Advisory Blog

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Examining the Impact of China's New Regulatory Regime

By: Kunjal Gala | October 14, 2021

London - Since November 2020, Chinese authorities have aggressively tightened regulations across a number of sectors, including the internet, health care, education, gaming, gambling and crypto currencies — ostensibly in pursuit of its social and political goal of "common prosperity." Although tighter regulation was clearly on the horizon, investors and industry officials were caught off guard by the strictness of the new rules and speed with which they took place.

There have been some prominent casualties of the new regulations. For example, one financial company had its IPO canceled, and several are facing significant impairment of their business models. It appears clear that China's government may be willing to implement policies that undermine the profitability of certain private sector companies in the short term to achieve its longer-term socioeconomic agenda. We believe that's a lesson with implications for all Chinese internet firms.

Initially, many investors believed some of these measures to be one-off, company-specific events. However, it seems Chinese regulators are applying a more measured, intentional approach toward the following:

- Social good. The government's overarching mission is to promote "common prosperity" through actions to increase affordability in four key areas: education, housing, health care and livelihood.

- Data security and control over content. Data collection, storage and analysis are core to internet platforms and the government now considers Big Data — as well as control over certain content — a matter of national security. China is not alone in this; many countries are looking at their national data strategies.

- Antitrust enforcement. Regulations here impact e-commerce, travel, ride hailing, local delivery, search engines and more. Their aim is to reduce monopolistic practices, increase competition and help smaller businesses.

- U.S. listings. Regulators are looking to limit the ability of Chinese technology firms to maintain listings in the U.S., given the requirements of the Public Company Accounting Oversight Board (PCAOB) to have access to audit papers, which China currently does not permit.

- Foreign investment. China appears increasingly uncomfortable with foreign investment in sectors that Beijing authorities are trying to rein in. For example, the for-profit education sector includes three industry leaders listed in the U.S. The government believes this booming sector has inflated the costs of raising children, contributing to falling birth rates — a key focus of Beijing following the recent change from the two-child policy to three children.

Investors do not like regulatory uncertainty and hence the risk premium for China-based internet companies and related sectors has gone up and related stocks have sold off.

Is It Safe to Invest in China?

In our view, China remains investable now and for the foreseeable future. The pattern of regulatory clampdown is not new, but what is new is the speed and aggression. Although China could have dealt with its "common prosperity" agenda more even-handedly, we believe this new environment will prepare the internet sector, health care, education and other areas for more sustainable growth going forward. Of course, some short-term pain is expected, but medium term, we expect to see these businesses move forward on a more sustainable growth path.

Bottom line: While disruptive in the short term, we believe Chinese regulatory measures may contribute to a more sustainable path for education, health care and other sectors the government views as critical to reducing wealth disparities. We still view China as an attractive region and in a future blog will discuss specific areas where we see opportunity.

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