched by China regulatory bodies. We do not see major bans on operations and e-Commerce players are doing business as usual. What is next up in the sleeve will be interesting to see.

Alibaba Swallowed RMB18.228bn Record Fines

On 10th April 2021, the SAMR issued an Administrative Penalty Decision of the Anti-Monopoly Investigation into Alibaba Group, after merely three full months since the commencement of the investigation.

SAMR found that Alibaba had violated an article of the Anti-Monopoly Law in that a business operator that has a dominant market position is prohibited from restricting business counterparties through exclusive arrangements without justifiable cause. It ordered Alibaba to cease violating acts and imposed a fine of RMB18.228bn, assessed on 4% of Alibaba’s revenue of RMB455.712bn generated in 2019 in China.

The decision also comes with an administrative guidance, instructing Alibaba to implement a comprehensive program of rectification, through strictly fulfilling its responsibility as a platform operator, strengthening its internal controls and compliance, upholding fair competition, and protecting the lawful rights and interests of the platform's merchants and consumers. The administrative guidance requires Alibaba to submit a self-assessment and compliance report to the SAMR for three consecutive years.

In its announcement, Alibaba stated that it accepts the penalty with sincerity and will ensure compliance with determination. To serve its responsibility to society, Alibaba will operate in accordance with the law with utmost diligence, continue to strengthen its compliance systems and build on growth through innovation.

All are boiler plate statements.

Ant Group Rectification Plan in Place

Just two days after announcing the record fines handed down by SAMR, Alibaba announced the completion of the formulation of rectification plan of Ant Group, its unconsolidated related party.

The announcement states that Ant Group, in its entirety, will apply to set up a financial holding company to ensure its financial related businesses are fully regulated. Returning to its origin, its payment business will serve consumers and SMEs by focusing on micro-payments and bringing them convenience. Ant Group will set up a personal credit reporting company and apply for a personal credit reporting license.

It will conduct the personal credit reporting business in compliance with relevant laws and regulations, strengthen the protection of personal information, and effectively prevent the abuse of data. Jiebei (借唄) and Huabei (花唄) will be operated by its consumer finance company which will be operated in compliance with relevant laws and regulations. Ant Group will strengthen consumer rights protection as well as suitability management of financial consumers. It will also further enhance its corporate governance, adhere to fair competition rules, bring related-party transactions into line, strengthen risk prevention and control, create a fair market environment, and further strengthen its corporate social responsibility commitments. Those actions mentioned above will be carried out after completing the relevant procedures provided in the regulatory requirements and Ant Group's corporate bylaws.

It is yet another set of boiler plate statements.

Business as Usual for Now

The underlying fact is business as usual. While Ant Group is willing to apply to set up financial holding company, in the mean time before this is done, its operations can keep running. While it is also willing to set up a personal credit reporting company and apply for a personal credit reporting license, there are no mentions of stopping this line of business, which is very likely now running without licenses and breaching regulations. Neither is mentioned on sourcing such personal credit services from Baihang Credit (百行征信) and Pudao Credit (朴道征信), the two licensed personal credit operators. It should be noted that Ant Group, or Alibaba, the exact entity cannot be known for sure, had applied for such license years ago and has not been granted one.

There are no specific measures mentioned in the announcement to address the key issue underlying the SAMR investigation: the exclusion clause with merchants in joining the Alibaba e-Commerce platform. Of course, the more drastic actions, such as to dismantle the Alibaba group, are apparently out of question.

All in all, the fines may serve as a ticket to play the game and it is business as usual, for now.

Not Yet Out of the Woods

While Alibaba and its peers in the e-Commerce trade are doing business as usual after paying the fines, it seems that the stock market is sensitive to negative news, or just negative interpretation of news.

Cold Ashes Backfires
By just quoting a thousand-years-old poem, Meituan founder and CEO sent share price of Meituan on a prolong losing streak over multiple days. The insightful interpretation of the poem's underlying meanings by some key opinion leaders reminded investors of what the Alibaba founder said in teaching regulators a lesson yet in turn being taught. The post was subsequently withdrawn. It is good that Meituan has just completed its share placement and is not doing spin-off lately. JD.com does and its founders and CEO keep quiet.

By coincidence or not, a few days later news is circulating that Hupan University's plaque, with writings set in stone, was burnt away by torch, literally. Apparently, the school is not conforming to the latest regulations in having university in its name. The burning came after administrative order to stop new admissions to the school this year. Hupan University is founded by Jack Ma few years ago and he once said he will work as a teacher again.

Market reaction to Alibaba was calm and its share prices just stayed flat at 20-days low level.

Tencent is used to low profile and we are keen to see if anything is happening.

