The New York Times | https://www.nytimes.com/2021/04/28/opinion/jack-ma-china-ant.html

GUEST ESSAY

Jack Ma Taunted China. Then Came His Fall.

April 28, 2021

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Ant Group, China's biggest fintech conglomerate, was preparing last November for its initial public offering. Analysts projected it would raise $34 billion, the largest sale of shares in history. The company, founded by Jack Ma, had become synonymous with financial innovations, which are often risky.

In the run-up to the I.P.O., Chinese regulators trying to assess financial risks on Ant's books had been brushed off by Mr. Ma. In an audacious speech, he criticized regulators as too cautious and pilloried state-owned banks for their "pawnshop" mentality of providing loans only to borrowers who could post collateral.

Even oblique attacks on China's government rarely go unpunished. This was a direct provocation. Yet such was Mr. Ma's aura, and his apparent imperviousness to government strictures, that domestic and foreign investors were unconcerned. They salivated at the prospect of buying shares of Ant — it was, after all, a politically powerful behemoth and indispensable to the economy. Its Alipay platform, which pioneered remarkably cheap and efficient payment technologies, has revolutionized China's financial system. Other arms of the conglomerate provide consumer credit and small-business loans online within minutes.

Then it all fell apart. Two days before Ant's shares were to begin trading on the Hong Kong and Shanghai exchanges, the government blocked the I.P.O. Regulators cited the company's opaque accounting practices, which, they said, could be hiding huge amounts of risky loans. Given Ant's sheer size, they noted, any problems could roil financial markets and hurt investors.

Thanks to his misstep in openly criticizing the government, regulators have Mr. Ma right where they want him, and intend to make him relinquish control of his empire.

But the government isn't done. This month, regulators forced Ant to produce a "rectification plan" to restructure the company by separating out its different entities, which include insurance and wealth management services. It had to commit to increasing transparency and improving its accounting and consumer protection practices, in addition to limiting its expansion into new lines of business. It seemed that, in bringing the hammer down on the company, the government aimed to limit its growing economic and political power.

But in so doing, the government spooked investors. Suddenly, President Xi Jinping's pledges to encourage private enterprise and innovation looked like mere lip service.

The Ant episode seemed to signal an end to China's era of innovation in fintech. But more broadly, it appeared to mark the cancellation of its experiment in financial-market liberalization and the return to government intervention and a hostile environment for investors. Yet however heavy-handed Beijing's moves may be, they suggest that it aims to control financial risks, even if the process for doing so looks chaotic.

The episode does send a strong signal about the limits of Beijing's tolerance of free enterprise. Firms can innovate and grow big but will meet swift retribution if they challenge government policies.

The halt of Ant's I.P.O. came at a key moment. China's latest economic figures, released on April 16, confirms its robust recovery from the Covid-19 recession. But to maintain high growth, the country needs to increase productivity of its industries, upgrade technology, and rely less on inefficient state-owned companies — daunting challenges.

During 2020, the government developed a “dual-circulation” strategy to become more economically self-sufficient. It entailed promoting homegrown innovation in industries like telecommunications and green energy, and relying more on domestic sales rather than exports. In part, the strategy is a response to persistent economic tensions with the United States. But it comes alongside an important pivot in government attitudes: The private sector is important for economic development but must follow official priorities and show unswerving loyalty to the government.

Why did regulators not rein in Ant earlier? To put it simply, Ant’s success made the government look good. Its position as a global fintech champion galvanized China’s economy. Ant made digital payments and banking products available to a wide segment of the country’s population, aiding anti-poverty efforts. The Alipay app has over 700 million monthly users, including residents of remote rural areas. Ant has financed some 29 million small businesses, including street vendors.

Perhaps Mr. Ma believed he need not look over his shoulder. After all, for many years, China tacitly tolerated underground financial institutions subject to fewer regulations and less supervision than traditional commercial banks. These outfits, known as shadow banks, offered higher interest rates to depositors and provided credit to riskier borrowers, including small-scale entrepreneurs the government-backed banks ignored. (Eventually, the government clamped down on this sector once it became too risky: rising loan defaults and bank failures meant depositors could lose their savings.)

Ant took advantage of the government’s passive approach to regulating fintech companies, developing a wide range of financial products and services catering to a growing middle class. Mr. Ma used his influence and political power to shield his company from regulatory oversight, even refusing to share its trove of consumer data with the government.

Financial regulators fretted about how Alipay, along with a rival, WeChat Pay, swiftly dominated digital payments, deterring new entrants. Indeed, this has spurred a government project to develop a digital version of China’s currency as an option for digital payments. Ant, they feared, was also harvesting data on its users to judge their creditworthiness and offer them loans on better terms than state-owned banks.

Meanwhile, it could hide any risks from these loans by shuffling its revenues and losses across different arms of its conglomerate. Even while it expanded, as a fintech company Ant could dodge the stringent regulations banks are subject to. In effect, it could become too big to fail.

For fintech firms in China, Ant’s forced restructuring will serve as a template. Competitors like Tencent have been put on notice: Be transparent, comply with regulations, protect consumer data — or else. (China’s government knows only too well how extensive data gathering confers power.) While the government tolerates private enterprise and encourages innovation, entrepreneurs should think twice before voicing overt defiance of the government.

Liberalizing China’s financial system is well and good, but the simultaneous desire to exert government control will hardly encourage innovation or efficiency. Even Beijing, despite its remarkable economic record, will find it difficult to have it all.

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