

BINANCE DOING BUSINESS IN CHINA

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ABOUT THE PAPER

This is an academic paper explaining how the Chinese company Binance is doing Business in China. How they developed and what challenge did they face. It is part from a lecture given for the course Doing Business in China given by lecturer Tomas Casas Klett on April, 2022.

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THE CRYPTOCURRENCY EXCHANGE: BINANCE

Changpeng Zhao, who also goes by the nickname CZ, is the CEO of the biggest cryptocurrencies exchange in the world: Binance. He is one of the current most influential people of the crypto sphere. He's net worth elevates to around \$65B (Forbes 2022). He was born in Jiangsu, a Chinese province, to Chinese parents. He also has the Canadian nationality as his family decided to move to Vancouver due to his father's beliefs (Healthy Celeb 2022). CZ is a coder who studied Computer Science. He worked in finance, developing software for matching trade orders and as an entrepreneur, building tech companies like Fusion Systems which he built in 2005 when he returned to his homeland, China. In 2013, the founder of the biggest cryptocurrencies exchange of our time heard about Bitcoin and really fell in love with it. He started acquiring experience by working for diverse companies like OKCoin, another cryptocurrencies exchange. Two years after he created BIJIE TECH in Shanghai, a company that provided crypto exchange services. One day, all BIJIE TECH's platforms were shut down and the company disappeared (Cryptotips 2021). We still do not have any explanation about this, and it raise a lot of question as if it was intentional or not. It could have been to develop the future Binance, or it might have been a government decision as China was not leaning towards being an advocate on cryptocurrencies and decentralization.

CZ gathered a lot of experience in the financial world and the crypto world. In 2017, building on all this knowledge he decided to create Binance, his own cryptocurrency exchange in Hong-Kong. The now famous company was launched in July of the same year by raising \$15M in an Initial Coin Offering (ICO) (Stieb 2022). The industry at that time was growing fast and CZ took advantages of it. Bitcoin hit his historical \$1000 a coin and medias even called this year "the year of the crypto" (Håland 2022). The success was immediate. The timing couldn't have been better as the Chinese Central Bank declared 2 months after that ICOs were now illegal (Håland 2022). In March 2018, 134 days after its creation Binance became the leading cryptocurrency exchange in the world (Binance 2022) and still is today (Figure 1). Their customer also grew quite fast to reach now over 30 million customers worldwide. Around 2000 employee in 20 locations. And \$20 billion of revenue in 2021 (Charlie 2022). Binance as a clear vision that is to increase freedom of money globally and a define mission which is to be the infrastructure services provider for the blockchain ecosystem (Binance 2022). The exchange is characterized with low fees, high range of cryptocurrencies and numerous tools at the disposal of the trader like derivatives.

HONG KONG AS A STRATEGIC CHOICE

As we have seen Binance was launched in Hong-Kong. This city has a long history, but it is important to notice that after the city returned to China in 1997, Beijing ruled honouring the joint declaration with Britain. Hong Kong was having a special treatment which allowed them to rule rather autonomously. This was set to expired 50 years after in 2047. However, this "one country, two systems" arrangement fell in 2015 (Overholt 2019). This declaration became meaningless for Beijing (Reuters 2017) and the Chinese government started tightening his grip on Hong Kong.

Many factors could have influenced CZ's choice of launching Binance in Hong Kong. There is the fact that the crypto ecosystem there was developed. The place was very popular as many exchanges like FTC, crypto.com, OKCoin debuted there. Indeed, this ecosystem allows crypto start-up to have everything at their disposal in one place. It is therefore way easier to launch something in such an environment. Having Talent, employee, structure, community, advisors' firms, and customers at hand. Hong Kong was also well known for being one of the world's leading financial hubs and as "the Pearl of the Orient". There is also the fact that China is a huge market with huge potential. China is well in place to become one of the first cashless nation (Lehman and Rothstein 2021). Chinese people were

