China Briefing

Alibaba: Why Jack's data house will always win

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Executive summary

- Jack Ma's public presence or absence is irrelevant; he has built Alibaba a data moat, a protection such that the company will remain no matter what happens to him.
- The recent regulatory restrictions are two different phenomena: a weak antitrust slap on the wrist that will have no impact, and a serious attempt to clean up China's financial system.
- China's government has clearly signalled that it is happy to keep the Alibaba ecosystem intact if Ant plays by the new rules. Recent US attempts to sanction Alibaba will only bolster China's resolve to keep the company strong; as the only threat to Alibaba's future is Chinese regulatory shutdown, this will help and not hinder commercial progress.

Where's Jack?

Currently there is only one question with regards to Alibaba: "where's Jack?". Alibaba leader Jack Ma has kept a low profile in the wake of Alibaba's fintech arm Ant's IPO cancellation.

Behind the scenes, however, a far more substantial struggle rages. China has quietly spent the past few years strengthening its regulators. Banking and monopoly watchdogs are empowered and better coordinated.

And the regulators' targets are clear. Alibaba and its rival Tencent, private companies both, have grown so quickly that today they form the backbone of Chinese society. Alibaba's control over data is unprecedented. Never has a company known so much about you. That coverage and scope has made it a most innovative and effective firm, not to mention a profitable one. Alibaba has grown so influential that its greatest existential threat is the Chinese government (like Tencent, as we showed in this Briefing).

It is this to-and-fro between regulators and tech giants that matters most. Even if there are further individual actions against Jack Ma, we do not see them as the most important thing to understand. Rather, we need to look at signs of what regulators think rather than speculations about where Jack may be.

The most authoritative statements of the Chinese government are clear: the platform economy is here to stay. Current indications are that actions against Alibaba will be limited to regulating Ant and concentrating the fintech market (which will help Ant in the medium and long-terms). There will be some slap on the wrist antitrust fines, and there is the possibility that some investments will be reviewed. The government may be able to restrain Alibaba's growth to some extent, but in the long run, they need it, and they know it.

Understanding Alibaba

Chinese politics is hard to understand, and it is generally easier to simplify matters into a contest between individuals. The headlines look great — Xi versus Jack! Reformers versus blockers! — but they also miss that China is changing constantly. Tracking these shifts requires a framework for knowing who is up and down and why (for this Briefing, we have for the first time created a video showing how we did this).

Specifically, if Xi Jinping wants people to follow his orders, only coordination counts. So to go after Alibaba, it is not enough to just get Jack. Instead, the anti-monopoly regulator must stop the platforms from joining their many services, each of the many individual ministries must turn the screws on Alibaba's many businesses, and several laws, including recently passed data privacy laws, must all be enforced. This requires extremely strong signals from the top.

Why? Because Alibaba is ubiquitous in a way that is nearly inconceivable to non-Chinese users. Its main products include a separate high- and low-end B2C marketplace (both Amazon and LMVH); a B2B marketplace, the biggest in the world; film, lifestyle, ticket, and travel apps; a food delivery app; a mapping and satnav device; the Chinese equivalent of YouTube; China's larger, better version of Twitter; and finally the world's largest fintech company. This is the panopticon, come to life, one with a full view of your preferences, activities, and spending.

Let's take a typical day. You buy your groceries online, and they are delivered. This lets Alibaba know your preferences, budget, address (and thus wealth level). You use Alipay; that lets it know your full financial information and occupation. Getting to work, you read on the latest Weibo blogs and make some comments, and then decide to book a ticket to Yunnan to get away from the news. Before you do that, you join with your friends to play an online game with cows and with your neighbours on a large Swiss cheese order. Every part of that creates meta data. Alibaba always knows. The only company that can compete with this is Tencent — both know much more than Amazon or Google.

Alibaba's amazing data access lets it solve the enormous coordination problems that are hard baked into the Chinese government system. It not only collects all the data, but (unlike the government) it can tie it all back to one unique ID. In the pandemic, they used this data to create essential public goods and services.

This is one reason why China's leaders need Alibaba and Tencent. They cannot make these things themselves. Figure One below shows why: in order to ensure competition between local leaders, each part of the system is essentially an island, judged from above but unable to coordinate across themselves. So each level has its own champion, or SOE, and these are both owned and regulated by the head of the jurisdiction.