Exhibit 1: Jack Ma Founded Hupan University – Plaque Blown by Torch

Source: caixinglobal.com

Alipay and Zhima Credit – Linchpins Still in Place

In handing down its decision on Alibaba quickly, SAMR grasps what is on the table and leaves deep-rooted issues to undertakings by Alibaba. One of the root causes of monopolistic position enjoyed by Alibaba is in its payment system – Alipay (支付寶), in our view. Instead of contractual exclusive clause with merchants, which is illegal now, Alibaba can still enjoy de facto exclusion of other e-Commerce platform operators by offering tied up benefits with the Alipay payment gateway.

Seamless integration with Zhima Credit (芝麻信用) personal credit score services in its big data database create stickiness which is in the DNA of e-Commerce. Unless open systems architecture which provides seamless interfaces among each module in the e-Commerce food chain, so, say Tencent WeChat Pay (微信支付), can respond to Alipay requests for payment after assessing the risks involved by querying its own counterpart WeChat Pay Score (微信支付分). This takes time and needs coordination and cooperation which are not in the DNA for now.

Standstill Still Works for Now

Alibaba did not mention timeline in the implementation of its undertakings to SAMR in its announcement. Indeed, granting of licenses by China government regulatory authorities is beyond the control of Alibaba and it had applied for personal credit services license few years ago. Yet apparently there is no response from authorities on whether such application is still in process, suspended, or failed. As long as business as usual, a stalemate is acceptable to Alibaba. Though a quick end to this dilemma is a tied up with Baihang Credit or Pudao Credit, the two licensed personal credit operators, and case closed.

Of course, it is the prerogative of SAMR to hand down another billion dollars fines to Alibaba.

RMB2,000 Each for 500mn Users – Billions of Reserves Needed

Another issue is the set up of a financial holding company to put its financial related businesses under regulatory scrutiny. This may incur significant equity capital tied up in meeting the tiered capital reserve ratios as stipulated by the central bank. The exact amount may be difficult to estimate but given the average balance of RMB2,000 for 500mn users, Alibaba may need to trim down either one or both to lessen the burden. Of course, reactivating the Ant Group initial public offering, which was suspended in November 2020 and then without subsequent updates, will do as well.

DCEP – the Disruptive Technology?

Digital Currency Electronic Payment (DCEP) is coming back again after months of hibernation and the People's Bank of China (PBOC) gave the green light to connect virtual bank affiliated with Alibaba. In additional to the initial hypothetical-use tests of the digital yuan in several regions, with monetary sum involved only in tens of million dollars for each location and the number of users involved only in tens of thousands with average amount granted at RMB500. Tapping the e-Commerce market can significantly expand the scale of deployment.

Blessing in Disguise – Clearing Anti-Trust Threshold

Yet DCEP can be a challenge to Alipay and WeChat Pay, especially if its adoption comes with administrative orders. This may take away substantial market shares from the two key players but unlikely to hurt the fundamentals of China e-Commerce market. On the optimistic side, this may be a blessing in disguise as the 50% threshold for single player and two-third threshold for the top two players combined in market share are cleared. Though it must be admitted that payment is only one area that regulatory watchdogs are eyeing, other areas such as exclusion clauses with merchants are more fundamental concerns.

Another concern is whether DCEP infrastructure will be funded by China e-Commerce players, in one way or the others. Alipay and WeChat Pay had made large investments in developing a base of consumers and stores in the initial stage of building their payment network and by now, it is sunk costs. Yet DCEP will need massive investment in infrastructure for nationwide deployment and for fairness to all citizens, may need to be deployed in areas, say rural villages, that lack the basics for DCEP adoption.

In addition, DCEP should come with more stringent security measures and controls to safeguard its legal tender status. This is costly and cumbersome as Alipay and WeChat Pay users are adapted to payments of a few dollars in red packet style to internet celebrities, or the like. The sheer volume counts.

This is all costs and whether and how Alipay and WeChat Pay to contribute to DCEP deployment will be of interest to look at. Of course, administrative orders will work magic and a levy may be on every dollar spent in e-Commerce transactions.

Without details on the implementation of DCEP at the moment, its impacts on Alipay and WeChat Pay may differ significantly, depending on whether DCEP will be available for their payment services, on top of whether services fees will be charged. If DCEP payment is made via Alipay and WeChat Pay, the current oligopoly by the two in the mobile payment market will likely continue, just coming with another layer.

KOL Backfires – Fans Stoking Fires

A key feature of China e-Commerce platform is drawing eyeballs with internet celebrities, or KOLs. Yet before they can secure jobs in promoting products for merchants, they must promote themselves and exploit spectators' psychology in greed, lust, gluttony, which are among the seven sins, to the fullest. Yet there are times of backfires.

Mengniu Campaign Turned Sour

The latest scandal is Mengniu promotion campaign in sponsoring the program Youth with You 3. By stoking fire on fans to vote for their favourite idol, Mengniu launch products with one-time QR code that identified the idol. Fans buy the product that comes with their favourite idol's image and by scanning the one-time QR code inside the package, they vote for their favourite idol. A common advertising trick that has been in existence for long time, indeed.

