China's anti-trust crackdown gets real

By Torsten Weller, China Policy Analyst

- China's new anti-monopoly crackdown is being driven more by bureaucratic actors than personal rivalries
- Growing concerns over unsustainable consumer debt have put tech firms in direct conflict with financial regulators
- Politically-backed reformers like Guo Shuqing are often crucial in pushing forward reforms and enforcing new rules.

Summary

In early April Chinese tech juggernaut Alibaba was dealt a regulatory double whammy. On 10 April China's market regulator, the State Administration of Market Regulation (SAMR), fined the company a record-breaking RMB 18.2 billion (~£2 billion) for 'serious anti-trust violations'. The fine was equivalent to 4% of Alibaba's revenue in 2019.

Two days later, the People's Bank of China (PBoC) – China's central bank – also ordered Ant Group to separate its lending business from its mobile payment platform Alipay. The PBoC further asked the company to apply for a credit reporting certificate. The resulting restructuring will probably reduce Ant to a payment services platform, depriving it of its lucrative digital finance business which last year contributed nearly two thirds of its revenue[1].

The Western media has portrayed Alibaba's woes mostly as a dramatic clash of egos at the top of Chinese politics and business. Both the Financial Times[2] and The Wall Street Journal[3] have published pieces attributing the recent crackdown to the conflict between Alibaba founder Jack Ma's pugnacious personality and Chinese leader Xi Jinping's obsession with loyalty.

Yet while personal animosities might have played a role in recent developments, they provide an incomplete explanation for the regulatory activism that has been underway for some time regarding China's major tech companies. More dangerously, this narrative of warring egos suggests that political connections, and not regulatory compliance, remain the most important factor in deciding a company's fortunes in China.

A more accurate picture points instead towards the importance of an evolving regulatory environment, in which an increasingly modern legal framework, a more efficient bureaucracy, and political concerns over the health of the Chinese economy are all contributing to a far more active policing of China's major tech companies.

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[1] https://www.ft.com/content/5c14c1d1-bd9e-4654-9a12-93c4ac46792d

[2] https://www.ft.com/content/1fe0559f-de6d-490e-b312-abba0181da1f

[3] https://www.wsj.com/articles/china-president-xi-jinping-halted-jack-ma-ant-ipo-11605203556

