FINTECH ONE-ON-ONE PODCAST 391-MARTIN CHORZEMPA

Welcome to the Fintech One-on-One Podcast, Episode No. 391. This is your host, Peter Renton, Chairman and Co-Founder of Fintech Nexus.

(music)

Before we get started, I want to tell you about Fintech Nexus LatAm happening in Miami on December 13th and 14th. Latin America continues to be the hottest fintech region on the planet and our 2022 event will feature all the leading players. So, join the LatAm fintech community this year where you'll meet the people who matter, learn from the experts and get business done. Register at fintechnexus.com/latam and use the discount code "podcast" for 15% off.

Peter Renton: Today on the show, I'm delighted to welcome Martin Chorzempa, he is a Research Fellow at the Peterson Institute for International Economics and is also one of the world's foremost experts on Chinese fintech. I got to know Martin when we did events in China in my travels there and he has written a book, it's called "The Cashless Revolution."

It talks about really the history of Chinese fintech from the very beginning all the way through the heights in the 2010s, the peer-to-peer lending space which was where I got heavily involved and the amazing growth and spectacular fall of that industry, but he also focuses a lot on Tencent and Ant Financial/Ant Group which is a division of Alibaba and about the personalities that were involved there. We talk a lot about politics and how that's become a real important piece in the fintech puzzle in China and we go in-depth into many of the great pieces of the book. It was a fascinating discussion, hope you enjoy the show.

Welcome to the podcast, Martin!

Martin Chorzempa: Thank you for having me.

Peter: My pleasure. So, let's get started by giving the listeners a little bit of background about yourself. You've had a very interesting sort of career arc to date that landed you in China. We're going to talk about your book a lot today, as I said in the intro, tell us a little bit about how you got to China and how you got back to the US.

Martin: So, I studied Finance in undergrad and then went off to work in Germany and do some research as a Fulbright scholar, but China was much more interesting. It was a new, more foreign language, it was a rising power and it just made sense so I applied for and got a fellowship that found me a job in Beijing as the only guy who looked like me (Peter laughs) in a Chinese think tank. And that really provided me language training and then blew me right into this Chinese work environment where I was privy to fascinating discussions about what this fintech revolution and peer-to-peer lending and all the cryptocurrency and all these new concepts at that time, what they all meant for China and how China should respond and there's me in the room, which was quite exciting.

Peter: Right:

Martin: And then after two years there, I got into the Harvard Kennedy School to pursue graduate study realizing that, you know, people aren't going to take you too seriously in the econ space unless you must, at least, have some sort of advanced degree and I got into my dream program so that brought me back to the US.

Peter: Right, right. I want to talk a little bit about CF40 which was….I think we met when CF40 put on a Bund Summit which is actually….we'll talk about a very famous speech there, we were partners with CF40 back in the early days of our time in China. So, tell us a little bit about your work that you did there.

Martin: Yeah. So, CF40 is this Chinese think tank called the China Finance 40 forum and it's sort of modus operandi, it's bringing together academics, policy makers and practitioners of finance and economics together to have these really unique close-door, generally close-door meetings, where they can have off-the-record, actually frank discussions of important finance and econ issues. It was really a unique kind of space that brings together this network of people, they put on really interesting events and one of them which was in collaboration with LendIt for a while was one of the things that got me into the peer-to-peer lending space initially when, a lot of people thought it was going to be the future of finance and the future of lending which was going to disrupt the whole way that people do finance, but it didn't turn out that way though.

Peter: Right, I know, exactly, we'll get into that as well in a little bit. Before we dig into the book, maybe you could tell us a little bit about what you do at the Peterson Institute today.

Martin: So, I'm a Senior Fellow at the Peterson Institute for International Economics in Washington, DC so as a think tanker what I do is produce a whole set of policy analysis. So I work on fintech policy, crypto issues, the US-China economic relations and increasingly US-China technology issues. So, if an export control on China comes out, I'm going to provide some comment on it, I just talk to journalists, I write books clearly and policy papers, that will go more in-depth on an issue and then also quick reaction blog which may be something really important in the news so I think you need some expert analysis. It's how you might think of a think tank, it's somewhere between a journalist who has a few hours to respond and an academic who has a few years to respond in an academic paper and we're somewhere in the middle with things that require more reflection than a journalist can possibly put in, but more timeliness than an average academic can do.

