Feature Report

e-Commerce

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China e-Commerce – Overcast in the East, Stormy in the West

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Common Prosperity Initiative Supported by Alibaba and Tencent

China Government debuted the common prosperity initiative and both Alibaba and Tencent show their supports and contribute tens of billion to the cause. In all, in addition to our view that e-Commerce players are supporting Chinese economy, they also shoulder the grand state goal.

China Clamp Down on KOLs Negative to e-Commerce

China Government continues to clamp down and overhaul the entertainment circle and its cluster of top influencers. Yet the role of KOLs in promoting e-Commerce in China cannot be underestimated. We even see lesser KOLs themselves chasing top KOLs to rub heat and Zhong Nanshan crosses his field of medicine to take up KOL role with good sales results.

Amazon Shut the Door of Chinese Sellers to Overseas Markets

U.S. e-Commerce platform Amazon took actions on Chinese sellers and shocked the market. The ban on 50,000 Chinese seller accounts has resulted in the loss of more than RMB100bn (US$15.4bn) for sellers operating under the "Made in China, Sold on Amazon" model. Yet such affected sellers cannot agree upon teaming up in a jointly filed lawsuit against Amazon.

Right One's Own Practices or Nothing Left

Amazon's extensive clean-up campaign targeting questionable practices like paying for positive reviews may help introduce Chinese e-Commerce players a different level in doing business with protections to themselves, their competitors, and buyers. We are yet to see whether this incident can expedite the purging of bad practices, or at least bring more acceptable practices to prevail, in China e-Commerce industry.
At least it is business as usual in China.

SEP 20, 2021	Closing Prices (HK$)	Mkt Cap (HK$ bn)
0700 HK Tencent 騰訊控股	454.20	4,359
9988 HK Alibaba – SW 阿里巴巴–SW	151.50	3,286
3690 HK Meituan – W 美團–W	234.60	1,439
9618 HK JD.com – SW 京東集團–SW	294.60	922

Overview

China Government debuted the common prosperity initiative last month and stole the limelight. Property sector was under dual pressure in restoring its balance sheet on one hand and distribute its exorbitant profit for the cause of common prosperity on the other. Artist and key opinion leaders (KOL) were under fired and China e-Commerce sector itself was spared for now and wading thru the flooding disaster and COVID-19 pandemic well.

The salvoes fired by China government targeting the e-Commerce players are apparently still in flight. We marked the first shot as hit in the suspension of the dual Hong Kong and Shanghai initial public offering of Ant Group (螞蟻科技集團) and the subsequent record RMB18.228bn fines on Alibaba imposed by the State Administration for Market Regulation (SAMR).

Yet the closely watched investigation of either-or, also known as choose one from two (二選一), anti-monopoly behaviour on Meituan (美團), announced by SAMR on April 26, was still in progress after five months, much longer when compared to only three full months in the Alibaba case. Fines in the billion RMB range should be expected, yet has to wait for the final verdict. Nevertheless, Meituan has plenty of reserves thru its earlier fundraise exercise, despite it is making loss for now.

The anti-monopoly watchdog was flexing its muscle in the meantime and banned the merger of HUYA (虎牙) and DouYu (鬥魚), both somehow under the Tencent (騰訊) umbrella, amid other minor penalties imposed on various e-Commerce players. Yet the soft issue on government regulators summoning Tencent and NetEase (網易) to discuss restrictions around the streaming and playing of video games among minors, will be an indication of hard stance and put pressure on platform operators.

The focus is still on Meituan. The SAMR, together with other government departments, issued specific guidance on food delivery platform to protect the right of couriers. The guidance covers every aspect in the process, from order allocation mechanism, delivery routes, hard labour concerns, and road traffic education and training, individual insurance coverage. Other than daily work flow, more fundamental issue such as labour union for couriers and feedback mechanism to platform operators are also touched.

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 business as usual.