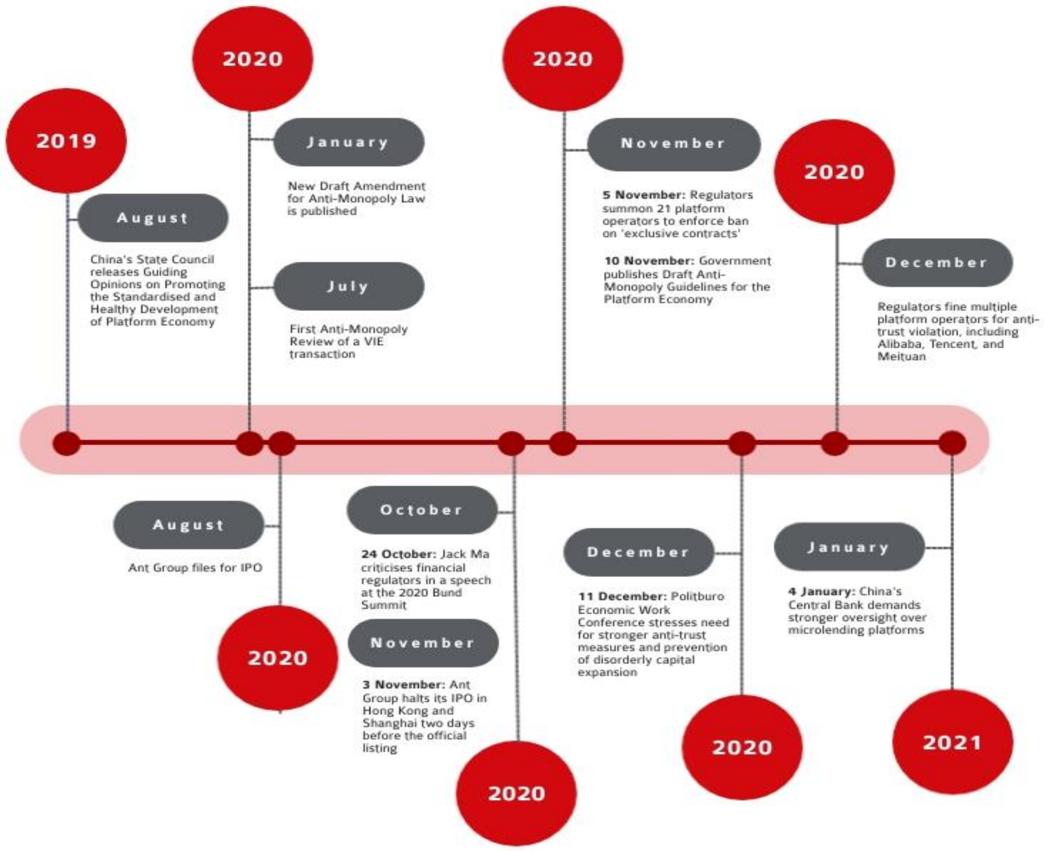
Background

The dramatic halt to Ant Group's IPO last year and the prolonged disappearance of Alibaba's founder Jack Ma from public life has put the Chinese tech giant firmly into the global limelight. It is therefore hardly surprising that the recent regulatory moves against Alibaba and Ant have been seen as part of a large-scale clampdown on Ma's business empire, and more specifically, as politically motivated retribution against an outspoken critic of the current state of Chinese business regulations.

This perception has been further fuelled by Jack Ma's defiant speech at last year's Bund Finance Summit [4], in which he called China's bank regulators a club of old men, and Xi Jinping's praise for Zhang Jian [5] - a patriotic entrepreneur of the late Qing era.

A closer look at these events suggests that pressure for government action has been long in the making. As Caixin, a business weekly, reported earlier this year, Chinese anti-trust regulators have in recent times grown increasingly wary of the dominance the country's tech giants, and not just Alibaba [6].

Timeline: Chinese Anti-Trust Measures from 2019 to 2021



Source: Caixin, Buzz Tech China ©CBBC

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[4] **[Chinese]** https://sfl.global/news_post/mayunshanghaiwaitanjinrongluntanyanjiangquanwenwushanjian/
[5] http://www.xinhuanet.com/english/2020-11/13/c_139513117.htm
[6] **[Chinese]** https://weekly.caixin.com/2021-01-08/101648195.html

Closing in on E-Commerce

In August 2019, China's State Council issued a statement calling for better regulation of the country's platform economy [7]. A few months later, in January 2020, the government also published a draft amendment to China's 2008 Anti-Monopoly Law which would extend the law's scope to online and e-commerce companies and increase fines for violations. The amendment also raised the maximum level of fines from the risible low of 500,000 RMB (£57,000) to 10% of annual turnover [8].

Interestingly, the fact that the amendment hasn't actually yet been passed did not dissuade the SAMR from using this change to the AML's penalty provisions in its case against Alibaba. It is also noteworthy that the record fine of £2 billion – or 4% of Alibaba's 2019 turnover - was well below the possible maximum penalty of 10%.

The SAMR sentence is remarkable in another aspect. Similar to anti-trust regulators in Europe and the US, Chinese authorities have struggled to adapt monopoly rules designed for 19th century-style manufacturers to the complex nature of 21st century software companies.

As in the case of Didi Chuxing's merger with Uber in 2016, tech firms have often argued that they provide the same services as offline businesses – in that example: public transport. Because this includes everything from city busses to municipal taxi companies, Didi Chunxing could claim that it did not in effect have a dominant market position[9]. Instead of controlling over 90% of China's ride-hailing market, Didi's market share would thus be less than 20%, it argued [10].

Alibaba has followed a similar strategy, arguing that its e-commerce platform was a B2C platform and that both retailers and consumers had other choices like brick-and-mortar shops[11].

The SAMR rejected that argument. In its written explanation – which is worth reading in full – the regulators outlined several key differences between physical stores and e-commerce platforms, labelling the latter as an online retail platform service provider.

For businesses these differences are:

- Coverage of geographic areas and service hours;
- Operating costs;
- Ability to support operators to match potential consumers ;
- Efficiency of market demand feedback provided to businesses.

Key differences for customers

- Availability of goods;
- Shopping convenience provided to consumers;
- Efficiency of comparing and matching goods.

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[7] **[Chinese]** http://www.gov.cn/zhengce/content/2019-08/08/content_5419761.htm
[8] https://www.chinalawtranslate.com/en/draft-revisions-of-the-anti-monopoly-law-public-comment-draft/
[9] https://www.bjreview.com/Opinion/201610/t20161017_800069482.html
[10] https://www.economist.com/briefing/2019/04/04/chinas-plans-for-the-electrified-autonomous-and-shared-future-of-the-car
[11] **[Chinese]** https://m.china.caixin.com/m/2021-04-10/101688429.html

The SAMR's reasoning doesn't only mark a sharp break with its approval of the Didi-Uber merger, when it followed Didi's argument and recognised it as a utility rather than an online service platform. It will also be closely followed by regulators in the west, who are struggling with similar problems[12].

