INSIDE ANT FINANCIAL'S NEST

Alibaba, Alipay, Ant Financial – by now everyone in banking knows the triumvirate of brands that have transformed financial services in China. And the domestic story is only the start. Going global will be Ant Financial's biggest-ever test, with tougher markets, tighter regulation and a whole new world of risk management. But it is nothing if not ambitious

By: Chris Wright **Illustration:** Justin Metz

For a company that is changing the world, Ant Financial occupies modest premises. Far from the funky fractured lattices of parent Alibaba's head office, Ant resides in a nondescript grey tower block half an hour's drive across Hangzhou in east China.

There is little signage upon it to mark its dynamic inhabitant, nor much evidence of technological sophistication. In the morning, 6,000 staff scrum to get into the six lifts that serve the building. In an overspill tower five minutes' walk up the road, Euromoney eventually reaches an executive interview via a plywood-flanked goods lift.

Considering that it has been roughly valued as a $60 billion enterprise – the true figure will be clarified if a long-discussed IPO goes ahead – it is worth remembering that Ant is still to a large extent a start-up that has only existed in its current form since 2014. On some floors, that is what it feels like: on one there is a life-size Iron Man figure, which at first glance appears to be working on a Dell laptop next to a table football game and an open-plan kitchen. To one side is an exercise bike next to a wall with an orange-painted mural saying, in English: 'Our family'. Decals of Marvel superheroes cover the windows.

But this sense of geeky Silicon Valley freshness is misleading, because Ant is so much more than an optimistic upstart. A truer sense of the company's modern reality is on its 16th floor lobby.

Here a screen runs 20 feet across a wall, with strict instructions not to photograph it. On it an image of a globe revolves, from which spikes of orange and yellow burst volcanically, representing the payment transactions that are taking place through some form of Ant Financial's Alipay network around the world. They reach a mighty height in China, as you would expect, but bubbles of activity in Russia and Brazil hint at the company's future.

Elsewhere on the screen are stats, but no stats about Ant Financial stay accurate for long: 450 million Alipay users, 200 million online transactions a day, 1.05 billion transactions in 24 hours during a November shopping festival. It is a tricky undertaking to keep track of it all. The communications staff keep a factsheet of the enterprise's numbers, but they have to be revised bi-weekly as the growth keeps accelerating.

In its early years, Ant was observed from overseas with fascination but little concern. Ant and rival Tencent's WeChat platform have demonstrated beyond doubt that China is the world's most vibrant fintech market, achieving domestic usage levels that outstrip the population of most continents. But they have been local, landlocked phenomena.

Now, however, Ant is spreading internationally, with steadily bigger ambitions. Its MoneyGram bid – although in the balance at the time of writing – is the clearest illustration yet that Ant aims to do much more than just serve Chinese tourists in overseas restaurants. This has consequences for everyone in mainstream financial services.

"Our vision is that we are trying to serve 2 billion customers within the next 10 years," says Jia Hang, senior director in the international business unit at Ant Financial and the man responsible for the global roll-out of the core Alipay business. "That gives you a sense of scope."

Only 30% of the human race? Some start-up.

THE ALIPAY/ANT FINANCIAL DOMESTIC STORY IS WELL-known by now, but the business is poorly understood outside China.

The true powerhouses of Chinese fintech have all been driven by e-commerce parents to which payment engines have been attached, and so it is with Ant. The heart of the business, the Alipay payment platform, came into existence in 2004 to support Jack Ma's Alibaba and in particular its Taobao online shopping website, the closest Chinese equivalent to eBay and Amazon. Alipay was devised as a facility through which money could be exchanged between buyers and merchants with trust on both sides.

At this stage, and this stage only, it was like PayPal. "I'm going to tell you many times in the next 15 minutes," says one insider, "that we are no longer PayPal."

The key to understanding Alipay is that it is considerably more than a payments gateway. The skill of it has been to turn it into something truly essential for everyday life. It is deliberately and skilfully invasive: a company representative calls and pays for Euromoney's taxi to the train station using Alipay on her phone, then books the train ticket to Shanghai the same way. She could equally use it to pay bills, book cinema tickets, contact her doctor, top up the phone, transfer money to friends or split a bill with those friends. Or she could use it for offline transactions – about 30% of Ant's business and growing – using a QR code and her phone to make payments in supermarkets or clothing boutiques. These days Alipay likes to be thought of not as a digital wallet, but as a lifestyle enabler.

