



# REPORT

## The Ant Group IPO

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There are only a handful of companies that can be described as truly transformative. Ant Group has upended the Chinese banking system and, with WeChat, has become the model for global financial services in the decades ahead. Ant Group has the potential to be the financial backbone of a slew of industries and could well provide the framework for a cashless China and, potentially, a cashless globe. It is all too easy to paint to rosiest of scenarios for the Ant Group as they dominate China and look to take on the world.

International dominance is far from certain. Given the current climate between Washington and Beijing, the prospect for Ant Group in the world's richest economy is non-existent. While tensions may ease in the event of a Biden Presidency, the United States will be a negligible revenue source for the company. Emerging markets are often cited as low hanging fruit as countries across Africa, Asia, and Latin America crave for Alipay's efficiency. Yet, as the Indian example has shown, rising techno-nationalism and skepticism over the Chinese Communist Party's (CCP) intentions may limit international growth opportunities.

I hosted a panel on October 13<sup>th</sup> to discuss Ant Financial's success and its future expansion in the context of geopolitical tensions. I was joined by

*Martin Chorzempa — research fellow, Peterson Institute of Economics*

*Zennon Kapron — founder of Singapore-based fintech consultancy Kapronasia*

*Colin Liang — head of China research, RWC Partners*

*Neil Sheppard — COO of the financial services group at Singapore-based Diginex*

We discuss the interplay between Ant Group and the CCP, the role and future for the traditional banking system, the outlook for capital markets transactions in the context of this payment's ecosystem, and other risks to Ant Group.

In the context of Ant Group soon becoming the world's largest IPO, this conversation and our latest discussion on the Digital RMB was fortuitous.

## Ant Financial: A Background

**Colin Liang:** Ant Financial started as an escrow solution for Alibaba's e-commerce business back in 2003. Over the years, it has grown into a one-stop solution that can solve all the daily financial needs of a customer. Three functions serve the consumer:

1. Consumers can pay or collect money from merchants or other individuals.
2. Consumers use their digital wallets to pay for daily needs, from food deliveries to hotel rooms.
3. Consumers can take advantage of financial services, such as consumer loans, mutual funds, insurance products, etc.

The last service has been the most profitable for Ant Financial. Ant has 1 billion annual users, and the company is growing by roughly 30% per year, handling 118 trillion renminbi in transactions. Globally they have a presence in over 200 countries with subsidiaries such as Paytm in India.

This demonstrates the potential market opportunities and that Ant is highly profitable. Ant Financial's pending IPO may also be the largest ever.

What is the best-case scenario in the next five years for the Chinese financial services industry's future, with not only Ant Financial but WeChat at its epicenter? What's their full potential and ability to transform the Chinese financial system?

**Zennon Kapron:** These two apps are at the center of Chinese daily life, from booking taxis to investments and loans. What's unique about these platforms is their history. Looking at Alipay, it was developed to solve the issue of trust in e-commerce. Previously, a cash transaction upon delivery of items on Alibaba's e-commerce sites presented problems: the deliveryman could run off with the money, or a customer may be unhappy with the product.

Alibaba designed this two-week escrow system where the consumer needs to be satisfied before the money is released to the merchant. That helped e-commerce develop in China by having a point of trust. The solutions that Ant Financial, Alipay, or all the other wealth management platform offer is in addressing these points of friction.

Moreover, one of the most significant impacts these companies made was to make wealth management products available to individuals who would be underserved by the traditional banking network. For that, the growth rate over the next few years could be quite strong, and a lot of it is within the domestic market.

This is very constructive for smaller transactions, but for entities engaged in larger transactions such as capital markets, how will this evolving ecosystem change the landscape?

**Neil Sheppard:** It's a fairly ubiquitous technology in the sense that scalability goes both ways. A transaction structure in capital markets may not work at the retail level, but the digital

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ecosystem's advantage is its growth in scale from the bottom up. The technology allows scalability from one individual to many, many more.

Traditionally, innovation in financial services began at the institutional level, where it's tested with people that know and understand how it works. Now, when central banks and institutions look at digital currencies and payment systems, they're seeing how these new systems are tested and used on a small scale. The critical process here is to build trust at the base level first, and that's an interesting reverse from before.