Peter: Right. And before we get into this, I mean, you were able to learn the Chinese language pretty quickly, it sounds like, and you were relatively fluent by the time you left, right. And I think you told me one time you actually spent time reading Chinese language newspapers which from people that are trying to learn the language is an incredible feat so tell us a little bit about your fluency.

Martin: Yeah. So, I started learning Chinese on my computer and then had one-on-one language training in Beijing and I looked at learning Mandarin as the equivalent of building a nuclear power plant (Peter laughs) which is a huge amount of upfront investment to get the thing running and you have to get it running all the way, you can't just speak a little bit, not that it would be useful. But once you get that thing running all the way, you get these immense, stable returns for a very long time and it's essentially made my whole career since then. So, by the time I left China, I was translating for meetings between senior US people and vice-ministerial level Chinese officials where they would tell me the thing in Mandarin and I would translate it into English in real-time and then I would translate the response back and forth. That's probably the hardest thing my brain has ever had to do (Peter laughs), hold on to every single word and turn it into something new while the person is talking.

Peter: Right. Do you visit Chinese language websites and read Chinese language today?

Martin: All the time. This book would not be possible without that because to understand the dynamics, what happens in China, not only just the stuff that gets written about in the Western press, you have to read Chinese press, but also you have to be good at parsing the party documents because people will tell you something, but then you actually have to go down and read, what is the Central Bank exactly saying, what is their plan for the fintech sector going forward, what exactly is banned in terms of cryptocurrency transactions, that kind of thing. There's not enough room in the Western press to report all those things. So, if you can't read it on your own, you're in trouble and if you really needed Google to translate something, you can do that, but you're never going to find that within the website, unless you actually are reading around in Mandarin,

Peter :Yeah, got it, okay, Well, let's go into the book, it's called "The Cashless Revolution: China's Reinvention of Money and the End of America's Domination of Finance and Technology, " I've just finished reading it, it was a fascinating read. If you're even moderately interested in fintech, this is something....you don't have to be interested in Chinese fintech, I think, it's a story for the ages, the rise of Chinese fintech.

Can we say the rise and fall of Chinese fintech, it really hasn't fallen all the way, but it's not where it was a few years ago. Before you answer that, let's go back to… you arrived in China in 2012 and my first trip there was in 2014, I was a couple of years behind you and I really feel like the China you described in 2012 was very different by the time I got there in 2014, but tell us a little bit about what it was like in 2012.

Martin: Well, arriving in China felt like going backward in financial time in a sense. All of the banks were state-owned, with, you know, rare exceptions, the availability of investment options was quite limited, very few people used consumer credit outside of, you know, loan sharks and everybody paid for almost everything in cash. My Visa card from the West was clearly useless in China, nobody accepted that, but even my China UnionPay, ICBC Chinese Bank debit card was accepted very rarely so I pretty much only used that to get cash out at ATMs.

So, it seems like this backward system, and it was really dominated by financial repression where the government is essentially focused on limiting competition with state-owned financial institutions, and that really held everything back. They weren't integrating technology in the way that they should, they weren't integrating technology and adapting the way that foreign banks had done and that meant that they were just woefully behind and there was a lot of room for disruption.

Peter: Right, But there was this sort of latent force in play because you already had the two biggest fintech companies that were really….. they're not just fintech companies, but you had Alibaba, well, Ant Financial was already established there as a sort of subsidiary of Alibaba, you had Tencent. Both of them are run by very famous executives, Jack Ma and Tony Ma, who are unrelated, but tell us a little bit about that because they were already pretty well established in 2012, but they hadn't kind of gotten going yet in fintech so tell us a little bit about those two companies and where they were at in 2012.

