“TOO CLOSE TO THE SUN”: WHY ANT TECHNOLOGY GROUP BECAME A CHINESE COMMUNIST PARTY TARGET AND WHY ITS IPO STILL MATTERS

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In a last-minute meltdown (within 48 hours of going to market), one of the most anticipated initial public stock offerings (IPOs) in history fell apart over a conflict between the Chinese Communist Party (CCP) leadership and Ant’s billionaire founder Jack Ma. Ant Technology Group, a Chinese online payments and financial services company, was poised to proceed with its IPO in November, 2020. Expected to raise some $37 billion, it would have been the world’s largest IPO to date.

On November 3, 2020, however, the offering was faced with an indefinite suspension after the Chinese government stepped in to halt the deal. After a period of immense market enthusiasm surrounding the Ant IPO, its abrupt suspension reinforced existing concerns about the limits of free enterprise in an authoritarian China, and about Ant Group’s business practices themselves.

PSSI builds on a series of in-depth reports by our partner research and risk management firm, RWR Advisory Group, that delineated a number of material risks to investors posed by national security and human rights concerns associated with Ant Group. In short, the IPO’s collapse is a reminder of the outsized risks of investments inherent in Chinese corporations, particularly those as prominent, and flawed, as Ant Group.

Originally established as Alipay in 2004 by Alibaba’s founder Jack Ma, Alipay was rebranded in 2014 to Ant Group. The company remains partially owned by Alibaba (33%). With over 600 million users in China alone, Ant Group is the country’s main payments processor, comparable to Visa and Mastercard in Western countries. In a recent interview, PSSI’s Chairman and Co-Founder, Roger Robinson, argues that, among other abuses, Ant Group has been instrumental in establishing China’s intrusive social credit scoring system.

The company filed plans for an IPO in August, 2020, planning for the offering to be underwritten by five separate banks (four of them U.S.-based) and expecting to raise approximately as much as $37 billion. This would have indicated a valuation of the company at over $300 billion, placing Ant Group among the top 20 highest-valued companies worldwide. The IPO was well on its way to being wildly oversubscribed, with retail investors placing bids for some $3 trillion in shares.

With the winds of the markets under his wings, Jack Ma made public comments at the Bund Summit in Shanghai highly critical of the Chinese banking system’s “pawn shop mentality” (in favoring collateral over the needs of small and medium sized businesses) and admonishing the government for its continued adherence to the Basel Accords international financial regulations instead of setting its own standards. These remarks – viewed as arrogant and disloyal by Communist Party leadership – combined with a perceived threat to its power stemming from Alipay’s dominant position as a payments platform for the Chinese people led to the sudden undoing of the Ant Group IPO.

Shares of Alibaba crashed nearly 10% on the announcement. PSSI estimates that the suspension, along with new regulations negatively impacting Alipay, will end up decreasing Ant Group's valuation when it does come to market by some 33%-45%. This could amount to over $100 billion in losses, greater than the annual GDP of Slovakia. According to the Chinese central bank, the decision was made in order to protect investors and consumers.

THE SYSTEMIC CONTRADICTIONS OF CHINESE MARKET CONDITIONS

One underlying reason why the Ant Group IPO was suspended is the divergence in interests of China's rising wealthy elite and the Chinese Communist Party, which fears losing its absolute monopoly on authority in the country. Jack Ma is hardly the country's first billionaire, but to the government, he represents a threatening new kind of figure. Like Jeff Bezos or Mark Zuckerberg in the U.S., Ma has rapidly accumulated a vast fortune in the booming tech sector, and has become a sort of harbinger of future economic change as the Chinese economy moves away from state-dominated manufacturing. The ubiquity of Ant Group's services gives Ma an unprecedented degree of independence to act on his own private interests rather than those of the Communist Party. As Ma began to take greater advantage of this independence, openly criticizing government policy, the government perceived that to penalize him it needed to go after the source of his personal wealth and access to global capital.

The damage to Ant Group's valuation establishes that the Chinese government cannot crack down on a figure like Ma without incurring significant market blow-back. That said, in any situation where the Chinese government is forced to choose between wealth and power, it will choose power every time. The need to constantly balance the interests of a large, globally-integrated economy with the imperative of unchallenged Communist Party rule means that China will inevitably be required to make such ad hoc policy decisions to prevent the contradictions of its economic model bringing the system to ruin.