## The Party's national champions

Discuss the historical development of these digital platforms and the Chinese Communist Party's intentions. What has the Party been trying to achieve with its innovations for the last few years? Is it correct to assume that Alipay and WeChat automatically fit into the CCP's agenda?

**Martin Chorzempa:** The growth of WeChat Pay and Alipay has been aligned with government objectives from the beginning. Here are some key points:

- Alipay launched in 2004 when regulations did not exist for online payments in China. At the time, the People's Bank of China (PBOC) wanted to see innovative competitors in the payments industry, including the government's owned UnionPay.
- The administration of President Hu Jintao and Premier Wen Jiabao felt that China's financial system, which was not digital and very inefficient, needed innovation to grow.
- Internet platforms have spurred consumer spending and small business operations by extending credit at little cost and putting money into accounts in minutes. In contrast, traditional banks would probably have to spend hundreds of renminbi in overhead costs to initiate one of these loans.
- A relatively stable equilibrium has balanced Ant and WeChat Pay on one side, which serve multiple political interests, and regulators on the other side. The former has taken charge of re-opening the economy after COVID-19 by contact tracing and spurring spending.

In conclusion, over the last few years, these platforms have shifted from competing directly with the banks to collaborating with them. Their technology, focused on the front end, helps efficiently allocate banks' capital and wealth management products to consumers and small businesses who otherwise wouldn't receive it. In turn, a lot of that money is either deposited in the PBOC or the banks.

Even if regulators wanted to rein in these digital platforms, it might be difficult because of how much value these digital platforms provide in all areas, including COVID response. Moreover, these companies have become national champions for China, and China wants these companies to be successful globally.

## Financial Platforms as policy tools?

Are they now policy tools of the state that are “too big to fail”? Will they amass power, or will they be reined in to be more reflective of the Party’s policy priorities, like what happened to state banks in 2011?

**Martin Chorzempa:** It's too simplistic to say that they're just going to become tools because these companies also retain immense political power themselves. Ant Financial, for instance, is best positioned to serve through its technology and its users: small businesses and consumers in rural areas. These also happen to be the kind of people that the government wants to extend credit to.

It's also unclear how much their interests diverge from the state, except in the international expansion element, where being too close to the Chinese government can be a drawback. There's also pushback from the digital platforms: when, for instance, the PBOC tried to get access to credit data in these companies, they've used their power and political leverage to quash those initiatives not to give that data so far. So, it's a very complex dialectic between extremely powerful firms and an even more powerful government.

Could these two companies become so dominant in their influence over the financial system that the Party has to play by their rules, which is drastically different from the last 40 years?

**Martin Chorzempa:** There was a risk of that for a while, but regulators have had the final say in certain matters.

When Ant Financial rolled out its Sesame credit score as the Chinese equivalent of FICO, the PBOC found problems with that: the score could turn into a measure of loyalty to the platform itself, and the idea ended up being scrapped.

Regulators also worried about the stability of the Ant Financial payment networks. Essentially, Ant has accounts at all of the major banks, and they move money around their network of accounts; in the PBOC's own words, Ant was acting like a second central bank doing interbank clearing, which is not what they're supposed to do. In response, the government created NetUnion, a government-controlled clearing center, which all digital payments have to go through.

## Risk for nationalization

Discuss the risk of nationalization of companies that are trading at lofty valuations. What are the risks from a business model perspective?

**Colin Liang:** The chances of nationalization would probably be low for Ant because Xi Jinping and China need to be seen as open. Even recently, they've allowed the private sector to take minority shares in state-owned enterprises.

But in general, regulation is a risk because this is a new industry where players are trying their hardest to find loopholes. Ant Financial, for instance, is trying to sell funds on their own platform, thereby attracting more traffic through their prospective IPO.

Overall, these platforms are eating the pies of traditional financial institutions: they're undercutting every single financial institution by charging less for each transaction. Regulatory risks are real. On the business side, however, the risk will be relatively small. Even if there may be bumpy points along the road, the market won't punish them until the incidents happen.