The more immediate impact, however, will be on China's other tech platforms. The SAMR's main target in the case against Alibaba was its widespread practice of 'forced exclusivity', which involves forcing vendors to sell their products exclusively on one platform, or face penalties such as low grading in search results and other discriminatory effects.

'Forced exclusivity' has plagued China's tech sector since its beginning. Kai-fu Lee, the tech investor, even cited it as a sign of the superiority of China's cut-throat competitive business environment[13].

Yet Chinese regulators have been less enthused and have long exhorted tech firms to drop the practice[14]. They have also been crystal clear that the decision against Alibaba is mainly a warning for the entire sector. To drive the point home, SAMR published a notice on 13 April, requiring all platform operators to change their terms of use to allow users to choose more than one platform.

CBIRC enters the fray

Alibaba's woes are not limited to its e-commerce platform. Last year China's banking regulator, the China Banking and Insurance Regulatory Commission (CBIRC), began to voice concerns over Ant Group's online lending business.

On 2 November 2020, CBIRC, together with China's central bank, issued draft guidelines[15] for online micro-lending platforms. The new regulations introduced steep capital requirements and treated online loan providers such as Ant Group like banks, and not like tech firms as most platform owners, not least Jack Ma, had argued they should be.

The fact that Ant Group's £27 billion IPO was suddenly halted the following day led many foreign observers to believe a targeted campaign against Ant and its founder Jack Ma was underway. Yet as Rui Ma of Tech Buzz China noted, discussions about stricter rules for online lending platforms had gone on for some time. Rui even suggested that Ma's defiant outburst was more a sign that he knew that the regulatory die had been cast – and not in his favour[16].

The CBIRC's recent activism cannot be explained without considering the role of its chairman: Guo Shuqing. Guo's appointment as the head of China's banking regulator in February 2017 was widely considered as the harbinger of a veritable 'regulatory storm' in China's finance sector[17].

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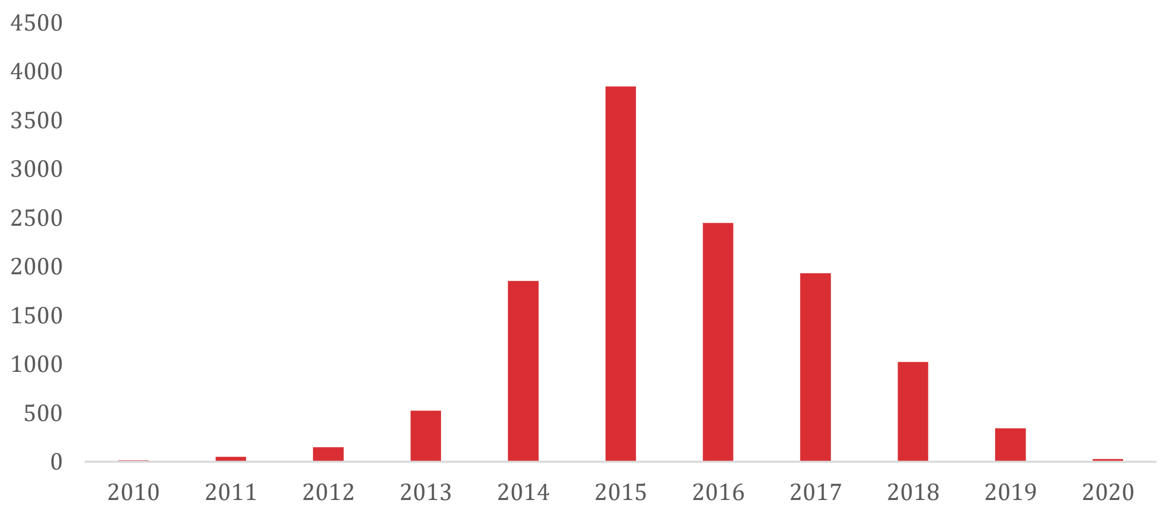
[12] https://ec.europa.eu/commission/presscorner/detail/pl/ip_19_4291
[13] Lee, Kai-fu (2019), AI Superpowers: China, Silicon Valley, and the New World Order, Boston: Houghton Mifflin Harcourt
[14] https://technode.com/2019/11/06/forced-exclusivity-is-illegal-says-regulator/
[15] **[Chinese]** https://www.cbirc.gov.cn/cn/view/pages/ItemDetail.html?docId=938822&itemId=915&generaltype=0
[16] https://www.techbuzzchina.com/newsletter/signup/extra-buzz-19-ant-group-the-biggest-ipo-that-wasnt
[17] https://www.hoover.org/sites/default/files/research/docs/clm53bn.pdf

Guo had served under former Premier Zhu Rongji and Zhou Xiaochuan – then head of the PBoC – before becoming head of the China Securities Regulatory Commission – which oversees China financial service industry - in 2011. Guo left that post in 2013 and was promoted to governor of Shandong province. Combining both administrative and political skills, Guo was seen as the perfect fit to address China's overleveraged and underregulated loan market.

