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China's antitrust probe may create level playing field for smaller tech firms: Pantheon's Jie Gong

By Eudora Wang
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The investment world is not overly concerned about the recent series of efforts that Beijing has made to step up scrutiny of monopoly practices in China's Big Tech giants. The country's heightened antitrust probe is expected to create "a more level play field" for smaller competitors, according to a partner at Pantheon Ventures.

"From an investor's point of view, the regulation deters the Internet giants from deploying certain aggressive tactics to stymie competition, which helps create a more level play field for smaller competitors to emerge and thrive," said Gong Jie, a Hong Kong-based partner at UK-based investment firm Pantheon Ventures, in a recent interview with DealStreetAsia.

In that way, sectors will no longer be controlled by a couple of dominant players at the expense of young contenders.

Pantheon, with $65.9 billion in total assets under management (AUM) by the end of 2020, invests in private equity, infrastructure & real assets, as well as private debt. The firm has about 360 employees, over 100 of which are investment professionals, across eight offices in New York, San Francisco, London, Hong Kong, Seoul, Bogotá, Tokyo, and Dublin.

An early sign of Beijing's determination to rein in its Internet giants surfaced in November 2020, when Alibaba's fintech spinoff Ant Group had its $37-billion initial public offering (IPO) derailed by regulators days before it was due to list.

In the country's latest antitrust development, the regulator slapped a record fine of 18.2 billion yuan ($2.8 billion) on e-commerce behemoth Alibaba in early April – equivalent to 4% of the firm's total 2019 revenue – for the firm's misconduct of forcing merchants to sell exclusively on its platform, a practice known as "picking one from two."

Meituan, the biggest on-demand delivery service provider in China, is also under the spotlight after the regulator announced on April 26 the initiation of another anti-monopoly investigation into it, while Reuters reported two days after that Tencent would be the next target.

Personally, I don't see the recently announced anti-trust regulation and the probe into tech giants' practices as particularly unexpected or alarming. Tech giants have amassed a great deal of sway in many industries," said Gong.

"However, current probes into a number of Internet giants in association with the regulation do create some uncertainty about how regulation is interpreted and applied. Prompt completion of the probes with clear-cut conclusions will lift that overhang and provide clarity," she added.

Jie Gong is a partner at Patheon's Asia Investment Team, as well as Vice Chairman of the Hong Kong Venture Capital and Private Equity Association (HKVCA). Prior to Patheon Ventures, she was the head of Asia at Morgan Stanley Alternative Investment Partners' private equity fund of funds group.

Edited excerpts of the interview:-

It has been more than a year since the pandemic started – what are the key learnings that you've seen since the time you spoke at the DealStreetAsia summit six months ago?

One observation is the unevenness of the COVID impact. Some sectors flourished with accelerated development because of the pandemic, whereas the decline in other sectors has been exacerbated. There are clear winners and losers this time, as distinct from the previous crises that adversely impacted all or most sectors, albeit to varying degrees of intensity.

Another observation is the divergence of fiscal and monetary policies. Typically, the entry into and exit from policy easing as a response to global crises are fairly synchronised across geographies. But because countries are at different points in the pandemic cycle, China's monetary and fiscal policies, for example, have already entered into a tightening phase, reining in credit and liquidity to prevent overheating, while large scale economic stimuli are still being pumped into the system elsewhere.

Do you think such unevenness will continue, and how would it affect investments?

From an investment point of view, this is a matter of business model fundamentals as well as valuations.

There have been a few factors underlying companies' inflection points during the pandemic, for example, accentuated need for productivity despite physical disruptions, changes in the mix of sales and marketing channels. Those with favorable fundamentals whose growth have had the inflection point went up a lot in valuation.

Ultimately, for investors, the answer to the question lies in the constant calibration across the sectors of expectations around earning growth, valuation and future interest rate.

Regulatory uncertainty around antitrust regulation towards China's Internet sector have increased in the past months. How does this affect PE and VC investing? How do you expect this to play out over the next one to two years?

Personally, I don't see the recently announced antitrust regulation and the probe into tech giants' practices as particularly unexpected or alarming. Tech giants have amassed a great deal of sway in many industries. For years, there have been debates at think tanks, in academia, and on social media about whether there should be boundaries around these gigantic companies' power, and the social impact of some of their competitive practices.

From an investor's point of view, the regulation deters the Internet giants from deploying certain aggressive tactics to stymie competition, which helps create a more level playing field for smaller competitors to emerge and thrive. In that way, sectors will no longer be controlled by a couple of dominant play2021 expense of young contenders. Competition, ultimately, is good for customers – and it is also good for the entrepreneurial spirit to thrive.

However, current probes into a number of Internet giants in association with the regulation do create some uncertainty about how regulation is interpreted and applied. Prompt completion of the probes with clear-cut conclusions will lift that overhang and provide clarity.

The valuation level in certain sectors, especially technology, has been on a rise over the past few years. Are you seeing these valuations sustaining themselves in the long run, especially in the technology sector?