Perhaps the most transformative moment in Ant Financial/Alipay's story came in 2013 with the launch of a product called Yu'e Bao. The term means 'leftover treasure' and it came about because of a realization that customers were parking money in Alipay. Not being a bank, the company could not pay interest, so instead set up a money market fund to offer a return on that unused cash.

With a minimum investment of a single yuan and a maximum of Rmb1 million ($145,000), the fund differs from the mainstream domestic fund management industry and is clearly aimed at the little guy, a key part of the Ant Financial underdog ethos. A ubiquitous staff mantra internally is: 'Bring small and beautiful changes to the world.' The Ant name comes from the idea that small things can be powerful agents of change when working together.

The proposition was sufficiently attractive that it became the biggest money market fund in the country in a matter of months and today has Rmb800 billion under management. It attracted 81 million investors in its first nine months and has 300 million users now. That is more than there are investors in the A-share market.

The first lesson from this is just how effortlessly and powerfully Ant Financial eased into financial services, by keeping things simple. The second lesson – which will be very relevant as it grows overseas – is how easily it slipped off the troublesome burden of licences. Ant Financial does not have a securities licence. So it offers the fund through Tianhong Asset Management, which does have a licence from the China Securities Regulatory Commission – and Ant is the majority shareholder of Tianhong. It is also important that one of the main drivers of the Yu'e Bao idea was Eric Jing, then CFO but now CEO, and it may give an indication of his priorities.

Another important point to understand about Ant Financial is that it is a lot more than just Alipay. For sure, Alipay, is at the heart of it all – analysts at EY estimate the system handles 68.4% of China's mobile payment transactions and more than half of Chinese third-party online payments. But numerous other businesses have been launched over the last few years, among them MYBank, a private online bank

"So this is a three-layer model. The first layer, the foundation, is payment. The second is lifestyle service. And the third is financial services – loans, insurance, wealth management"

Jia Hang, Ant Financial

established in 2015 to serve small and micro enterprises; Ant Fortune, a wealth management app that includes Yu'e Bao as well as access to numerous other products; and Ant Financial Cloud, which offers cloud computing services for financial enterprises.

But the most interesting is Sesame Credit, known domestically as Zhima Credit. Without it, Ant would not be what it is, and certainly would not be expanding.

In China, most people do not have a credit history. They do not have credit cards either, which are generally a quick way of acquiring some history. Consequently, many Alipay users do not have a credit score. The trick Ant Financial has pulled is to turn this apparent risk into a business opportunity. Users sign up and allow their data to be collected, after which Ant tracks consumption data through Alipay: how and when people pay, whether they pay on time, how often they are late and whether they pay by instalments.

All of this information gives the user a score, a Sesame credit rating, which they can then use for other purposes. For example, there is a growing trend for a sort of Uber for bicycles, particularly in Shanghai and Hangzhou. You simply find a bike on the street, use your phone app to unlock it and leave it wherever you want to go, whereupon other users will be able to use GPS to locate it or other bikes in the fleet. If you have got a good Sesame credit score, you do not have to pay a deposit. You can do the same with car hire, or when checking into a hotel. They are replacing the model of the credit-card guarantee.

Lucy Peng, the former Ant Financial CEO who now serves as executive chairman, likes to say that if Alipay is the backbone of Ant Financial, then Sesame Credit is its conscience.

The fashion in the firm these days is to say that Ant Financial is not a fintech, but a techfin; a distinction that causes even some insiders to roll their eyes, although they all talk about it and it is even enshrined in a mural by the lifts. The idea is to suggest that, genetically, Ant is a tech company that happens to be using that tech in financial services, rather than a financial services company trying to leverage tech into what they do. Well, maybe; it is true that Ant is developing extraordinary technology like using virtual reality goggles to pay for online goods by nodding or even by blinking. It has an incubator division called F Lab run by Lin Feng, a tech-head who says things like: "It is very boring to have to take off your goggles for payment."

But no matter whether it is a fintech or a techfin, the fact is that Ant Financial is a powerful force in Chinese finance, and its seamless creation of one of the world's largest money market funds almost as an aside should convince any doubters that it is a genuine threat to the country's financial mainstream.

THAT IS THE PICTURE AT HOME. BUT what about overseas? Where is Jia Hang going to get his 2 billion customers from? Even China is not that big.

