



PRIVATE MARKETS INSIGHTS

CHINA: THE INTERSECTION OF INNOVATION AND E-COMMERCE

Q&A WITH HARBOURVEST PARTNERS' BEIJING-BASED MANAGING DIRECTOR SALLY SHAN

One of our core, long-term investment themes focuses on the wave of technology-driven innovation sweeping the globe. Day after day, new products and services emerge that disrupt traditional business models, and fundamentally change the way people communicate with each other and consume and pay for goods and services. Nowhere are these dynamics more at play than in China, where the internet and rising demand for mobile technology are creating fertile ground for private investment opportunities.

As always, the key to private investing success in China is partnering with local experts who have access to the most proven managers. HarbourVest has been actively investing across Asia for more than two decades, and today has more than 20 professionals based in offices in Beijing, Hong Kong, Seoul, and Tokyo.

In the following interview, Beijing-based Managing Director Sally Shan discusses the ongoing evolution of China's digital economy, and explores some of the more promising areas for investment.

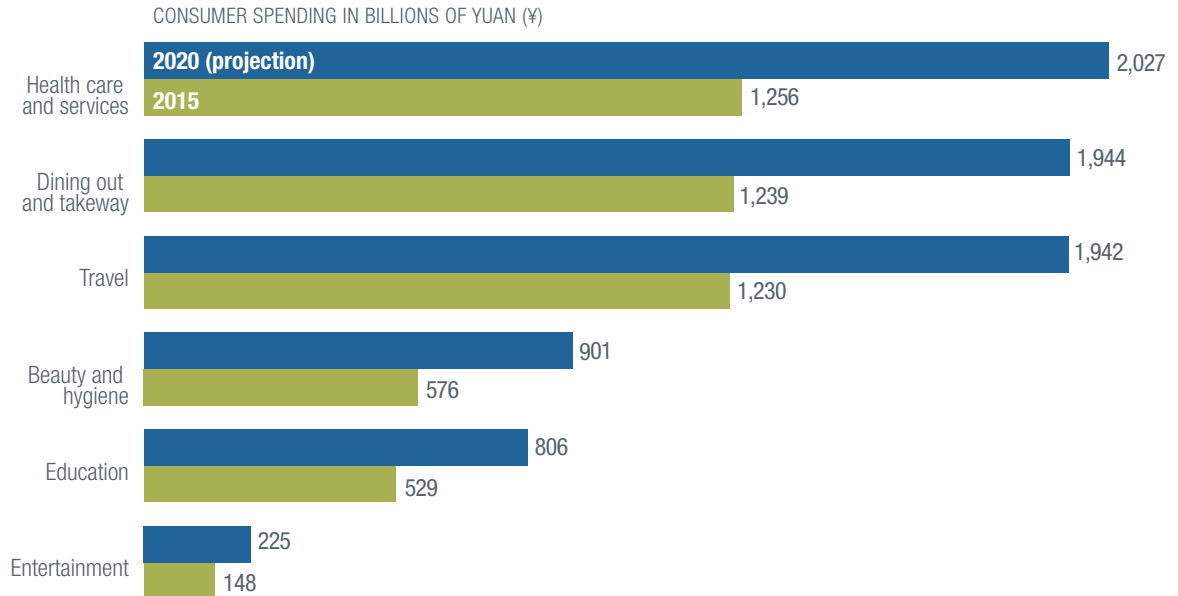
China has evolved into a global hub for innovation and e-commerce in a very short period of time. What have been the key drivers?

To understand where we are at today, it's helpful to trace the path of China's digital economy and how it has matured to the point where it now plays a key role in private equity strategies. There have been two 10-year periods that have brought us to this point. The first came between 1998 and 2008, when we had the arrival of personal computers and the birth of the internet. Unlike in the US – where people embraced PCs, bought them, and put them in their homes – Chinese consumers essentially missed the PC wave. In the early days of the web, China had three main portals which people accessed largely through internet cafes. The cafes provided a more communal, social setting in which to get exposure to PCs and the web, and they turned out to be both idea “labs” and major growth engines for those who had the foresight to invest early. Over time, we began to see

MOBILE-DRIVEN CONSUMPTION IN CHINA

Consumer spending online is expected to increase sharply by 2020

Source: Sanford C. Bernstein, Euromonitor International



different experiments pop up in the cafes. Online video and music apps such as musical.ly and search engines like Baidu took hold, and virtual gaming became very popular among young consumers.

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What about the second period?