Exhibit 2: Mengniu Campaign Turned Sour

Source: hket.com

Yet when fans see the votes more valuable than the milk products, or as some insiders tip that masterminds behind are working to promote the idol, the campaign turned sour. And we see milk river in ditch. A reversal of value in the eyes of consumers. Or beauty is in the eye of the beholder.

Public opinions roared and state media jumped in, and Mengniu apologized.

Government may tighten the rein on internet celebrity advertising as in previous cases. Especially at a time when major players are under scrutiny of malpractices. This will hurt China e-Commerce development, as customers are adapted to wind direction guiding by KOLs.

Yet the positive roles of internet celebrities in promoting business should not be under estimated. Man Wah, a sofa maker that transforms from OEM targeting overseas market to domestic retail, is seeing a boom in its China sales with online and KOL leaded sales on par with consumers initiated business.

Mutual Aids Platforms Closing

There are more healthcare mutual aids platforms closing. Qingsong (輕鬆互助) and Waterdrop (水滴互助), which were once among the top three mutual aids platform together with Alibaba's Xianghubao (相互寶), closed their doors. So are the smaller players Wukong Mutual Aids (悟空互助), 360 Mutual Aids (360 互助), and Airstar (小米互助) under Xiaomi group.

Even Alibaba's Xianghubao (相互寶) saw its membership shrinking, a worrying sign for a platform that needs critical mass to boast its value. Analysis cites surging contribution demands on its members and arbitrary exclusion of illnesses covered on the platform end as the culprits.

China government is always keeping a keen eye on such healthcare mutual aids, which are not classified as insurance products and thus not under regulations. Also, the sheer number of memberships, in tens of millions or even hundreds of millions for Alibaba's Xianghubao at its peak, can be trouble hot spots in case of failure.

As joining multiple such mutual aids platforms are common, the closure of others may not directly benefit Alibaba's Xianghubao in terms of membership switching. Indeed, there are news reports that even its membership has been fallen to under 100mn. Whether Alibaba can reorganize to put all of its financial operations under the to-be-formed financial holding company will be the key to the future of healthcare mutual aids. The best scenario is that the mutual aids program will revert to insurance, returning to the Alibaba's Xianghubao at its inception in 2018, only under the umbrella of its own insurance arm this time.

Or it may retort to cross selling Haoyibao (好醫保) health insurance products. Hope that it is not following the path of sharing bicycle. Alibaba did survive several rounds of regulatory hits in its twenty-year history, and it works magic in the past.

Conclusion: Between a Rock and a Hard Place

Having paid the record RMB18.2bn fines, Alibaba is apparently business as usual for now. Details of its undertakings in reorganization, especially the timeline in obtaining the relevant licenses, are unknown and may be immaterial as long as it can conduct business as usual. Whether the antitrust behaviors are peculiar to Alibaba or common practices in the China e-Commerce market, it is in the eyes of regulatory authority and we cannot tell. In our view, other fines should be expected in near future and the good news is that investors' sentiment is still resilient.

e-Commerce has been a strong pillar in China economy and it is a brag point amid the sluggish global economy. Especially at a time when the manufacturing sector is facing a surge in commodity prices and shortage of key components, such as ICs. Apparently, the severity is not only hurting profit, it is hurting production. Indeed, e-Commerce performs well and indeed help minimize people flow and interactions in the pandemic environment.

Yet to tighten regulations in some areas, such as internet celebrity promotion, may be imminent. Too many of these internet celebrities retort to extravaganza acts to attract eye balls. Yet the flip side is that general public are quite attached to such acts and fans are fervent to their idols. To e-Commerce merchants, products sell well with internet celebrities carrying goods. Yet it backfires sometimes, as in Mengniu case.

Looking at another direction, it may be a good time to rethink mixed-ownership reform. It has been five years since China Unicom partnered and allowed private investors, such as internet giants Alibaba, Tencent, Baidu, JD.com and others to take up 35% stakes. China Unicom since revitalized and emerged a strong player in 5G communication services. Other state-owned enterprises may tap the cash pool of internet players and enhance their profile in capital market.

The killer apps, in internet parlance, will be for China government to groom another e-Commerce platform, with state backing or not. This may be the fast track in breaking the oligopoly of incumbents. By taking a core component from each incumbent, a working mammoth will be in form, and hope that it is in substance as well. With one of the core components carved out, incumbents are less capable in exploiting their market positions. It is killing two birds with one stone. Yet the risk is that in the transition period, economy may be hurt, especially at a time that uncertainties loom at large, in China and worldwide. We buy the more moderate way in tightening grip via regulatory actions and administrative orders.

Strengthen regulation maims, doesn't kill e-Commerce.

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