His ambition reflects that at the very top. "Globalization," says CEO Jing, "is Ant Financial's most important strategy for the coming decade."

The thing is, although the growth of Ant Financial and Tencent/WeChat has been mesmerizing, there is widespread acceptance – even internally in those organizations – that the circumstances in China have been unique and pretty much perfect for the evolution and then dominance of fintech.

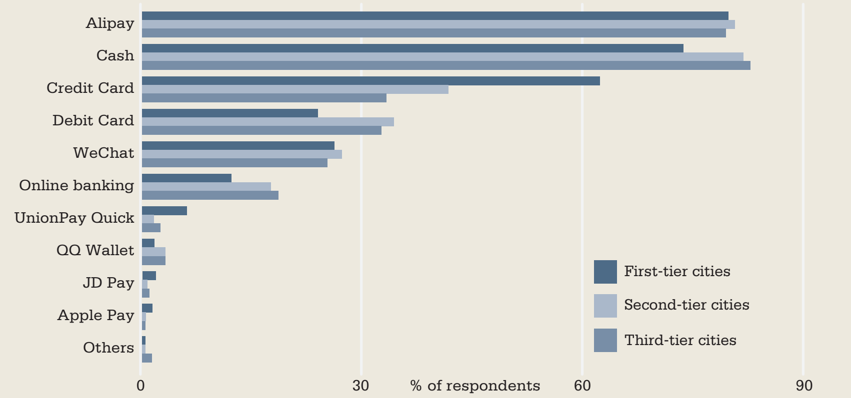
First and most obviously, there is the enormous population. Anything is scalable when you have 1.35 billion people to aim at. Better still there is an enormous and growing middle class with disposable income, including many affluent young people.

Then you have the fact that banks in China have, historically, under-served the retail and small-business segments of China, leaving an easy gap for fintechs to fill that would not be the case in, say, the US.

Third, you have a population that is extremely comfortable with the use of a smartphone for transactions, having largely missed out earlier stages of bank evolution from fixed-line phone banking to credit cards. More than one person in two in China uses a

Payment method used most regularly

Survey of 1,000 urban consumers, H1 2016



Source: FT Confidential Research

Much more than a geeky start-up. The Marvel superheroes and unprepossessing exterior belie Ant Financial's much more serious modern reality

smartphone to conduct financial transactions, mainly through Alipay or Tencent's WeChat payment service.

Fourth, there is a regulatory environment that has been benign for fintechs. It is getting tougher now, but, if anything, that is better still for the BAT triumvirate (Baidu, Alibaba and Tencent) and peer-to-peer leader Lufax; they grew when it was easy to do so and now find strengthening regulation makes it harder for others to join them.

"While there are lessons to be learned from the rise of fintech in China – including from the response of regulators and incumbents – it is clear that not all products and services can simply be replicated in the west," says Neal Cross, chief innovation officer at DBS in Singapore, in a written statement jointly attributed to James Lloyd, Asia-Pacific fintech leader at EY. "China's heady mix of rapid urbanization, regulatory acquiescence, a massive and underserved SME market, escalating e-commerce growth, and explosion in online and mobile penetration, have created a fertile ground for innovation in commerce, banking and financial services more broadly."

Cross adds: "From an international perspective, the key question is whether these powerful domestic Chinese fintech players will be able to replicate their success abroad – or whether they, ultimately, will prove unable to compete outside of their Galapagos-like protected market."

How can Ant Financial expand when other markets surely do not offer the same environment? Only India can compare for population. In any event, Ant does not have the right licences in most locations.

The first wave of Ant Financial's outward expansion followed the easy money, Chinese tourists. So, for example, when Alipay/Ant signed an agreement with Commonwealth Bank of Australia, the pitch was to allow Chinese visitors to use Alipay technology in Australia through CBA's e-commerce and point-of-sale infrastructure, while also allowing Australians to use Alipay when buying Alibaba products.

It is a no-brainer for any partner.

"The prospect of bringing our customers closer to a globally leading mobile payments provider and its 450 million active users is truly exciting," says Kelly Bayer Rosmarin, group executive of institutional banking and markets at CBA. For the same reason, Samsung Pay is now allowing Alipay to use its devices and technology in Korea, despite apparently being in competition with it.