already well embedded into digital content with services like Alipay. Technology and innovation also are part of the current five-year plan which proves the attractiveness of the region for crypto. Hong Kong is also very well geographically positioned to access Asian markets and at the same time expand to the world. In addition to that China was at that time the largest Bitcoin mining market and the region had a strong crypto user base as in 2021 Asia's crypto users supposedly accounted for more than 50% of the total users worldwide (Ng 2021). Moreover, Hong Kong was part of China without being part of it. Meaning that policies applying in mainland China were not the same as the ones applied in Hong Kong. Indeed, as seen before the system often called "one country, two systems" allowed Hong Kong to be a special self-regulated city. Another point is that in the early days of the industry, crypto was blurry and not that much regulated as it is today. There was room for ambiguity and exchanges were still quite free to do business. At first in 2013 China considered bitcoin as an alternative investment (Wimmer 2021). But that didn't last. In December 2013 the People's Bank of China (PBoC) changed its stance regarding cryptocurrency and didn't consider it being legal tender anymore (Spaven 2013). At first it was the financial institution that were not allowed to trade or having any kind of financial relation to crypto. Bitcoin was therefore banned from transaction. As the PBoC ordered every bank to close their crypto accounts. However, this announce had some loopholes because it said that crypto currencies exchanges were legal if they registered themselves and it still allowed people to trade cryptocurrencies between them. So, exchanges were basically given the exclusivity. Hong-Kong also started regulating but didn't consider bitcoin as being a virtual currency but rather as a virtual commodity where less stricter rules applied. That was probably why cryptocurrencies exchange like Binance didn't see this as a real threat of a future ban but rather like an acknowledgement of cryptos legitimacy. The fact that it was being considered and therefore regulated like any financial securities proved in a certain way that all this hype was not for nothing. And as it also was the year when CZ heard of crypto it could have been an indication that this market could be a great opportunity.

Hong Kong thus attracted a lot of crypto based companies and was considered as a crypto hub with a strong user base at the time. In June 2018 Hong Kong raised \$223 million through 20 ICOs and numbers grew through the end of the year (Fintech News 2018). Also, the Chinese stance towards crypto were different from what it is today.

BINANCE IS MOVING AWAY FROM REGULATIONS

In 2017 CZ was speculating that China might not want this new technology to go out of hands and that stronger regulations may come. Three months into existence CZ's company therefore decided to transfer all his server to Japan (Wu 2018) to avoid those increasing regulations aimed at shutting down exchanges. Indeed, Japan was another crypto hub. But later, Japan regulators also warned Binance which announce to move again in Malta (Nakamura 2018). However, by 2020 Malta's government said that Binance was not licensed in the country (Protos 2018). Which raised a lot of questions. This lack of transparency made things mysterious as Binance, to this day, still has not announce a clear headquarter location. They have activities and offices in many countries, but evidence shows that Hong Kong still may be active. They do offer job position in Hong Kong in their website and their terms of use suggest all arbitration shall pass by Hong Kong (Binance 2022). Binance is wandering across the globe playing their cards strategically to position themselves where it is more suitable for them and where they cannot be bothered. Binance is really having this strategic business mindset that set them apart from the others. They understand the industry extremely well and respond quickly to any evolution, opportunity or regulation.

Instead of flying off the country Binance could have taken another stand. One of Binance rival Huobi took another choice. They opened a government branch inside the company (Decrypt 2022). This indeed increased the loyalty and reliability for this company in the eyes of the government whereas

Binance face local media critics and disappointment. We can compare this to the case when Apple and Google were asked to keep data they generate inside the country to respect Chinese law. Apple did comply and Google did not and left. Binance as we see did not do as Apple and bend the knee like the Dutch Trade Mission in the 18th century. But they also did not exit the country to never return as we have seen. They had a more extended vision and wanted to be a global player while keeping a foot inside China.

CHINA TIGHTENS ITS GRIP ON CRYPTO

Later, in 2019 the Chinese Central bank released an official paper saying that a lot of monitoring activities will be launched in the crypto industry and that non-authorized business offices will be shut down (Khatri 2019). Binance was also targeted as later in this year one of their Shanghai “not real office” was shut down (Wan 2019). Interestingly, Binance clearly denied those allegations as they probably had to be very cautious about the story they wanted to tell. However, some medias with strong sources have found that they were not only having one office in Shanghai but rather two (Chaparro 2019). Binance answer was that “the term office is very subjective” and those two locations were only a gathering of Binance employee.

Moving into the year 2021 which was probably the most severe one for the crypto industry. In September a new regulatory document did not leave any room for interpretation as it banned crypto from all non-government owned crypto exchanges from China (Sergeenkov 2022). They banned all cryptocurrency trading transactions. They finally did attack more strongly the crypto mining industry justifying that it was non-environmentally friendly and conducted a massive scale operation to shut down every operation.