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Across all fronts, big and smaller players are facing fines and restrictions over issues of consumer rights, labour rights, protection of minors, among others. In May, JD.com (京東) was fined RMB300k over false information on food products. In July, regulator ordered better protection for workers of food delivery firms. Laws are drafted and expected to rein in fake reviews and inflated public metrics, while barring use of data or algorithms to hijack traffic or influence user choices. Live-streaming industry were advised to speak Mandarin and dress appropriately when marketing products online. Online gaming was branded as “spiritual opium” and Tencent accordingly announced curbs on minors’ access to its most popular game, “Honour of Kings”.

Companies possessing big data are well taken care of. Ride-hailing DiDi Group (滴滴出行) was ordered to stop accepting new users. A cap may be placed on the percentage that ride-hailing platforms can take from drivers’ fees. Draft rules may order data-rich Chinese firms to run a security review before listing overseas.

Common Prosperity is the Name of the Game

Despite the summary penalties on other e-Commerce platform operators did not materialize after Alibaba’ record fine of RMB18.228bn, they are not yet out of woods and still facing regulatory pressure on business operations and financial positions.

China government are working on other grand initiatives in the meantime. Common prosperity is among the most vocal one. After Deng’s make some rich first initiative is considered realized, at least to the few nouveau riches, it is time to promote common prosperity to all. Facing challenging external environment, it looks inward. Under a strong government initiative, some rich and influential e-Commerce platform players are showing their supports to this goal and chip in.

Alibaba Chip in RMB100bn to Spread Wealth

There are news reports that Alibaba will invest RMB100bn over the next few years into the common prosperity initiative, in response to the state goal to spread wealth, at the time when the sector faces intense scrutiny from regulators. Tencent also pledged RMB100bn towards various initiatives while the founders of Pinduoduo (拼多多), Meituan and Xiaomi (小米) all have all put money toward social causes.

In the same tone as in its acceptance of the penalty with sincerity and compliance with determination, Alibaba CEO Daniel Zhang stated that Alibaba is eager to do its part to support the realization of common prosperity through high-quality development. He considered Alibaba as a

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beneficiary of the strong social and economic progress in China over the past 22 years and firmly believe that if society is doing well and the economy is doing well, then Alibaba will do well.

The Alibaba Group Common Prosperity Advancement Working Committee will be established and be tasked with delivering initiatives focused on technological innovation, economic development, high-quality employment creation, care for vulnerable groups and the establishment of an RMB20bn common prosperity development fund, by 2025. Fund will be disbursed before 2025 to promote investments in technology, support small businesses, foster development in rural areas, help small businesses expand overseas and improve the welfare among gig-economy workers, including delivery men and drivers. This aligns well with Chinese Government guidance.

Tencent Earmarked RMB50bn

Tencent also earmarked RMB50bn following a similar pledge towards its common prosperity fund to help lift low-income groups, improve health care coverage, contribute to rural economic development and support grass roots education.

Chen Lei, the chairman and chief executive of another e-Commerce giant Pinduoduo, said that the firm launched a RMB10bn agriculture initiative to help rural residents whose average income was a third that of urban residents.

Wang Xing, the founder of food delivery giant, said that common prosperity is built into the genes of Meituan, which means “better together”. Just short of another Tang dynasty poem. Yet apparently no concrete sum is on the table as Meituan is still loss making and still waiting for the results of anti-monopoly investigation, and costs to be incurred in compliance with new guidance on couriers, among others.

Other e-Commerce players, like TikTok (抖音) / ByteDance (字節跳動), are chipping in lesser sum in the hundreds of million.

In all, in addition to our view that e-Commerce players are supporting Chinese economy, they also shoulder the grand state goal and funnel back the tax incentives and financial subsidies to society.