Chinese tourists are quite a constituency. Outbound spending by Chinese tourists increased at a compound annual growth rate of 36% a year from 2010 to 2015, according to Citi. Through this, as of December 2016, Alipay was supported in 70 countries and regions and in 18 currencies, with tax reimbursement supported via Alipay in 24 countries. By then, Alipay was already linked with more than 200 overseas financial institutions and payment solution providers to enable cross-border payments, either for Chinese travelling overseas or for overseas customers who have bought goods from Chinese e-commerce sites.

The second wave of Ant's international expansion – helping non-Chinese use Alipay to buy Alibaba products from outside China – is also a powerful one.

"We are serving over 40 million non-Chinese people making purchases on Ali Express," says Hang, speaking of the Alibaba international platform. “To do that, we need to connect to all the funding channels – banks, e-wallets or other payment methods – all over the world and make sure people from Russia, Brazil, Europe can make payment.” This is where the spikes on Ant Financial’s lobby globe are interesting; Brazil is Alibaba’s largest overseas market, followed by Russia.

It is the third wave that will prove to be the biggest and most transformative driver. This is the export of the whole Alipay model through partnership – and specifically, through partnership with established businesses that have licences and compliance procedures in place locally.

“For us, compliance is the most important thing in each country,” says Hang. “That is why we need a partner. We don’t want to do it by ourselves.

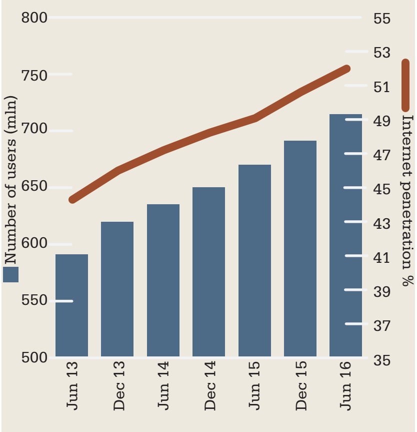
“Secondly, we only want a minority of the shares: we share the product and help the company grow quickly, and we get the benefit from our revenues. Our partner handles all the regulatory requirements like the licence and the provision of all the right information to the local central bank or the government.

“We are heavily dependent on our local partner. Apart from compliance, they have the local experience: they know the culture, the language, what the market needs. What we can provide is operational experience, knowledge, product, technology. We are middle-to-end, but they are the front.”

THE CLEAREST EXAMPLE OF THIS approach is the Indian company Paytm, possibly the only finance-related company in the world growing faster than Ant or Tencent. Alibaba and Ant invested more than $500 million in Paytm’s parent, One97 Communications, in 2015, and have since built up a stake of more than 40% in the business (they decline to give the exact percentage).

The web spreads

Internet users and internet penetration rate in China



Source: CNNIC, DBS, EY

Paytm is the closest equivalent in India to the Alibaba/Ant story. It started out as an online method of recharging mobile phones, then grew into a bill payment digital wallet and then a broader online marketplace. It gained a licence from the Reserve Bank of India to launch a payments bank in January, focused, in Ant Financial style, upon bringing basic financial services to hundreds of millions of unserved or poorly served Indians. The new bank, which was formally launched in March, also allows payment through QR codes, just as Alipay does.

Paytm already has 215 million customers, nearly half the 450 million Alipay figure despite almost all of the growth having come only in the last two years. (Paytm is said to have gained 50 million users in the aftermath of India’s demonetization initiative and the cash crunch that followed it.)

And it is a perfect fit. India is the only other country in the world to boast a similar market size to China, both in terms of population and the leapfrogging of conventional banking by much of the newly affluent population. India at a state level has spent years building the infrastructure for fintechs to thrive and it is ripe for any mechanism that allows financial convenience to people who are not wealthy. But its regulatory environment is a minefield. So rather than build something from scratch, why not take a minority stake in a business that looks like you, acts like you, knows the market and has the licence?

“We were thinking that we would like to find a market similar to China,” recalls Benny Chen, Ant Financial’s country manager for India. “It is a fast-growing economy with a massive and young population, but as well as that, the financial system is not well-established. Probably more than 70% of the population has never had the chance to enjoy financial services before.

“That brought us to thinking that maybe technology is the only way to massively change the landscape of financial services – very similar to China.”

The Paytm model involves the local company having the front end, the local nous and the licences, and Ant Financial in the back providing technology and a vision for how the business should look. Ant is certainly hands-off on the business side. Chen is chief country officer for India at Ant Financial but is not based in India, spending the majority of his time in Hangzhou. Nevertheless, Chen paints it as very much an Ant-driven initiative that Paytm has grown from mobile recharge to the broader lifestyle integration characteristic of Alipay. (It is not clear whether Paytm’s driven and vigorous founder, Vijay Shekhar Sharma, sees things quite the same way.)