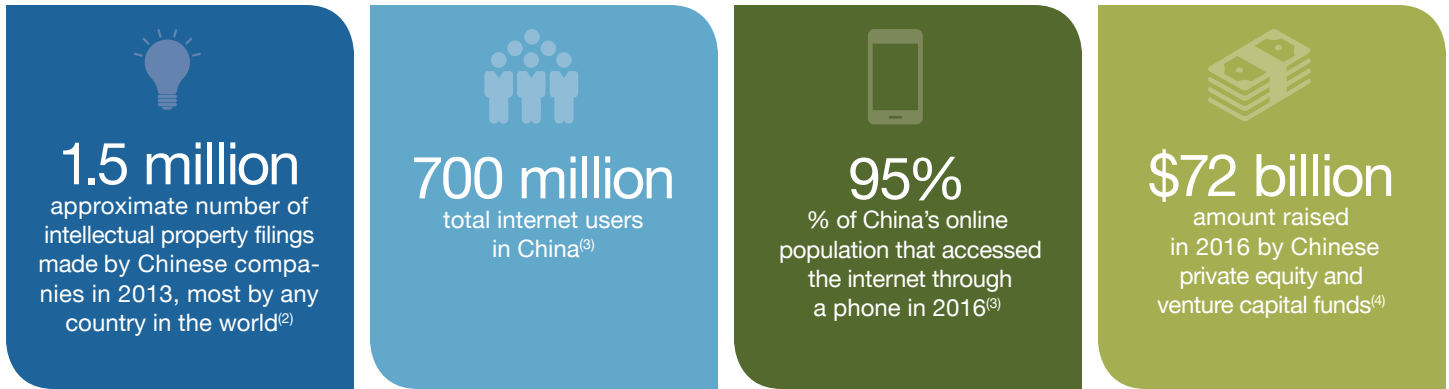
From 2008 to today, it's been all about mobile technology and new advances in that space. Just as the US was onto PCs early, China was an early adopter of cell phones and texting. As more people went mobile, they wanted to do more and more on their devices – but they also wanted to be assured that there was an element of trust and security supporting their online activities. Prior to 2008, the trust factor on the web was very minimal. Some companies tried to capitalize early and failed. Then Jack Ma and Alipay took the eBay model and made it easier and free. More importantly, they set up an escrow process to hold payments until the transaction was final, which helped build trust between buyers and sellers. Since then, e-commerce in China has taken off, and continues to provide ample opportunities for investment.

What do you see as the next big investment opportunity? Do you see a third wave of disruptive innovation and growth?

I think the next wave is closely correlated to the improved trust factor. As security and privacy has been introduced, it has given rise to a whole new area of future growth: mobile payments. Five years ago, nobody was paying for anything through their devices. Today in China, you can essentially live a cashless life – you can pay for food, taxi rides, child care, even face lifts with your devices, and people are doing just that. China's mobile payment volume rose almost four-fold in 2016 to nearly \$9 trillion (USD), while mobile payments in the US rose just 9% to \$112 billion.¹

What sectors do you believe may benefit the most from the rise in mobile payments?

There will be plenty of opportunities in the media and entertainment sectors. Financial services and health care also stand out as two areas where this new technology will create a wide spectrum of opportunity for the foreseeable future. "Fintech" companies are starting to gain share from traditional financial institutions due to their ability to provide faster, cheaper, easier-to-use services. The mobile payment trend will also change the way people access health care. China's population will age rapidly over the next decade-plus, with more than 400 million Chinese reaching age 60 or older



by 2032. This should translate into a significant increase in health care spending, most of which will be conducted online. China spends an average of 6% annually on health care-related expenditures, while other developed countries spend an average of 12% annually.⁵ I think there will also be opportunities for growth in other parts of the world. While Asia and Europe derive the most revenue from mobile payments, Latin America and North America have significant room to grow.

What are some of the key considerations investors should be mindful of as they look to Asia and China for opportunities?

Asia can be a difficult market to navigate for several reasons. The region is home to exponentially more small and medium-sized businesses than can be found in Europe or the Americas, so working with managers who know the landscape extremely well is critical. Additionally, the wide dispersion in returns generated among Asian managers and the nuanced private equity regulatory framework make working with a partner who has a local base an absolute necessity. With wise planning and execution, the potential rewards make Asia – and especially China – more of a must have in private equity portfolios than a nice to have.

Sources:

- ¹ iResearch (China), Forrester Research
- ² World Intellectual Property Organization
- ³ China Internet Network Information Center
- ⁴ PwC China
- ⁵ Organisation for Economic Co-operation and Development

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