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Ant Group Rectification Plan Eyed

We see Alibaba's rectification plan of Ant Group as a role model for followers. In its earlier announcement, Ant Group, in its entirety, will apply to set up a financial holding company to ensure its financial related businesses are fully regulated. Its payment business will serve consumers and SMEs by focusing on micro-payments and bringing them convenience. It will set up a personal credit reporting company and apply for a personal credit reporting license.

Yet apparently nothing substantial has been officially announced. The most visible part is the new personal credit reporting license and there is no news on the progress of so far. 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. Alibaba is in standstill and as long as business as usual, this may be acceptable.

The closest hit is a news on Ant Group to set up a subsidiary with SOEs taking majority equity stakes, in aggregate, and apply for a personal credit reporting license. It is said that this will put data of 1bn users and 80mn merchants under control. Valuation of the subsidiary and consideration from each party may shed light on Tencent case.

Pudao Credit, the new licensed personal credit operator, is making progress in business development with the issuance of Commercial Credit License. It made strategic cooperation agreement with Cango (燦谷集團), a NYSE listed company in automobile trading services, in areas of information securities, credit infrastructure build up and big data innovation.

Business as Usual Under Didi Case Precedent

Despite business as usual and its will to set up a personal credit reporting company and apply for a personal credit reporting license, Ant Group is very likely now running without licenses and breaching regulations. With reference to DiDi Group (滴滴出行) which breached rules on illegally collecting data and drastic measures enforced by the Cyberspace Administration of China, both Zhima Credit (芝麻信用) personal credit score services and WeChat Pay Score (微信支付分) seem likely to fall into this area. Removal of these apps will knock out one of the key pillars of China e-Commerce industry. Though this is unlikely. Or until the Digital Currency Electronic Payment (DCEP) is in place.

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KOLs Under Fires

Internet celebrities and key opinion leaders (KOLs) are key to China e-Commerce platform in drawing eyeballs. After the Mengniu scandal, China Government tightens the rein on internet celebrities and goes beyond targeting poor selling practices. The artists themselves are targeted.

The most talked about is the affair of Kris Wu (吳亦凡), a top influencer that draws millions of followers and secures the role of spokesman for more than 10 brands / products. Yet the dark side of his personal life and the duel with girl involved over social media platform backfires. China Government grasps the opportunities and continues the clamp down and overhaul of the entire entertainment circle.

A number of actors are targeted and essentially all these top influencers lose their roles as spokespersons for the brands and products and millions of dollars went down the drain. Movies that feature them are likely not to be shown as well.

On the good side, fans clubs are advised to chase after their favourite artists in rational way and avoid counter accusations of the other camps. This is good for development of the ecosystem and mitigates the time and monetary burden of fans in posting supportive comments to their favourite idols and lavishing on unnecessary goods in order to show their supports, or just not to have theirs lose face versus other idols.

In the ideological field, the blanket extended to cover effeminate male actors, KOLs for brands that touch upon China's bottom line in Taiwan and Japan issues. Those with foreign passports are declaring allegiance to China. The most visible case is Nicholas Tse, a Hong Kong actor who also holds a Canadian passport, who said he will renounce his foreign citizenship.

This will hinder China e-Commerce business development, as customers are adapted to wind direction guiding by KOLs.

KOLs in the DNA of China e-Commerce

The KOL culture goes far beyond actors. Even Zhong Nanshan cannot be spared. There are grounds for him to promote BaiYunShan FuFang BanLanGen KeLi (白雲山複方板藍根顆粒), a traditional Chinese medicine that helps cold related sickness. Yet it goes too far in carrying goods (帶貨) Vitamin-C rich fruit to fight sickness, despite the charity nature of the event and the success of the program.

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Exhibit 1: Zhong Nanshan Carrying Good

Source: hk.on.cc

Indeed, the culture goes far into lesser KOLs chasing top ranking KOLs. A tier structure arises.

To gain popularity, minor KOLs are exploiting spectators' psychology in lust and gluttony in the past. Yet after government cracked down in the past few months, they have to resort to the tradition of squeezing into whatever hot topics to rub heat (蹭熱度).

