

# Mythical Beasts

China is home to the second-most unicorn companies in the world

By Deng Yaqing

China's new-look economy is gaining momentum. With a focus on entrepreneurship and innovation, a cluster of privately owned and rapidly growing start-ups have provided a boost for the country as it undergoes a momentous shift in the drivers of growth.

According to a study recently released by Deloitte, by the end of June 2017 there were 252 unicorns—startup companies valued at over \$1 billion—worldwide, with 106 in the United States and 98 in China, far surpassing the figures for any other country.

"China's innovation capacity is now largely on par with America's, which is reflected by the robust growth of Chinese unicorns. Most of these companies are excellent performers and frontrunners in their respective fields," said Albert Wang, founding partner at Maintrend Capital and former partner at SAIF Partners, in an interview with *Beijing Review*.

On May 3, Xiaomi, a Beijing-based unicorn heavyweight specializing in consumer electronics, filed to go public in Hong Kong, where its IPO could raise about \$10 billion in the largest listing globally in almost four years.

Chinese mainland and Hong Kong securities regulators are sparing no effort to improve their listing policies to attract unicorn companies. On June 6, the China Securities Regulatory Commission (CSRC) issued rules for a test run of the issuance and trading of Chinese Depositary Receipts (CDRs). The securities regulator has also released amended rules on IPOs, and a package of measures to support unicorn companies in their domestic issuance of stocks or CDRs. Meanwhile, the Hong Kong Stock Exchange is now permitting innovative, high-growth companies to list using a dual-class share structure, which Xiaomi was the first to apply for.

"Increasing consumption capacity, improving productivity and abundant entrepreneurship have provided the necessary conditions and resources for Chinese companies to grow and prosper," Wang said.

"However, the strict requirements and high threshold for getting listed in the domestic market and the American stock market's lukewarm attitude toward Chinese firms have long denied these companies the opportunity to raise capital in the secondary market. They have no choice but to finance in the primary market, which explains the birth of so many unicorns," Wang continued, predicting that an increasing number of Chinese unicorns will seek to issue IPOs in the Chinese mainland and Hong Kong markets as their businesses grow.

## Core competitiveness

Innovation and a favorable business environment have set the stage for China's new era of fast-growing unicorns. Yet, while some of the top companies in this group will find success in the secondary market, other less competent ones could lag behind or even collapse.

"Besides the ability to attract capital, unicorns need to foster and maintain the ability to innovate in order to survive, which focuses more on integration and making use of various market resources than sticking to the development of a certain technology in the laboratory," Gao Yuning, an associate professor with the School of Public Policy and Management at Tsinghua University, told *Beijing Review*.

Such innovation can involve a variety of technologies including those not necessarily developed by China, which can nonetheless be consolidated by Chinese unicorns in an efficient way to form new, secure and effective business models.

"A unicorn should be able to grow into a platform company rather than relying entirely on a single technology, and only in this way can such a company realize sustainable and rapid development," Li Lixin, Managing Director of Northern Light Venture Capital, told *Beijing Review*.

"Many great companies that have gone on to be listed are platform companies, such as Alibaba, Tencent and Didi Chuxing. Such a company represents a certain business

environment in which a host of small and medium-size companies reside," said Li.

A unicorn also needs to maintain a leading position in a certain segment of the market and dig deeper into this area rather than blindly seeking expansion, so that it can develop superior services and products to better satisfy market demands, said Gao.

At the heart of a unicorn's competitiveness is its ability to address the urgent needs of consumers, Gao added. Take shared bikes, for example: The companies offering this service do not rely on particularly advanced or hard-to-come-by technology, but they have managed to provide a popular service that people need, and the demand is virtually inexhaustible.

"Competition here is more brutal and fierce than in the American market, so a fast-learning team is indispensable. Financing capacity as well as shareholder structure also play important roles. In some cases, companies that provide products and services of the same quality experience totally different outcomes due to disparities in the above-mentioned areas," said Wang.

## Potential challenges

"Funding and innovation are two essential factors for corporate growth. However, excessive financing and innovation may generate bubbles that, once they burst, may affect the confidence of entrepreneurs, investors and governments," said Wang.

As the struggle among platform companies continues, competition over consumers' attention and business is intensifying.

"What matters is whether a company can create the value that consumers really need. Here value means not economic benefit, but knowledge, entertainment, relaxation and so on," said Gao.

Alongside market value, requirements for corporate social responsibility have steadily risen, as seen by Didi Chuxing's supervision over its ride-sharing drivers

and transactions, and Internet lending platforms' efforts to protect personal data and fend off financial risks, said Gao.

"Moreover, as established unicorns that thrive by adjusting their business models continue to expand their territories, fledgling companies may find themselves squeezed. On the flip side, if technology companies fail to grow fast enough, they will likely be outstripped by industry newcomers with greater momentum," said Li.

## Further opening up

There is no doubt that the Chinese government wants to see successful companies choose to go public in the mainland or Hong Kong markets, so that Chinese people can share in the rewards of the new economy.

"In the past, the strict requirements and extensive restrictions of the A-share market deterred numerous unicorns from attempting to get listed at home. Now, with the threshold lowered, a new trend of domestic IPO applications is taking shape, and the international competitiveness of China's capital market will be further improved," said Li.