Martin: Yeah. These are two of China's most important companies. So, Jack Ma (Ma Yun) is the Founder of Alibaba which started off with the kind of business-to-business e-commerce site and then expanded to try and compete with what was then eBay-dominating China's kind of consumer-to-consumer market with this online marketplace called Taobao. What they discovered early on is that the whole kind of payments apparatus that we take for granted around here where you can just kind of type in a credit card into a little window and hit send and you feel confident that if the goods don't arrive, you'll get your money back, you feel that your data are pretty safe doing that, none of that stuff existed in China and that really held back these companies in their early years.

And so, Jack Ma, is this fascinating character because he's this very outspoken, very brash kind of entrepreneur who loves to take risks and then you have Tony Ma, the Co-Founder of Tencent which is the other one. That company mainly dominates in social media and gaming and there they couldn't figure out how to charge users for things like items and games and chat Avatar outfits, you know, really small amounts of money and we don't really have that figured out here either, to be honest with you. It's called micro payments because credit cards are so expensive for those and in China's case, somebody would have had to walk all the way to the bank branch or go to the post office to be able to make that kind of payment and for a small payment you're never going to bother with that kind of effort and stand in line for it.

So, already in the early 2000's, these guys are realizing that payments is this huge impediment to their business and they each create a payment system that fixes a specific problem that their business faces and they work on those then for many years. By 2012, they've had a lot of experience running payments for online, but what they haven't done yet is cross this bridge head where they actually go and compete with the state monopoly on card payments which kind of dominated all offline payments. They're not really competing with any of the state banks in their lending and the investment activity so you have these companies that have learned a lot, they really understand payments and people trust them with their money. Because of political constraints they haven't yet been able to go head-to-head with the state-owned incumbents and really remake the system yet.

Peter: Interesting. So then, when you talk about it in the book they really started copying a lot of the things that were happening in the West, think you talked about they're copying somewhat like Facebook, some of the Facebook kind of ways they were doing things and Amazon obviously, when did they go from being a copycat to really introducing groundbreaking technology?

Martin: I think it's really around 2014/2015 that we start to see something uniquely Chinese being developed here and that's the super-app model. A lot of what US fintech was talking about during this period of time, which a lot of people are excited about, was unbundling. You're going to take a bundle of a bank and each company is going to take a little piece of what the bank does and do it a little bit better, more efficiently.

So, that means if you're a user of those products, to have the equivalent of one banking app you need about 25/30 apps to do all those functions and China said, why don't we take everything that the bank does and have that be in the bundle. And we're also going to take all the stuff that these tech companies, like Twitter and Facebook and your web browser and Uber and Lyft and everything else, we're going to put all that in one single application that becomes more like an operating system, an alternative operating system to what Apple and Google's Android create, and fuse that all together.

When you fuse that all together, you get this incredible movement of data between different elements of these silos so that the payments helps create an underwriting model for lending and the investment data provides perfect targeted marketing for the other elements of it and they all end up reinforcing each other in this flywheel. And pretty quickly, you get about a billion people using these apps that can be used for just about anything you could imagine doing in your daily life. The apps have changed our lives a little bit, you know, it's a lot easier to get a cab or calling an Uber rather than trying to walk out on the street and hail a taxicab, but in China so many elements of life were just totally revolutionized by the availability of these apps which has allowed them to get everything at their fingertips instead of waiting in line.

Peter: And, you know, you've for this super-app drove the user growth because suddenly, people who are just using text, they might be using WeChat for text messages and maybe a few games for Tencent, but then suddenly, they had a payments tool and the same with Ant. I mean, this was all kind of being developed and the government kind of was taking a wait & see approach, right, I mean, what was the government's role in really enabling this growth to like a billion users.

Martin: Well, in the early years it was like a libertarian's paradise, honestly.

Peter: Right.

Martin: From the time that Tencent launched its virtual currency, the Q Coin in 2002 and Alipay was launched around 2004, there was no regulation. The Central Bank didn't have any sort of sets of rules so you had to hire a lawyer to figure if you're in compliance with, they just said, generally, we encourage the development of online payments, have at it. And, you know, if something would have blown up, they would have taken an action, but nothing really blew up so they just left it unregulated for many years and said positive things about it. One of the interesting things about this time is, you know, that means you're in a gray zone, you don't fully know if it's legal, but you don't fully know if it's illegal.