The business might become bigger still. Paytm gained a payment bank licence in January through which it will offer deposit and wealth management services (it already offers a virtual gold product).

“Achieving a large user base is never the only focus,” says Chen. “It has to be focused on the user case coverage of the network: the reach of the customer.” Chen describes the alliance with Paytm as being “not just the technology perspective, but the sharing of business minds, of our business philosophy”.

India is also a good fit because of the government’s focus on digital banking as a method of financial inclusion. “We believe technology can change people’s lives,” says Chen, delivering a widespread Ant Financial mantra. “The government is very focused on equal financial services for Indians. It’s good, because it means that what Paytm is doing is also on the agenda of India’s overall digitization process. We are happy to be part of that journey.”

And Paytm is just one of several examples. In Thailand, the partner is Ascend Money. In South Korea, it is Kakao Pay. In the Philippines, it is Mynt.

Always the model is the same. Ant announced it would invest $200 million in Kakao Pay, the mobile payment subsidiary of South Korean messaging platform Kakao, in February, as part of a larger strategic partnership to offer an Alipay model to Kakao Pay’s 14 million users (Kakao itself has 48 million users). In the Philippines, also in February, Ant tied up with Globe Telecom, one of the biggest mobile operators in the country, and Ayala Corporation, one of the largest conglomerates, to buy in to Mynt. Mynt operates a micropayment service called GCash and a business called Fuse Lending, which offers personal and business loans to unbanked Filipinos through mobile technology, alternative data and new credit scoring methods. Ant will own what it calls a "substantial minority" in Mynt.

Southeast Asia offers the same high-population, low-service metrics as India and China. Do not expect to see Ant making waves in Singapore (although Alibaba owns a stake in the local Lazada online commerce business). The population is not big enough and is already well-served financially. But Punnamas Vichitkulwongsa, CEO of Ascend Group, the Thai payment firm through which Ant is pushing its products and technology, says there are 370 million people in southeast Asia without bank accounts. That is a big market to aim at.

"It's our life purpose to help the under-served, which include digital consumers and the under-banked," says Vichitkulwongsa, who says he wants to reach 100 million customers and SMEs in Thailand and southeast Asia by 2020. "Our partnership with Ant will help accelerate innovative financial services and platforms, enabling a strong financial services ecosystem."

Ant's international endeavours will not stop with payment. It will grow through credit scoring and lifestyle facilitation just like Alipay itself did. "It is based on payment, but through that we can have a lot of data from the user side and the merchant side regarding their daily behaviour," says Hang. "Based on that, we can provide lifestyle service, calculate their scoring for credit and offer them financial services.

"So this is a three-layer model. The first layer, the foundation, is payment. The second is lifestyle service. And the third is financial services – loans, insurance, wealth management.

"We are focused on the mid- to low-level people. We are not serving VIP users: the traditional financial institutions can provide them a much bigger service. We're more focused on the normal people."

In all these places, the smartphone will be the vehicle through which these people, some of them underserved, some of them wholly unbanked, become customers of a distant Chinese fintech. This is where Hang will get his 2 billion from.