As long as this dysfunctional system survives, it will prevent the development of truly free market institutions and adherence to the rule of law in China. This situation notwithstanding, we are not seeking to present Jack Ma and/or Ant Group as innocent victims of China's repressive governance. On the contrary, Ant Group has a deeply problematic corporate record of abuses which likely contributed to the government's decision to suspend the IPO – the reason being the government's fear of the embarrassing effects of having a high-profile corporate entity fall afoul of financial market regulators in the U.S., home to over 60% of global liquidity and capital markets roughly the size of the rest of the world's combined.

RWR REPORTS ON CONTROVERSIAL OWNERSHIP AND INVESTMENT ISSUES OF ANT GROUP

PSSI's private sector research partner, RWR Advisory Group, has conducted pioneering work on Ant Group's risk profile for months prior to the IPO suspension. In a series of five reports, RWR identifies a number of categories of material risk which undermine investor protection well beyond normal business considerations. RWR has scrutinized the company's national security-related concerns and detected serious enabling of human rights abuses. The U.S. State Department's leaked proposal to place Ant Group onto the U.S. Entity List, which would largely, if not completely restrict American companies from doing business with the Fintech firm, likely came about, in part, as a result of RWR's in-depth risk analyses.

Ant Group has been heavily criticized for its negligence in properly securing data and ensuring customer privacy. This is a pressing matter given that the Fintech sector is highly sensitive to cybercrime, as it holds large amounts of financial data connected to banks and other financial institutions. These privacy concerns were even addressed by institutions from within the Chinese government. For example, in January 2018, the Cyberspace Administration of China (CAC) officially stated that Ant Group had repeatedly failed to comply with the required national security standards for customer privacy. Following the sharing of sensitive data being with the CCP, India recently decided to ban Alipay, together with 117 other Chinese-owned applications.

In this connection, it is also worth noting that Article 7 of China's National Intelligence Law can force Chinese companies to provide the government with access to their data and to gather intelligence for the state. Notably, it was for this exact reason that Ant Group failed to close a $1.2 billion deal to acquire the US-based company MoneyGram International Inc. (MoneyGram), a global leader in the p2p payment and money transfer business.

Both firms decided to abandon the deal after a signal sent by the Committee on Foreign Investments in the United States (CFIUS) that it planned to reject the acquisition proposal on national security grounds. MoneyGram plays a critical role in U.S. financial infrastructure, serving millions of Americans and obtaining large amounts of sensitive information. The acquisition would have given Ant Group, and thus the CCP, unlimited access to this data, which could be utilized to identify vulnerable U.S. citizens and military personnel.

That Ant Group is duty-bound to comply with government directives is also behind the company's participation in so-called Military-Civil Fusion (MCF), an initiative that aims to employ the country's technology and science to strengthen the CCP's military capabilities. RWR discovered that Alibaba Group and Ant Group are closely coordinating and working with state-owned advanced weapon manufacturers, conglomerates that develop high tech naval warfare systems, as well as biometric laboratories that develop authentication capabilities, including eye verification.

RWR further exposed Ant Group's company structure and investment framework, based on recently disclosed financial data. The report shows that Ant Group appears to hold substantial shares through its subsidiaries in Megvii Technology Ltd. (Megvii), an artificial intelligence company well-known for its facial recognition technology. Megvii is helping equip mass detention facilities in Xinjiang (which many term concentration camps) with high-technology surveillance capabilities. Consequently, Megvii was sanctioned and blacklisted by the U.S. government, being officially placed on the Entity List of the U.S. Department of Commerce in October 2019 for human rights abuses.

Ant Group's involvement with Megvii is not an isolated incident. The well-known subsidiary of Ant Financial, Zhima Credit Management Co., Ltd., (better known as Sesame Credit), reportedly uses Megvii's cloud-based Face ID technology to provide identity verification solutions to its customers. More importantly, these technological developments have shaped the Chinese government's highly controversial social credit systems, which are being employed to control its people and infringe on their freedoms and civil liberties.

CONCLUSION

The Ant Group IPO was suspended for several of the reasons referenced, but all ultimately point to a profound sense of insecurity on the part of the Chinese Communist Party. Jack Ma's financial clout gave him the confidence to directly criticize government policy, provoking the government into a blunt display of its "police state" authority. Concerns about Ant Group being placed on the U.S. Entity List and having its access to the U.S. capital markets impeded, a situation made more likely by RWR's incisive reporting, also seem to have played a role in the CCP's decision to suspend the IPO.

The risk of embarrassment from seeing its monopoly on authority challenged from the inside forced the government to sacrifice its own financial ambitions to maintain its uncontested hold on power. However, these obvious systemic contradictions help to expose China's one-party system for what it is: an impediment to China's development of both democracy and a coherent, viable market economy founded on the rule of law.

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