One of the PBoC reasons to be so active in the regulations space could have been that cryptocurrencies trading posed a risk for Chinese financial system and for Chinese people. With their strong Confucianism heritage, China may want to justify this through protecting their valued citizen like a father would take care of his children. We cannot deny that crypto is an extremely volatile market. It is also very risky and people investing in it should know the risk related to it. But there are still people that goes all in expecting huge gain and instead lose everything. Hackers and crimes also could pose a threat as many people don’t have the knowledge to avoid easy traps. Another reason could be that \$50 billion worth of cryptocurrency left East Asian accounts between 2019 and 2020 (Chainanalysis 2020). There is a restriction in place for Chinese people who wants to invest in foreign country. Crypto can be a way of bypassing this firewall as no middleman is involve and bitcoin transaction can be untraceable for example. Wealthy individual who wants to have some assets in foreign country can use crypto in their advantages. China could have increased those regulation to avoid this capital flight and to protect the Chinese economy. China is characterized by wanting to have everything under control. This heritage of the first emperor and then throughout the Confucianism times always indicated a top-down approach to power. This is probably why the state own Central Bank wanted to have control over this new wild ecosystem that was unknown, uncertain and risky. It may be understandable that they saw this like a threat to the power in place. The decentralized concept could be a major concern for the Chinese government. Some people are motivated by wanting to eliminate the middleman that does our transaction which is most likely the current banking system. “Too big to fail” was a famous argument for wanting cryptocurrencies to prosper as it is self-regulated, and some says more trustworthy than the current system in place. As we knew more about this, some argue that blockchain could be used in many more ways to bring the power back to the people. Being able to control our own data or avoid censorship for example. It is therefore understandable why China may not be that much into this new trend as it could fragilized the power in place. Not regulating it would therefore be too risky.

BINANCE'S PRESENCE IN CHINA

We have seen that even though Binance “exited” China due to the increase of regulation they did not fully abandon the project of having a position in China (Wan 2019). They still do business in China but not with their exchange activities. They are building project that are in line with the Chinese view on the crypto industry. Indeed, President Xi announced in 2019 that the country should profit from the opportunity that this new technology called blockchain allows (Foxley 2019). The Blockchain research institute that Binance launched in China in 2020 (Binance 2020), which will be connected to the Belt and Road Initiative, shows loud and clear how Binance heard the message and that they are ready to cooperate. They also did help the government building his digital currency, the digital yuan (eCNY) (Digital Yuan 2022). They did adapt extremely well as they did comply with the regulation in place and moved in accordance to them. They do what the power in place advocates and therefore only concentrated on Blockchain technology in China. They also have good knowledge of the Chinese market and the power in place as they originate from there. Already having a foot in the country is a huge advantage that they will surely take advantage of in the future. They also knew that regulations were coming. They were able to move two months before the increase of regulation. That is all proof of high knowledge if it is not just luck.

However, regulations are a real trouble and not only for Binance. Their main core activity is still being an exchange. It would be interesting to see how it will develop into China's future.

FUTURE DEVELOPMENT IN CHINA

Binance is a young company in an unpredictable and extremely risky industry. It is difficult to forecast the future when it is that much volatile. But we can explore a few scenarios. One scenario could be that the government of China is going to take a more Taoist approach. Meaning that they will change their point of view and maybe allow Chinese user to trade or diminishing gradually the restrictions. If it happens building a separate entity that comply with the regulation in China like Binance did with Binance.US could be a possibility. Indeed, Binance build a distinct subsidiary especially for the US market that complies with the special need of the country. The fact that consolidate this theory is the announce about blockchain from president Xi that we have seen before. This was very disturbing as they cracked down the crypto sphere but at the same time praised it. Another scenario could be an even stricter top-down approach. Meaning that they will control absolutely every crypto transaction that occurs in China by any means. They could not tolerate Binance and shutting down every operation they have including blockchain activities in the country. A mix of those two scenarios would probably be the most reasonable scenarios as China is a very open country who tolerates a lot a thing. And CZ surely knows it. So that is why there is still hope for them in China and they are not giving up on it. The only thing that Binance should be careful of is to not go against the power in place which they already do well.

In a more broadly perspective all exchanges will need to move towards regulations in the future as the industry grow. Adapting to every country's specific regulation is extremely important for their long-term success and especially in China. They are a financial institution in a certain way. We can therefore logically expect that those exchange follow a certain structure and do not free ride. Therefore, we see Binance evolving towards a more traditional structure as they are supposed to announce an official headquarters very soon (Graves 2022).

WHAT ABOUT THE REST OF THE WORLD ?