The latest in on Li, who is on the top KOL list. She is so successful in building her own brand and operates her own workshop. Boasting 14mn YouTube followers and over 100mn fans in the internet world, herself is attracting other KOLs to chase after. Yet the latest news is that she reported to police as other KOLs are gathering around her home to do broadcasting, causing disturbance to the neighbourhood, and more importantly, some are using her name in deception schemes.

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

Source: bilibili.com Li's page

Other malpractices are also popular in China, yet may not be acceptable in the rest of the world.

Amazon' Arrow Targeting Villains

While the practice of internet celebrities carrying goods is not as popular in the U.S. as in China, user reviews are important in buying decisions. Malpractices in manipulating user reviews prosper in Amazon platform and Amazon acted to close down those suspected stores and froze funds in accounts.

About Face Towards China e-Commerce Stores on Malpractices

Amazon once actively recruited China e-Commerce sellers by routinely holding summits in cities across mainland China each year and attracted thousands of people, both those already selling on Amazon and those looking to join. Yet the bad practices come with them to the Amazon platform.

There are several popular malicious selling practices being used by Chinese sellers, among them: fake reviews, counterfeit products, sabotaging competitors' product listings, and the scale of deployment is so conspicuous and thus draw Amazon's attention.

Blind to the believe that reviews equal sales, half of Chinese sellers are using some forms of review strategy against Amazon's terms of service. Such review strategy can come in one of two varieties: the mild form that compensating / reimbursing real customers for leaving a positive review, or

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the more extreme technique of making fake orders and leaving positive reviews through zombie Amazon accounts. To facilitate execution, one seller will operate tens of stores under different names and operate zombie accounts to made reviews.

Amazon banned incentivized reviews in 2016, yet such practices evolved in morphed forms, from “rebate clubs” where consumers get rebates to compensating consumers for leaving positive reviews in the form of extended warranties and future discounts. Most commonly, vouchers come with the packages that provide cashback for good reviews.

In more extreme form, dedicated workers are hired to write fake reviews. Facebook groups are set up and for monetary compensation, they can have reviewers buy off Amazon, leave a nice detailed review, and get refunded via PayPal from the seller later. It is said that on a famous hotel booking platform, fake orders are priced at RMB20 (US$3) each. A good review takes an extra RMB5 (US$0.8).

By the same token, smear tactics can be deployed to competitors’ product listings. Not to speak of counterfeit products that are popular in, says, Alibaba’s platform as well.

Initiatives in Protecting Sellers and Buyers in Amazon Platform

Amazon has implemented robust proactive controls and provide tools like Brand Registry, Transparency, and Project Zero to brand owners to protect the logos, patterns, and intellectual property of 500k brands and safeguard the interests of its 300mn active customer accounts and over 1.9mn selling partners worldwide.

To fight counterfeit, Amazon established the Counterfeit Crimes Unit to build and refer cases to law enforcement, undertake independent investigations or joint investigations with brands, and pursue civil litigation against counterfeiters.

50,000 Chinese Seller Accounts Hit on Amazon Platform

While questionable practices like paying for positive reviews often go unchecked, or even tolerated, on Chinese e-Commerce platforms, Amazon kicked off in May an extensive clean-up campaign targeting such activities. The crackdown has affected thousands of merchants, according to a report in July by the trade group Shenzhen Cross-Border E-commerce Association, and ever since, there are no subsequent updated.

The scale of the recent crackdown is unprecedented. The ban on 50,000 Chinese seller accounts has resulted in the loss of more than RMB100bn (US$15.4bn) for sellers operating under the “Made in China, Sold on Amazon” model. Big names are among the list, including Aukey, Mpow and 340 stores owned by Shenzhen Youkeshu Technology, with RMB130mn of

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its funds frozen. While most are announcing the ban on vague terms, Sunvalley said flatly that three of its brands – RAVPower power banks, Taotronics earphones and VAVA cameras – were suspended for offering gift cards to customers willing to write positive reviews.