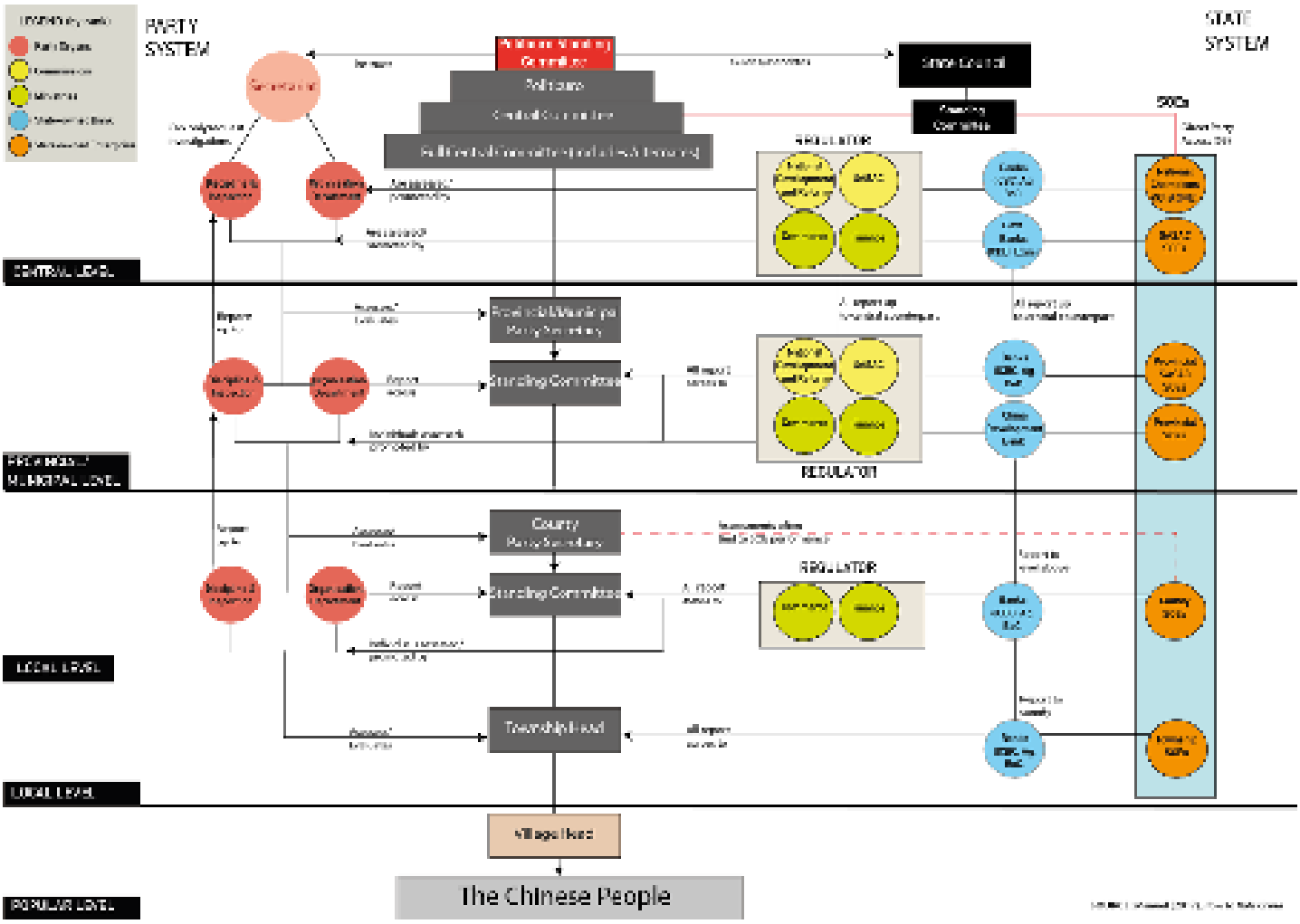

Figure One: How China regulates its own state-owned businesses

These coordination problems are at the heart of Chinese politics, business, and economics. How does the government navigate the needs of consumers, investors, other businesses, and overall governance? It lets the tech giants create, keep, and use big data, while itself creating the bodies that form the rules of the game. The tech giants cannot have their own credit ratings agencies and must submit to tighter data collection and privacy acts than those of many Western companies. Senior Chinese leaders lecture publicly that their market power must be controlled.