Inflation has been a much-discussed topic recently, and it merits close watch. There is a legitimate concern on the valuation multiple contraction as current valuations are well above long-term median levels. In many cases the valuation is "priced to perfection", leaving little margin for error.

An advantage of the private equity approach is that GPs can create alpha through hands-on ownership and bring their skills to bear in addition to those of company management teams. Furthermore, accretive bolt-on acquisitions to average out the entry valuation also help mitigate the valuation issue.

What would be the most promising strategies to take on in the coming year or two? Are there sectors or regions that could spring a surprise?

Broadly speaking, in the consumer, digital, technology and health areas there are many compelling sub-sectors with breakout potential – and that have sufficiently deep talent pools to realise that potential. Recently, I have seen investments in interesting areas like data processing units and graphics processing units. There are also terrific companies coming out of a convergence of healthcare and technology. Those areas will continue to blossom as there is simply so much scope for technology advancement and industry upgrades in the pursuit of productivity gain.

How about the SaaS sector in China?

There has been some evidence of an incremental increase in enterprises' willingness to pay for mission-critical software services which lead to net cost savings. In China, the software is very often provided as part of a suite of service solutions rather than solely on its own, as is typical in the US.

The portion of small and mid-sized companies in the Chinese economy is significantly larger than that in the US, as most industries are still very fragmented. For the smaller companies, the management has less mindshare on process precision and optimization than top-line growth, and indeed the economy of scale from work process optimization is less than bigger companies. That is why SaaS development in Chin has lagged. It takes time for enterprise solution companies to cumulate a large enough customer base and introduce SaaS in their product offerings.

Has there been a significant jump in logistics and supply chain services companies?

We have seen the opportunity set getting bigger for the past four to five years. Innovations and technology solutions in the logistics and supply chain sectors are not something new. There have been some high-profile deals that have attracted a lot of late-stage venture funding lately, which makes supply chain innovation more of a bright spot in the market.

Are investors leaning into sectors like smart city and Internet of Things (IoT), which are on the tailwind as Beijing promotes development of "new infrastructure"?

Related to smart cities, there are many opportunities along the value chain of the future generation of electric cars and autonomous driving. The government's policy support towards the development of smart cities is an important part of the ecosystem, but technology evolution – and China's large population, of course, being the world's largest car consumer market – are the fundamental drivers for new capital coming into this area.

Amid the pandemic-related market changes, do you think more corporate owners may take the opportunity to divest non-core subsidiaries? How big an opportunity is this for PE firms?

In Japan, there have been a number of high-profile corporate divestitures in the last year and a half. While these have caught a lot of attention because of the transaction size and the PE contenders involved, I do not have data that compares it with pre-COVID corporate divestiture deal volume. Therefore I could not say if this is a trend or not.

Another trend that we are seeing is the homecoming listing of US-listed Chinese firms, be it a relisting or a secondary listing in Hong Kong. Do you see this trend continue in the following months?

Quite a number of firms have already completed a dual listing in Hong Kong. The capital market participation has deepened significantly in Hong Kong, with a lot of institutional capital flow from mainland China and generally far more institutional investor participation in the mix compared with ten years ago.

On the other hand, many Chinese companies continue to go for a US listing. In the 12-month period ending April 2021, there have been over 20 Chinese ADR IPOs, raising $17 billion. On an aggregate basis, their aftermarket performance, for example, stock performance one month after the IPO, has been among the best since 2013. This reflects a buoyant capital market, the underlying quality of these businesses, and investor receptivity to their equity stories.

Do you think that LPs continue to see China as an important market for venture opportunities?

China's VC market is the second-largest outside of the US. For an LP that likes venture exposure and growth capital exposure, China is a market not to miss out on.

Capital has almost become a commodity with so much liquidity around. In that context, how do you pick the GPs that you put your money into?

We pick GPs that are differentiated and have evidential strengths that give them an edge over their peers. A lot of it is about industry knowledge, domain expertise, past deal track record; in short, attributes that speak to their ability to add value others are not able to bring to the table. These are very important in helping GPs differentiate themselves in front of their investment targets, as well as in front of LPs.

Of course, experience matters a lot. It's much easier walking into a room, saying: "I have helped X, Y, Z companies accomplish these goals and here are their contact information. You can talk to the founders about how we have added value." Success begets success. I also think it is also essential that the size of a GP's capital pool is reasonable and responsible, i.e., not so big that they would have to stretch their underwriting standard just to get the pool of capital deployed.

There have been a lot of discussions about whether GPs really do add value. Many who claim to do so were caught out during the pandemic when they could not really help their portfolio.

Are the GPs able to secure deals that they want? Ultimately, deals that a PE firm has done speak volumes on value add. If they are able to secure their investments in highly attractive companies at a reasonable valuation, it shows a few things. It could be that they have a great brand. It is more likely that it is because they can address a problem, provide a solution, or make a highly valuable connection to the entrepreneur.

Alternatively, they may really understand the sector and have provided the founder a bigger and better vision. Those are the things that entrepreneurs really appreciate.

Important Disclosure

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