What Went Wrong?

Some 20 mid-sized and large companies operating under the "Made in China, Sold on Amazon" model explored the possibility of teaming up in a jointly filed lawsuit against Amazon, but the plan was aborted after the sellers failed to reach an agreement about their strategies and demands, according to the lawyer who represented them. Others just chose to close the door and shut down the business on Amazon platform, if not went bankrupted.

Jobs lost and defaults to suppliers of these sellers on Amazon platform drew the attention of government. Yet after Commerce Bureau of Shenzhen Municipality hosted a meeting with such sellers on 13 August, seller participant indicated that the agenda are for government to understand the negative impacts on this incident and what is expected from government to help. Nothing was mentioned in the meeting on concrete measures from government to support sells and may be announced later. Other source mentioned that government official said that government cannot help their cause if sellers cannot prove that no rules of the US e-Commerce platform were violated. The government, however, will assist the affected merchants by introducing them to legal counsels.

Separately, on July 22, official from Ministry of Commerce said in a press conference that the obvious differences in laws, cultures, and acceptable business practices have caused Chinese companies a lot of challenges in their cross-border dealings. In some stages, companies may encounter issues of not conforming to domestic practices and fall into growth trap. China Ministry of Commerce asks companies to comply with domestic laws and rules, and respect domestic practices in business development.

Apparently, market force prevails.

We are yet to see whether this incident can expedite the purging of bad practices, or at least bring more acceptable practices to prevail, in China e-Commerce industry.

Hope that is not a long shot.

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Conclusion: Right One's Own Practices or Nothing Left

China Government debuted the common prosperity initiative after Deng's make some rich first initiative is considered realized. Alibaba and Tencent show their supports and contribute tens of billion to the cause. In all, in addition to our view that e-Commerce players are supporting Chinese economy, they also shoulder the grand state goal and funnel back the tax incentives and financial subsidies to society.

China Government continues to clamp down and overhaul the entertainment circle and its cluster of top influencers. The blanket extends to the ideological field which cover effeminate male actors, KOLs for brands that touch upon China's bottom line in Taiwan and Japan issues. Yet the role of KOLs in promoting e-Commerce in China cannot be underestimated. We even see lesser KOLs themselves chasing top KOLs to rub heat and Zhong Nanshan crosses his field of medicine to take up KOL role with good sales results.

We keep an eye in other directions, such as mixed-ownership reform. Ant Group will set up a subsidiary with SOEs owning majority equity stakes in aggregate, and apply for a personal credit reporting license. It is said that this will put data of 1,000mn users and 80mn merchants under control. Whether this is a small step towards taking a core component from the incumbent and make it less capable in exploiting its market position will be yet to seen. This has ramification to Tencent as well.

The actions taken by the U.S. e-Commerce platform Amazon on Chinese sellers since May shocked the market with reverberation. The ban on 50,000 Chinese seller accounts has resulted in the loss of more than RMB100bn (US$15.4bn) for sellers operating under the "Made in China, Sold on Amazon" model. While affected sellers cannot agree upon teaming up in a jointly filed lawsuit against Amazon, China government officials at both Shenzhen Municipality and ministry level resort to not directly engaging Amazon.

While questionable practices like paying for positive reviews often go unchecked on Chinese e-Commerce platforms, Amazon's extensive clean-up campaign targeting such activities may help introduce Chinese e-Commerce players a different level in doing business with protections to themselves, their competitors, and buyers. We are yet to see whether this incident can expedite the purging of bad practices, or at least bring more acceptable practices to prevail, in China e-Commerce industry.

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SELL:	SHARE PRICE EXPECTED TO APPRECIATE LESS THAN 5% IN THE NEXT 12-MONTH
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