The tech giants' goals are far simpler: they want to keep as much of their data as possible and use it to compete for primacy.

Keeping Beijing at bay

Alibaba and Tencent's unfair data advantage, the moat that repels competitors, has long grated. Fierce e-commerce rival JD.com complained twice to regulators in 2015 (once based on 2013 behaviour). They even launched a lawsuit in 2017, based on Alibaba and Tencent's so-called "there are two of us, and you've got to pick one" philosophy. It is this old complaint that was recently picked up by China's antitrust regulator, the State Administration for Market Regulation (SAMR). SAMR is investigating Alibaba for pressuring merchants to sell exclusively on its platform; this is the first investigation of this kind against a tech giant.

We don't judge this to be particularly serious. The announcement was one sentence long, and was specifically on Alibaba's e-commerce platform, not on its data monopoly. It did not talk about Ant, the fintech arm whose IPO was recently halted (more on that later). And it only issued a set of draft guidelines governing internet monopolies. These are non-binding.

SAMR itself is a new addition to China's regulatory framework. It comes as part of a suite of measures to improve China's consumer rights: China's first ever Civil Code; a strong anti-monopoly law; an increase in speeches by China's leaders. But SAMR has very few staff. And China's ability to break up monopolies is hindered by weak legal penalties. Even should it wish to punish the tech giants, it is very hard to raise fears when the maximum penalty for failure to notify of a merger is 10% of the annual revenue of the target company.

Above all, SAMR is not pushing a strong anti-Alibaba agenda. Their own internal newspaper, the most consistent guide we have to their thinking, has not outlined any pushback against tech giants and their business model (see video).

There is, however, a far more serious regulatory matter, and that is the cancellation of the Ant IPO. We wrote a more comprehensive overview of this when it happened. Since then, there has been an official upgrading of the line against Ant. The annual setting of economic policy listed "strengthening anti-monopoly work and preventing disorderly capital accumulation".

Alipay may have caught regulators' attention because it processed more than 118 trillion yuan, equivalent to USD 18 trillion, worth of transactions in mainland China in the year ended 30 June. Ant's online-lending model — which makes unsecured credit available to consumers and small businesses online — could potentially trigger "systemic risks" for China's financial system. It was these risks that led to Ant being accused of "unsound corporate governance practices, inadequate compliance with regulations, anti-competitive behaviour, and harming consumer interests". One phrase, "scornful defiance" is also very strong, suggesting the regulators believe Ant was not only in defiance, but also in contempt of regulations — and regulators. Ant is to "address" these. More importantly, it needs to cough up more of its own capital to support its lending operations or scale them back.

Why do we think the general Alibaba antitrust and the specific Ant situation are different? Because attacking Alibaba relies on unpicking all the many products. Going after Ant is a financial system issue, whereas going after Alibaba is a whole system issue.

Ant, as a finance firm, has specific roles. As China tech analyst Lilian Li writes, Ant has a phenomenal advantage that comes from its relationship with Alibaba:

"Take a university student, typically not the customer for credit loans since they are living on a budget. But this particular one has made a series of high-ticket purchases in Tmall, books frequent plane tickets to exotic locations, and spends very little time comparing when making purchases. Their payment linked to a family credit card and looking closer you can see substantial asset management products brought by the mum. An ideal customer to offer high price items and credit products to... They now know what's hot and trending and then push relevant items."

But it is not this intertwining between Alibaba and Ant that the government is attacking. Rather, it is Ant's ability to push various items that have been brought to heel: the government clearly wants to hold the reins more tightly in the finance sector. There have been progressively strict crackdowns on lending by insurance companies, on bank assurance, P2P lending, and non-bank wealth management products. This has meant that when regulators attack Ant, as the biggest firm in the market they going to be under huge pressure. (However, they/Jack Ma are unlikely to be taken away, contrary to public opinion: the words used in the official 违规 "rule-breaking" is not usually the one used for criminal offences.)