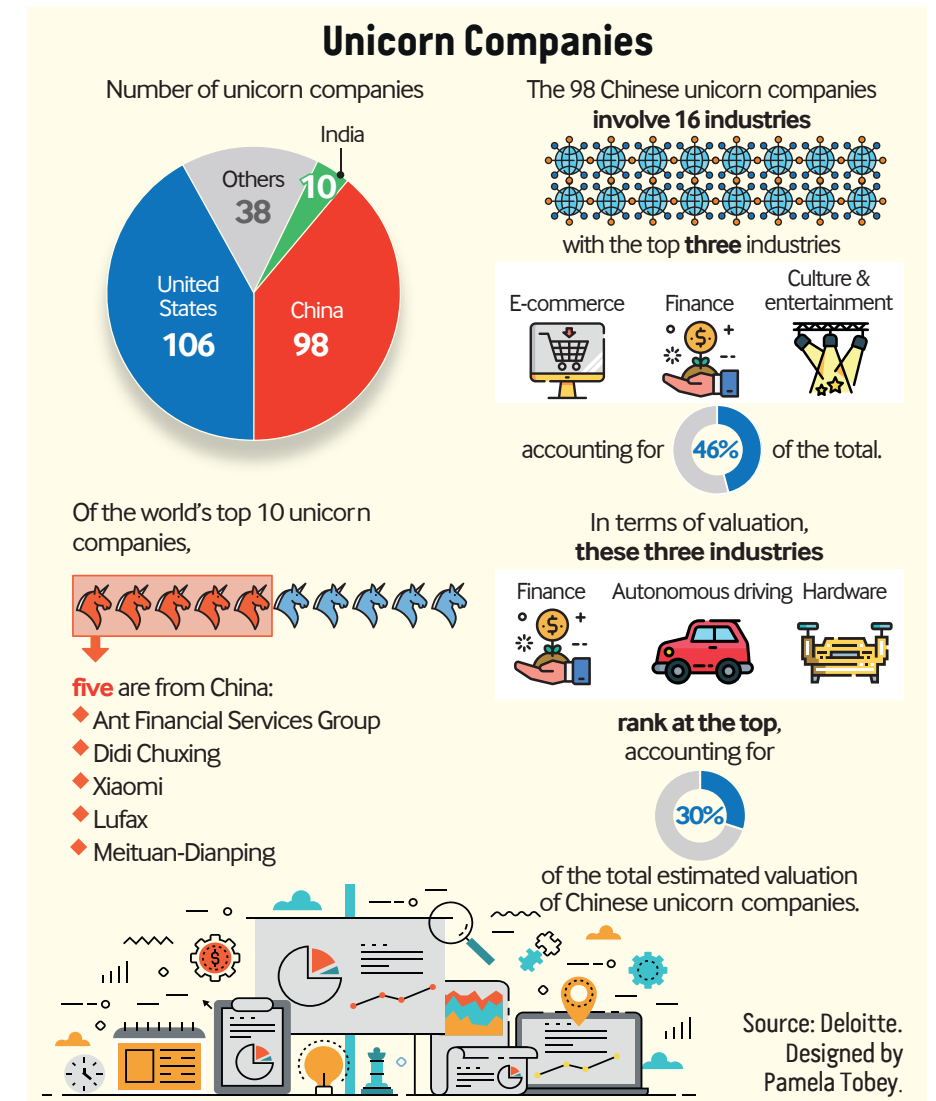
Conversely, CDRs usually find their way into developed and mature financial markets, and the issuance of CDRs in domestic stock markets necessitates higher requirements for supervision, access to information and investor protection.

Starting June 7, qualified innovative firms can submit applications for CDR issuance to the CSRC under the new pilot CDR program. The CSRC has said it will strictly control the number of enterprises and the volume of funding for the pilot CDR program, and properly arrange the timing and pace of CDR issuance.

"By learning from more mature overseas market, China should establish a comprehensive financial supervision system featuring cross-market and joint operation," said Gao, who also emphasized the protection of intellectual property rights and the release of more tax credits to encourage innovation.

"More efforts should be made in opening up, such as allowing cross-border capital and profit flow for fast-growing privately held companies," said Gao, who expects these enterprises to enjoy the same equal treatment and preferential policies as foreign-funded companies.

"As more Chinese unicorns look to go public by issuing CDRs in the mainland market, there will be a huge demand for capital, while giant companies currently



listed in the A-share market will carry out additional issuance. It is beyond the capacity of the present capital market to fill the gap in capital demand," said Li, noting that efforts need to be made to increase the supply of funds.

To address the problem, China needs to broaden its capital sources by allowing more overseas funds to flow into its stock market. According to Wang, in the process of enabling unicorns to go public at home, the Chinese authorities should push for the free convertibility and internationalization of the yuan, and press ahead with the opening up of China's stock market.

At the same time, investor structure should be optimized. "In China's mainland stock market, about 80 percent of players are private investors, while in overseas markets, the majority of market players are institutional investors. It follows that private investors should be encouraged to

entrust their money to institutional investors that are more professional, rational and better equipped to withstand fluctuations and risks," said Wang, adding that the country should also allow more private and overseas money to enter the stock market.

"However, the steps toward opening up should be in line with China's current economic stature and global investors' confidence in the country. Otherwise, problems may occur," said Wang, citing rampant speculation on the Thai baht and Russian ruble, which he believes was the consequence of disproportionate opening up. ■



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