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Characteristics of Chinese Technology Companies

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China's economy is often described internally as "socialism with Chinese characteristics". Its stock market, largely driven by the large technology companies, can also be described using such idiosyncratic phrasing. The large Chinese tech companies are not quite like the tech companies in America, Europe or anywhere else. They come with their own unique characteristics.

The level of government intervention and control in Chinese tech companies is unprecedented. In the last 12 months, we have seen the CEO of Byte Dance (the company behind TikTok privately valued at over $400bn) step down. The reason behind this is unclear but he has been known to publicly admire the openness of Western politics which allows for open debate and is also a fan of Hayek, which is probably not recommended reading by the Chinese Communist Party.

Also, in November 2020, the Ant Financial IPO was scrubbed, and CEO Jack Ma disappeared for a few weeks. More recently in July 2021, Didi (the Chinese Uber) went public in the US. A Few days after its IPO, the Chinese Cyber watchdog ordered the company to stop registering new users and instructed all Chinese app stores to remove Didi's app. *In the same month, antitrust regulators also blocked the merger that Tencent (a $600bn dollar company) had planned.*

These companies each have two things in common. They are all high growth technology companies, and they are founder led. Why is this important? Xi Jinping's unwillingness to allow Chinese Bezoses, Musks and Gates to exist is good news for anyone worried about China's growing power. How long does this continue? This remains unclear. Xi Jinping is 68. This would mean another 10-15 years is plausible.

When Elizabeth I worried about her rich and powerful subjects, they were just big landowners, and keeping them down didn't do any harm to the economy. The landowners of old were simply rent seekers. There was limited wealth creation, just the occasional wealth transfer. However, founder-led companies in rapidly growing industries are the engines of growth in modern economies. Regardless of one's opinions about large tech companies, it is clear that they follow a power law dynamic – a few companies create and capture a majority of the wealth and are the engines growth.

All this is reflected in the valuations of the Chinese tech companies, which mostly trade at a lower multiple of earnings than their American and European counterparts. This would imply that the continued interference by the Chinese Communist Party is likely already priced in. In the short term, returns may well be held back because of limited multiple expansion and limited growth. However, over the longer term, it remains an interesting opportunity that we continue to monitor closely at Tacit.

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