Ma Yun (2017-10-19) by author Kremlin, licensed under CC BY 4.0

We must be specific. This is financial regulators pushing back, not an antitrust investigation. Under the traditional framework, financial products and services tended to have clear boundaries, "firewalls" between their services, and relatively clear regulatory requirements. Tech giants like Alibaba considerably changed the structure, function, and nature of the industry, without facing the regulatory requirements faced by banks such as capital adequacy, asset-liability ratio, and information disclosure. As we argued already, it was the requirements ("Basel" as he called it) that Jack Ma was resisting against in his now infamous speech.

What comes next

In the long run, Alibaba will not be affected by recent Ant burdens. It wants to be the ecosystem, not the bank. And it has very solid growth prospects for the short, medium, and long runs.

Top leaders are clearly not attacking Alibaba. The most authoritative release of information following the antitrust announcement was an officially sanctioned column in the People's Daily. (This must be signed off on by one of China's top 25 leaders, and is as close to an official opinion as possible). The focus of this editorial was a national development and reform approach: it has an explicit reference to the wave of antitrust investigations and fines placed on US-based big tech companies in the last few years by both American and European regulators. The column tries to couch China's own action as a "market based" part of this global regulatory trend. There was no mention of consumer rights or any of the other things one might expect from a stronger crackdown. Similarly, the most authoritative meeting which mentioned Alibaba was the December politburo meeting. While this discussed anti-monopoly actions, it referred only to actions in financial sectors.

Official regulators then painstakingly clarified that the antitrust investigation against Alibaba "does not signify any change in the country's encouraging and supportive attitude towards the platform economy." The "platform economy" here is a broad umbrella term for the Internet economy, driven by China's own big tech firms. The authoritative leadership statement before that, issued on 18 May, was also supportive of platforms and made no reference to anti-monopoly trends.

The negative implications mentioned with reference to anti-monopoly were on intellectual property (IP) grounds. (Xi pointed out the importance of anti-monopoly efforts for IP protection at a recent Politburo study session). This focus on IP will suit Alibaba very well. In blockchain technologies and patents it is clearly the world leader, having declared it a fundamental part of its business (it even gets its own cost line in the Ant IPO prospectus).

Top blockchain patent holders in China in 2020

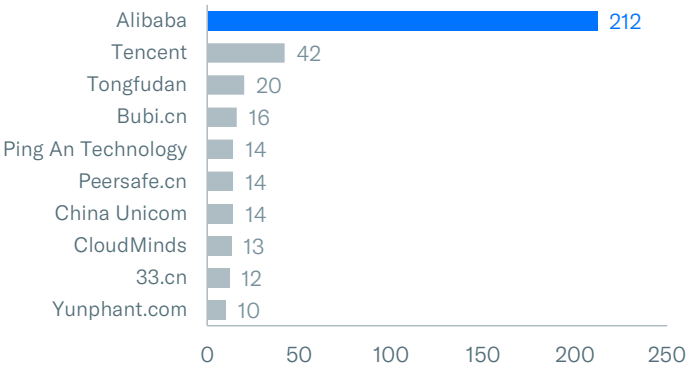

Figure Two: Top blockchain patent holders in China in 2020
Source: Patent Protection Association of China

The issue is not anti-monopoly, but rather financial regulation. And on that front, the government has clearly chosen market concentration. That will allow the tech behemoths, Tencent and Alibaba, to gain a major advantage. Alibaba's main competitors tend to be in different verticals: JD versus TMall for the affluent B2C market, for example. While JD has quicker delivery and perhaps a better reputation, it cannot compete with Alibaba's data advantage, no matter how much market share it gains. Others may follow in Tencent and Alibaba in achieving size, but they are unlikely to develop a similar data moat.

Finally, there are many worries as to how the US can restrict Alibaba's business. However, as we have already made clear, the existential threat to the tech giants is having government regulation. The more that they smash Alibaba, the more that the Chinese government makes Alibaba a national champion. US restrictions make very little difference to Alibaba's revenue and yet keep it safe from the regulators.

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investments@silverhorngroup.com
silverhorngroup.com

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18/F, 100QRC
100 Queen's Road Central
Hong Kong

Tel: (852) 2599 9100

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168 Robinson Road
#20-11 Capital Tower
Singapore 068912

Tel: (65) 6977 6902