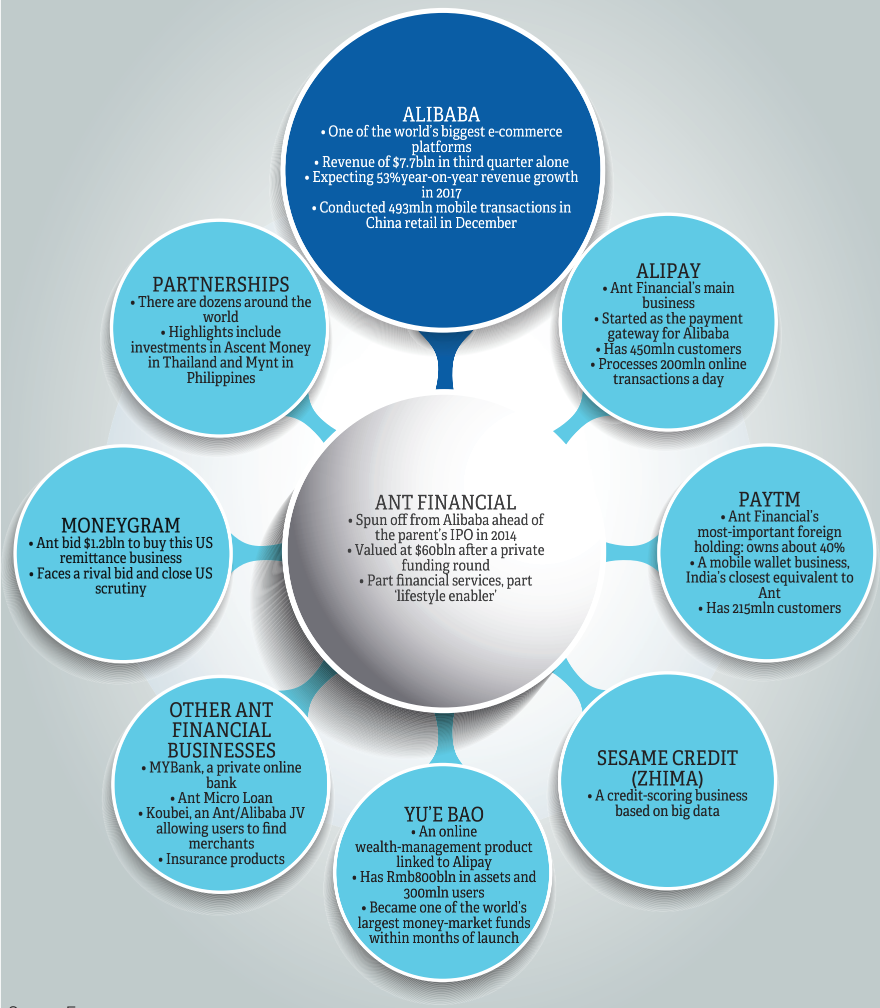
"China will probably be 0.6 billion; you can't get everyone. India, maybe 0.3, 0.4 billion. So I need to find another billion from southeast Asia, from Africa, from the Middle East, from South America."

Doing so, of course, raises questions not just about regulation but also credit assessment. When asked about this, Hang admits: "We still don't have a very clear idea about that." But the answer will likely be the same as regulation: rely on the partner to handle it, backed by Ant Financial's own technology and systems helping them to engineer their own credit scoring systems. "It's not just the product and the technology that we can copy to India or Thailand. We need data," he says, with customer consent to use it.

Out of a global staff of 7,000 at Ant Financial, 1,500 are in risk management. Alipay says its capital loss rate is lower than 0.001%, which, it points out, is lower than the individual likelihood of being hit by a meteorite. But holding those numbers together through international expansion may be the company's biggest challenge.

Ant's anatomy

Where the company comes from and where it is going



Source: Euromoney

While Hang heads the overseas engagement of Alipay, Ant Financial also has a president of international business, who presents a quite different face for the group. Douglas Feagin joined last June from Goldman Sachs, where he had spent 22 years, much of it as head of the financial institutions group for North America and in Asia.

He has followed a conveyor belt of talent from Goldman to Chinese fintechs and e-commerce leaders, including Michael Evans, formerly Goldman vice-chairman and now president of Alibaba; Martin Lau, a former Goldman executive director who is now president of Tencent; his chief strategy officer, James Mitchell, a former Goldman managing director in New York; and Tony Yip, global head of investments at Baidu, who is a former managing director in investment banking at Goldman in Hong Kong.

Feagin has been a driving force in the attempted acquisition of MoneyGram, which is, as fintechs like to say, a game-changer.

The $1.2 billion bid for MoneyGram International, the US money transfer firm, is of a totally different order to anything else Ant Financial has tried internationally before. This is not an attempt to take a minority stake. This is a bid to buy a whole business. Ant wants it enough to have increased its original $880 million bid by 36% in April.

The main thing that MoneyGram would achieve is the purchase of a ready-made global cross-border remittance business. Through the expansion of Alipay, customers can already use their app to pay for things online or in shops, but they cannot send money to friends or relatives abroad, or indeed home from overseas.

"Of course, it makes a lot of sense on the business side, but there are also a number of things we can improve for this market," says Hang. The fees involved in small remittances, he says, are unusable. Sending $50,000 is fine, "but if you want to send $50, or $5 for a cup of coffee, it's not workable. We are more focused on those small amounts, the tickets less than $2,000. Nobody does this market."