Jack Ma, at one point, the way he tells it, had to actually tell his team back in Hangzhou, the capital of Alibaba, that he would be the one to go to jail if they ended up on the wrong side of that gray line. He said, if someone has to go to jail, I'll go because he knew that they were nervous about it, payments were dominated by a state company and then what happens around 2012 is a shift. Instead of ignoring it, they realized that they can harness the power of financial technology to try and invigorate their moribund state-dominated banking system and some people like Governor Zhou Xiaochuan, who is another character in the story beyond the two fascinating entrepreneurs who actually made the products that made the fintech revolution happen.

Governor Zhou is running the Central Bank from 2002 to 2018, that's a really long time, unprecedentedly long tenure and he is the protector of fintech. He's not only going to make sure the government doesn't come smack down on you in the early years, but he's also going to specifically open up new realms of finance for these tech companies to enter so it starts with online payments, then it goes to offline payments and it's banking, lending, insurance, everything else and that’s what allows these companies to then go head-to-head with the incumbents.

Peter: Right. And I don’t think anyone in the West here really appreciates the peer-to-peer lending space, how big it went from virtually zero to being one of the dominant ways that money is lent, particularly to individuals in China so tell us a little bit about sort of the start of what really propelled that growth of peer-to-peer lending.

Martin: So, I talked initially about the financial repression in the system which was the government was funneling resources towards state priorities. What that meant was there’s this chronic undersupply of credit to the private financial system so that means small companies, private companies and individuals, they just don’t have much in the way of credit availability and they also don’t have that much in the way of investment opportunities. Many of those investment opportunities have these interest rates that are capped by the government lower than they should be in order to kind of subsidize their credit provision to many other elements, predominantly of the state economy.

So, when you have both sides of this two-sided market of investors and lenders that are under supplied and then you have these new, what seems to be this really exciting technological solution where you can match those two and it’s not going to be as risky as it was before, you know, because they can say, all we are is a matchmaker, we’re connecting borrowers and lenders. There was a plausible case to be made for the pure peer-to-peer lending model that that institution would not have risked in itself so it wouldn’t be risky like a bank transforming maturity and doing some of the other more complex and risky things that the banks did.

One of the really unique benefits of that in China for the entrepreneurs that these two were creating it was that there was really no sense of what regulator in China would be responsible for this thing so you had a game of hot potato. Everyone saw how quickly this thing was developing, this incredible rapidity. I think the peak was something like 1 to 1.3 Trillion renminbi and when I looked comparing the volume of new peer-to-peer lending credit to the total amount of new bank lending in China, at one point it was about 20% as large as all of the new lending from the entire banking system. For something that did not exist only a few years earlier, this thing just took China by storm and in part because some people looked at this and said, this is really positive. This is some non-intermediated system, it’s good, but what they didn’t quite realize was that behind a lot of that was a set of bad incentives where a lot of people who were investing in this, they didn’t want to recognize that they were taking any risk whatsoever.

So, instead of having a pure peer-to-peer model where if a borrower defaults, the person who invested in those notes takes a little bit of a loss, you had a system where they had a loan loss reserve and a buffer and all these things so that none of the investors would realize that they were taking any loss. And what that meant is that these things were essentially giant shadow banks that had very thin capital cushions and were hiding the losses until the very last minute when the thing would actually implode and then whoever was running it would try to leave with as much investor money as possible. Not all of the platforms were like this, some of them were positive, but the incentives in the space were really messed up in a way that incentivized and led to the greatest growth of the most fraudulent ones who provided the most outlandish promises of high returns and no risk.

Peter: I remember being in the offices of many of these peer-to-peer lending platforms and many of them would say, guaranteed return, 10% guaranteed return. We'd press them on the guarantee and there wasn't much behind the guarantee, but what it meant was that investors who, let's face it, the average Chinese investor, and I think this is an objective statement, is less sophisticated than the average Western investor. The average Western investor isn't very sophisticated, but they see 10% guarantee, boom, throw their money in and it was truly an amazing thing.