## The future of traditional banking

If some see traditional banks as “analog dinosaurs,” what is their future?

**Zennon Kapron:** I think we have to wait and see. When Ant Financial started in 2004, few would have said this platform would eventually grow into what it is doing today in terms of loans and wealth management, and everything else.

The government let it happen because specific sectors in China are underserved by banks and digital payments, so Ant's impact on financial inclusion is tremendous. For instance, state-owned banks lend to state-owned enterprises, leaving many small-to-medium enterprises and individuals in the lurch because of the costs.

To take one example: reviewing a loan application takes a month and costs about 250 US dollars for banks. Digital platforms like Ant, Yu'e Bao, or others do it in seconds and cost about 25 cents. A digital platform can profit from a loan of \$1,000 when a traditional one cannot.

That said, the government has allowed these platforms to develop to a certain point before regulating them. What we've seen in the past couple of years — and probably will see in the future — is a situation where traditional banks provide the trust and the balance sheets, while platforms like Ant Financial, Tencent, and WeBank, and others provide direct channels to the consumers. That's how it's already working.

It's a win-win for traditional banks — to take the Bank of Shanghai, a top city commercial bank as an example — they don't have much insight into individuals, whereas digital platforms do. If they can provide a good credit score for an individual, then the Bank of Shanghai can leverage the underperforming deposits they have on their account.

Why shouldn't traditional banks buy one of these companies and compete head-to-head with Ant in balance sheets and innovation?

**Zennon Kapron:** There's been a brain-drain from finance to technology in the wake of the financial crisis in 2008, and that's true for China and other places. New graduates are more likely to work for start-ups and other places that could be the next “big thing.”

Traditional banks face several issues. Even though it's a relatively new technology, achieving subscriber growth or user acquisition is already tricky. There are two or three major players in

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China, and then there's the government in the background. Brand loyalty and awareness are interesting aspects for younger generations, too. The incentive for talented young workers to join a large financial institution simply isn't there.

Major banks likely stay entrenched in their traditional advantages. The incumbent infrastructure behind much of the financial services industry is just incapable of the speed and efficiency that are demanded. Many financial institutions are scared by the amount of effort needed to revamp their operations in a way that incorporates the latest technology, even though they have opportunities to do so. They're more likely to fund a number of these digital platforms that allow them to effectively bank for banks.

**Could digital platforms like Ant Financial do the “reverse” and get into the banking business themselves by building their own balance sheets and fund themselves?**

**Zennon Kapron:** Backwards integration is an exciting concept, but to me, it doesn't fit with how these platforms operate and the way they want things to move forward. It may happen, and in fact, there is resistance to the dependency on existing infrastructure. However, while digital platforms command large capital flows, everything is still ultimately predicated on the foundations of a traditional banking structure that will remain intact for a while.

**Martin Chorzempa:** In one example of this, Ant and Tencent started their banks, and they owned microlending companies that were over-leveraged and giving loans independently on their balance sheets. These microlending companies dominated the consumer loan ABS market, coming into direct conflicts of interest with major banks. It looked like a significant step forward.

Yet the PBOC and CSRC stepped in and squashed the idea of packaging most of these as ABS. The microlending companies were forced to co-lend with banks, with the latter providing most of the capital with a tech layer on top. In a scenario where Ant would've gotten hundreds of millions of depositors and suddenly have one of the largest balance sheets in China, but instead, regulations stopped that from happening. That was a conscious choice from the government to protect the banks from being wiped out.

## Geopolitical risks of ‘techno-nationalism.’

**The world of fintech in China arguably changed when India recently banned scores of Chinese apps after the skirmishes between Indian and Chinese troops. If we think of this as the beginning of techno-nationalism, where countries are more likely to target each other's tech industry rather than traditional commodities, how do we see the international growth of Ant Financial in the context of hostilities between China and the US, and with India?**

**Martin Chorzempa:** It's been an uphill battle for years for Chinese companies. When WeChat entered India around 2012, it assumed it'd be successful given its experience in China. But that didn't happen: WeChat did not adapt to the local market in the same way that many American companies failed in China because they also didn't adapt.