Trying to build such a business from the ground up, with all of its infrastructure and compliance capability, would be time-consuming and possibly not worth the effort, so if the MoneyGram bid fails – with Kansas-based Euronet having made a competing $1 billion bid that faces none of the regulatory dramas that a Chinese company will encounter – Ant is perhaps more likely to look at another acquisition rather than trying to build the business itself. The compliance burden of moving money across borders, even in small amounts, is not something to be taken lightly.

Perhaps for this reason Ant is keen to paint itself as a background player, even when it would be an outright owner. In a letter to the Wall Street Journal in February, Feagin wrote: "MoneyGram will continue to be headquartered in Dallas and run by its current US-based management team after the deal closes. Ant Financial will continue to invest in MoneyGram's systems and compliance programs."

Whether it succeeds or not, the bid for MoneyGram is a statement in itself. Ant is taking on a number of themes working against it with this bid. One is the fact that China, at a state level, has turned against big outbound acquisitions, and indeed the outbound flows of client money that Alipay's expansion would facilitate. In this respect, Ant finds itself swimming against the national tide, which matters. Ant is private sector, but has some powerful state-backed shareholders and its efforts to align itself with national policy goals are reflected on those reception-area screens, where one graphic makes an attempt to link the company's expansion to the nation's One Belt One Road initiative.

The other trend Ant/MoneyGram is fighting against is the scrutiny of Chinese buyers of US assets by CFIUS (Committee on Foreign Investment in the US), the US regulatory body, in Trump's America. Perhaps it helps that Jack Ma was one of the first visitors to Trump Tower after the US election.

Feagin wrote an open letter in April attempting to head off these concerns, stressing that data collected by the business would be stored locally – on "ironclad US-based servers," no less – and that Ant would invest in global compliance and anti-money laundering programmes.

The next step? Sooner or later an IPO is coming – and every investment bank in China and the world wants a piece of it. They have been jostling, in one way or another, for years. Alibaba's $25 billion 2014 IPO was led by Credit Suisse, Deutsche Bank, Goldman Sachs, JPMorgan Chase, Morgan Stanley and Citigroup – all six of them will be hoping for a place on the Ant mandate. Several of them advise the group in an M&A capacity too. Citi advised Ant Financial on the MoneyGram bid. Credit Suisse's Vikram Malhotra is considered one of the closest bankers to Alibaba and the group.

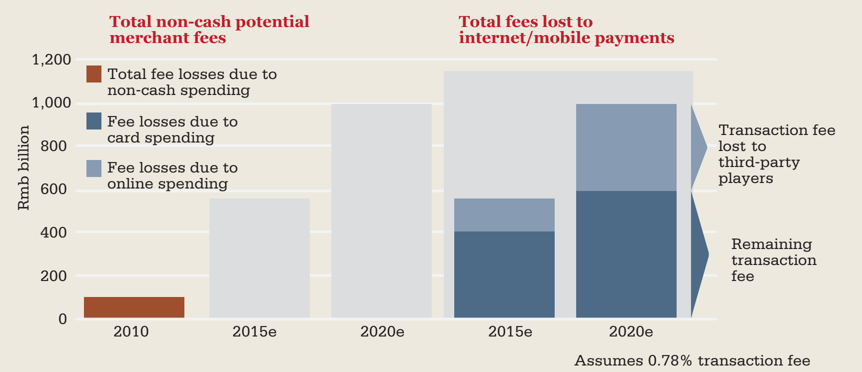
When it comes it may be across multiple jurisdictions, domestic and international; if those venues include Shanghai or Hong Kong, it is a certainty that mainland houses will be on the ticket too. (The Alibaba IPO omitted Hong Kong because the stock exchange would not allow its partnership structure; that would not be an issue for Ant Financial.)

The ardour for the company has long since been made clear. The $4.5 billion Series B funding round it closed in April 2016 was the biggest single private placement from a fintech worldwide, raising money from the China Investment Corporation sovereign wealth fund, China Life and China Development Bank – in short, without having to set foot outside mainland China.

It remains to be seen how international appetite for the company's stock compares with that domestic funding round, but it will be no surprise if the float of this outsized start-up in the charmless grey Hangzhou tower turns out to be the biggest IPO since its parent, Alibaba, shook the markets in 2014. EM

Bank fees lost to digital payments

In 2015



Source: EuroMonitor, iResearch, Kapronasia Analysis