THE ECONOMIST

Chinese internet firms

Migrating finches

China’s online firms are flying to American stockmarkets

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DICK COSTOLO, the boss of Twitter, was in Shanghai this week to see first-hand what the Galapagos islands of the internet look like. He follows in the footsteps of Mark Zuckerberg, Facebook’s founder, who also came for a study tour. Thanks to censorship and hostility to foreign internet firms, otherwise global giants such as Facebook, Twitter, Google and eBay are banned or irrelevant. Weird and wonderful local variations have, like Darwin’s finches, evolved in this isolated market instead.

Even as American technology bosses are exploring China, some of those esoteric local firms are bursting to get out. A moratorium, only recently lifted, on initial public offerings on mainland exchanges has led to a big backlog of IPOs. So China’s best online firms are now hoping to list on American exchanges. In January JD, an e-commerce firm akin to Amazon, launched a share offering in America that may value the firm at $20 billion. On March 14th Sina Weibo, the nearest Chinese equivalent to Twitter, announced an IPO that would raise up to $500m, reportedly valuing it at around $7 billion.

These announcements were put in the shade a day later when Alibaba, an e-commerce colossus rapidly expanding into internet finance, ended months of flirtation with the Hong Kong exchange by declaring it will soon float its shares in New York. It is rumoured that the firm plans to raise over $15 billion. David Chao of DCM, a venture-capital firm, predicts that it will be “bigger than Facebook”. The American social network’s offering two years ago raised $16 billion. Analysts expect the flotation to value Alibaba at $140 billion or more, compared with Facebook’s current market capitalisation of $175 billion.

The Hong Kong exchange lost out on Alibaba’s flotation because it rejected demands by Alibaba to allow a clique around Jack Ma, its founder, to retain control using special shares. The exchange was wise to uphold its ban on such arrangements, because unlike those in America, ordinary investors cannot easily seek redress through the courts when they feel they have been abused by a company’s controlling shareholders. Fortunately for the Hong Kong market, a flood of other IPOs is headed its way.

Will Americans welcome Alibaba and its peers? It was not long ago that they got burned by a series of fraudulent Chinese offerings. Duncan Clark of BDA, a consulting firm, argues that those “fraud caps” were obscure firms with complex, hard-to-verify assets. Today’s IPOs are of prominent, well-understood firms, so he thinks investors will see them as “proxies for China’s emerging consumer classes”. Helpfully, various hot American startups, such as Airbnb and Square, are unlikely to list soon, leaving investors hungry.

However, potential buyers of the Chinese firms’ shares should consider two risks. The first is regulatory uncertainty. In its prospectus, Sina Weibo warns that official censorship may threaten its business model. Also, China and the United States are in a dispute that may see the mainland units of the Big Four accountants banned from auditing Chinese firms listed in America. And there is a slim chance that either country’s regulators may object to the offshore vehicles (“variable-interest entities”, usually based in the Cayman Islands) used by Alibaba and other Chinese technology firms to list overseas.

The other risk arises from growing competition. Firms like Alibaba grew dominant when local rivals were scarce and foreign ones absent, but things are changing. Tencent, a gaming goliath, this month took a big stake in JD, thus turning it into a potent force in e-commerce. This week Alibaba spent $215m on a stake in Tango, an American messaging app. Alibaba, Tencent and Baidu (China's answer to Google) have gone on acquisition sprees to prepare for a battle royal, and this is eroding margins: Tencent reported disappointing earnings this week. As its tech stars expand into overseas markets, China will be pressed to let foreign rivals in. If one day it agrees to this, instead of Galapagos finches its local firms may come to resemble Europe's red squirrels, devastated by the arrival of their pushy grey cousins from North America.