To conclude it is interesting to note that China is not the biggest market for Binance in terms of users. They were already more successful worldwide back in 2017 with more than 81% of Western customers (Binance 2017) which is comprehensible with all the regulation that we have seen. Another aspect that needs further research is how Binance is doing business outside China like France who just recently welcomed Binance with open arms in their territory. Binance did not adapt that much into others country for now as an exchange work the same way in every country. However, that might not be the case anymore when regulations will start piling up. But this is unfortunately outside of the scope of this paper.

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APPENDIX

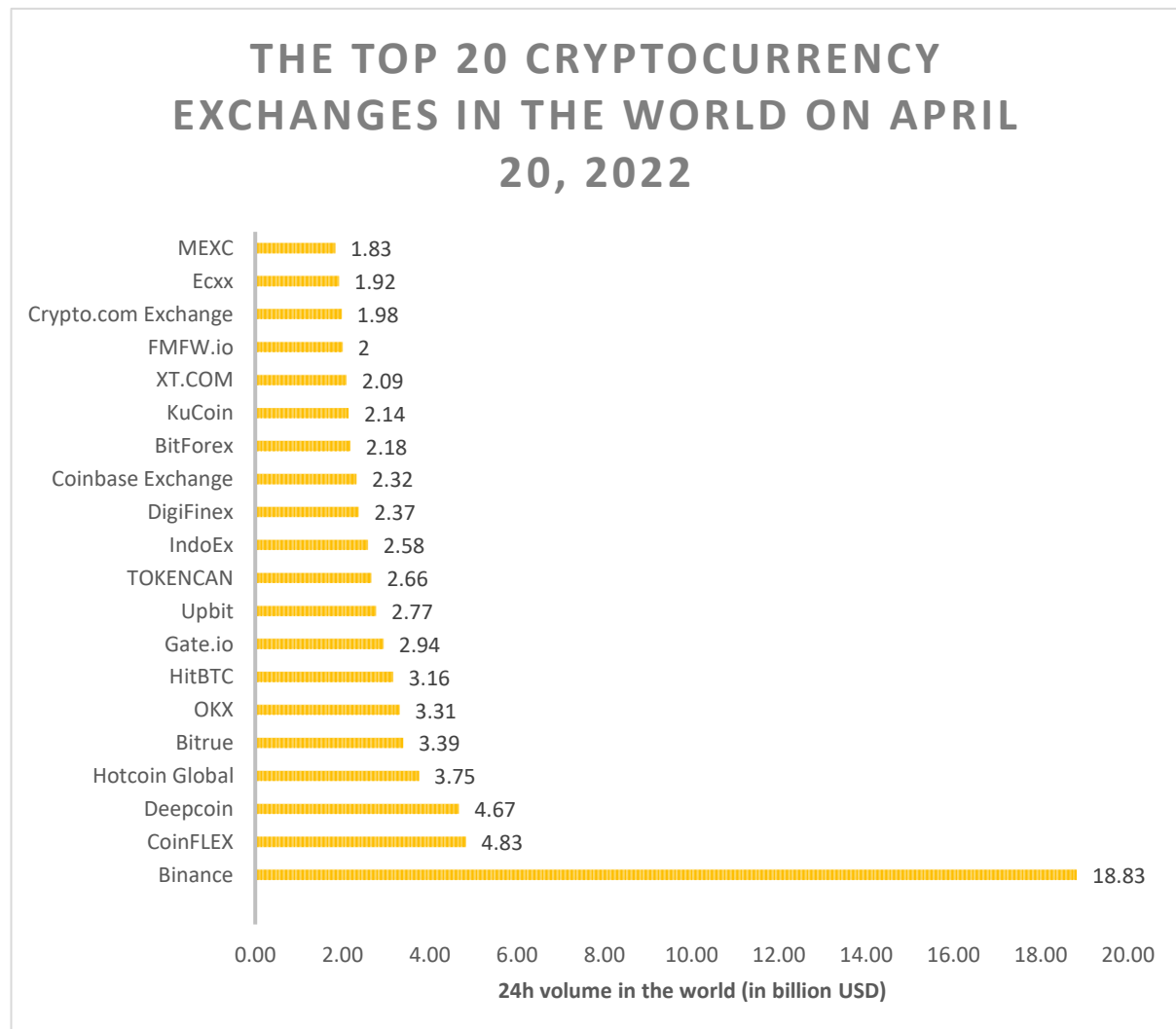


Figure 1 : The top 20 cryptocurrency exchanges in the world by volume (De Best 2022)