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We know from leaks back then that the Indian government was going to ban WeChat. Despite its promotions, the app's growth stalled, and it lost out to another local company. Another example was Ant's failed attempt to purchase MoneyGram in the United States, which would have given it a global remittance network and connections all over the world. Yet, they went around it by buying UK-based WorldFirst.

These apps' international successes have so depended so far on Chinese tourists who spend a lot of money abroad — at least before COVID-19. Ant and Tencent could sign these agreements that allow tourists to use Alipay in dozens of countries and currencies. However, that's still serving the domestic market. The only people outside of China who use the Alipay app those with connections to the country. And that has been allowed because it is a low threat to sovereignty.

Chinese companies have tried other forms of partnerships, such as Ant's agreement with Paytm in India. Ant supplied the backend infrastructure needed for payment systems and encouraged Paytm to use QR codes. Instead of going around the US and asking entities to stop using Visa — which won't work for geopolitical and other reasons — they can become global players by operating a little more behind the scenes. They can leverage technology from locally connected players who don't launch alarm bells.

**Does a company like Ant Financial, in becoming prominent and dominant, face the same problems of techno-nationalism as Facebook?**

**Zennon Kapron:** If you look at the US as an example, even domestic players face regulations by state and questions of operating in a domain deemed as critical infrastructure by regulators and by the government. The failure to acquire MoneyGram happened when US-China relations were actually on a much better level, but it still failed because of national security considerations.

I think Ant Financial's problem stems from its usability in other markets. There's no reason for people who don't have connections to China to be using WeChat or these payment systems when options like WhatsApp are available. Some are even scared about installing what is effectively a Chinese app on their phone.

The question is whether they continue to expand internationally in an "inorganic" way, like how WeChat operates through Naspers in South Africa with a rand-denominated WeChat wallet. So far, it hasn't been successful, and there are few examples of companies that have managed to expand internationally, besides WhatsApp, Facebook, and ByteDance's Tiktok. The bigger threat will be if companies like ByteDance get involved in financial services rather than Ant Financial.

Indeed, anti-China voices like Senator Marco Rubio in the US have called for delays in the Ant Financial IPO and their potential access to and ability to clear US dollars. But it doesn't matter for Ant Financial because China is 95% of their revenue base. Yet other parts of the world will be very accepting for something like Ant; similarly, Belt and Road have gone into many countries that need infrastructure. It's not a perfect example of questionable success, but people are open to innovation and new ideas if there are no domestic options to tackle those challenges.

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## Can Ant Expand Internationally?

Given the international headwinds that come from increasing techno-nationalism, is the pie big enough for Ant Financial to expand?

**Colin Liang:** It's important to note how payments become popular through organic growth — from daily services payments to money market funds and insurance. It's an evolution of complexity that has taken more than ten years. So, I think Alipay's international expansion is in a very preliminary stage. Financial services clearly will be the target of national security concerns and financial regulations, but I don't think Ant or WeChat be immediately involved. These platforms can leverage local platforms.

For example, in Singapore, Lazada is doing e-commerce while using Ant Financial for its backend infrastructure. Alibaba could also take a stake in Grab for taxi-hailing. So, it's all starting with the local service first and then the financial services. It will be a long process.

Will there be a natural migration for a business that uses a traditional banking system to switch to Ant, which becomes the financial system's spine?

**Neil Sheppard:** I think it's a more general question, not specific to Ant Financial, about whether or not the financial system that underpins consumer applications can evolve into more advanced technologies. It's about interoperability and the ability to build a backend system that takes advantage of what technology currently brings to bring efficiency and ultimately price benefits to the end-user.

## Conclusion

Upon its IPO, Ant Group becomes one of the world's twenty most influential public companies. While it will face challenges with international growth through skepticism over the Chinese Communist Party's intentions, it remains the model for payment systems in the years ahead. It will face competition from local upstarts in the markets it wishes to enter, but with a day one market capitalization likely to exceed \$300bn, it will have the scale and balance sheet to take on all comers.

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