He did not disappoint. Under Guo, China's regulators took aim at the country's vast shadow banking sector. P2P online lending, a key element of unlicensed lending, came under particular fire. The sector - which at its height in 2015 accounted for a transaction volume of £330 billion – sharply declined. In June 2020, only around 30 P2P platforms were still operating, according to official figures[18].

Graph – Number of Chinese P2P online platforms 2010 -2020



Source: Statista, WSJ ©CBBC

From this perspective, online micro-lending platforms like Ant, which unlike P2P platforms focus on small consumer credits, became the logical next target. In September 2019 CBIRC's bureau in Zhejiang – Ant's home province – warned online lenders to expect stricter controls [19]. And in an essay published on 2 November 2020, Guo Wuping – the Director of CBIRC's Consumer Protection Bureau – directly accused Ant's Huabei and Jiebei microlending services of predatory lending [20].

Following the financial regulator's new regulations for online lending, the SAMR saw an opening and published its own anti-monopoly regulations for online platforms on 10 November, expanding the SAMR's oversight to include variable-interest entities (VIE) for the first time [21].

[18] https://www.wsj.com/articles/china-hails-victory-in-crackdown-on-peer-to-peer-lending-11607515547
[19] https://www.caixinglobal.com/2019-09-19/noose-tightens-over-consumer-lending-in-east-china-101464020.html
[20] **[Chinese]** https://m.21jingji.com/article/20201102/herald/62dfca7696f0148a9353a88dbd9eedf5.html
[21] **[Chinese]** http://gkml.samr.gov.cn/nsjg/xwxcs/202011/t20201110_323282.html

The ultimate political signal came last December, when the CCP's Politburo warned against the 'disorderly expansion of capital'[22]. As Li Xunlei – the Chief Economist and Head of Research Institute of Zhongtai Securities – noted, the Politburo's decision directly targeted China's large tech firms and their vast investment portfolios [23].

The Politburo's statement also underlined that the current campaign isn't directed at only one company. In March, SAMR fined several tech firms, including Tencent, Baidu, and Bytedance for untransparent investments in start-ups [24], and Meituan – the food delivery giant known for its exclusivity agreements - will probably face similar sanctions. It thus seems that, like in the famous Chinese proverb, Alibaba and Ant are merely serving as the chickens that are killed to scare the monkey.

CBBC View

The anti-monopoly drive provides a perfect case study of the complex interplay between China's regulators and political concerns.

Both the SAMR and the CBIRC are the products of the 2018 constitutional reforms which led to a restructuring of China's government apparatus. The SAMR emerged from the merger of three separate anti-monopoly agencies previously situated within the Ministry of Commerce (MOFCOM), the National Development and Reform Commission (NDRC), and the State Administration of Industry and Commerce (SAIC) respectively. The CBIRC combines the previously independent China Banking Regulatory Commission (CBRC) and China Insurance Regulatory Commission (CIRC).

The CBIRC has benefited from the experience of its chairman and strong political support and concerns over financial stability in tackling the country's vast shadow banking system. By contrast, the SAMR's success in addressing monopolistic practices has been far more modest.

Yet it was probably the CBIRC's turn towards online consumer lending which shifted the balance in the regulator's favour, providing SAMR with an opening to enforce its own guidelines.

Although politics and individual rivalries remain an important element in China's regulatory landscape, bureaucratic agendas - especially when they are driven by experienced and skilled reformers like Guo Shuqing - are a far more important factor in explaining government action. It is therefore always worth remembering what American political scientists Ang Ang Yuan wrote in a remarkable 2018 essay for Foreign Affairs: "[In China] the bureaucracy is political, and politics are bureaucratised.[25]'

[22] http://www.xinhuanet.com/english/2020-12/11/c_139582746.htm
[23] **[Chinese]** https://economy.caixin.com/2020-12-14/101639083.html
[24] https://www.bloomberg.com/news/articles/2021-03-12/tencent-baidu-fined-by-antitrust-regulator-for-previous-deals
[25] https://www.foreignaffairs.com/articles/asia/2018-04-16/autocracy-chinese-characteristics

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Further reading:

China's Anti-Trust Authorities Target the Country's Internet Giants (China Policy Update, 15 January 2021)