I want to get to how it all fell, but before we do that I want to get back to Ant and one of the big things that kept on coming up in my conversations there was, that you know, the government credit bureau had limited numbers of people, had limited usefulness and then the government said, well, we will allow Ant Financial to have a credit bureau called Sesame Credit which ended up being a really, an amazing organization. You talk about it in the book but tell us a little bit about the launch of Sesame Credit and that was obviously an Ant Financial product, Tencent didn't get a credit bureau license and just tell us how they responded.

Martin: Credit is often a chicken and egg issue where if no one has extended you credit in the past then you don't have any credit history that tells someone who wants to lend to you how risky that is, but without that credit history, you know, it's hard for that person to justify giving you credit. In China's case, the lack of availability of formal consumer credit meant that most people, actually the vast majority of people, have no history in the credit bureau so you think about how easy it is to apply for a credit card or have a landlord accept your rental application, these kinds of things in the US because we have these really established credit bureaus and most people have, you know, used credit for a long time, have established how credit worthy they are.

That doesn't exist in China so there was a lot of excitement around this time about using alternative data sources that would allow someone to determine how credit worthy you are even if you haven't borrowed very much in the past and that used a lot of complicated machine learning method and things. Alibaba and Ant Group had some of the best data around on this issue because they can see how much you've been buying online, they have a sense of what your payments look like, what your inflows and outflows are and are able to kind of construct your financial health from that and then create a profile that would determine if you are safe to lend to.

Their hope was to become the FICO of China or even more and so they were very quick once they got permission from the government to do something like this to launch a product, but there were immediately a lot of concerns, especially because they tried to gamify it so they made it really fun, they tried to get young people in it as well and say, establish your credit score when you're young.
A lot of that stuff sounds really normal and positive to people like us who are used to establishing a credit history, but for Chinese policy makers it rang a lot of red flags. They said, wait we don't want young people to use credit yet because they are just going to irresponsible and buy a bunch of new iPhones and then their parents are going to have to bail them out.

The other things they were doing were things like if you had a really good credit score, you could get an easy visa to another country or you could get at one point a special low security screening line at Beijing airport. And the government said, we're trying to give you a credit product to try and give you the capability that lends to people, you're not the arbiter of who is a security risk at the airport (Peter laughs) so there was this sense that Ant took this a little too far and then it became too controversial, but the interesting thing is they didn't destroy the whole thing.

They said, you know, you can continue to use this for things like waiving deposits on a rental car or hotel and these kinds of things, but because it got sensitive, Tencent wasn't quite able to add one and Tencent was late to the party in part because of its own privacy concerns where people use Alibaba generally to buy things online, but they use Tencent generally to have the most intimate discussions they have with all of their friends and running their personal life on it. So, if they had a sense that their personal life and network was being used to evaluate them for credit, that's a little bit more sensitive and complex to something to accept than with Alibaba so kind of tells you about the different value of different types of alternative data. The closer it is to finance, the better it is when it comes to loan prediction and the better it is in terms of people accepting that it's going to be used for something like loan underwriting.

Peter: That brings up a good point. This data piece, Tencent have such rich data. The most amazing meeting I've ever been in and since I've started in fintech was in Shenzhen at the Tencent headquarters where we went through their whole kind of all the data, the various, different data pieces that they gathered. One thing that I always remember is they said, they can predict with 95% accuracy six months before you get a divorce by the data you have inside the WeChat platform. And it's not just the text messages, they would look at those, they would look at purchase behavior that you're buying, you're buying flowers at a place that's nowhere near where you live and you're just dropping off, you keep going to this other address so all that sort of data they would have.

Now, they weren't saying they were underwriting on these data, but they have the data which was truly staggering to me, I mean, this was in some ways the beginning of the end, right, the fact that they had so much rich data, the beginning of the government saying, hang on, you shouldn't be doing security at the airport, you have too much data. There was pressure for them to send these data or to actually share data with the government, right?

Martin: Yeah. So, the government initially wanted these private sector companies to do it and then they started to have concerns. This is kind of, remember that in the background of this is this global recognition of the drawbacks in giant technology platforms for competition, for privacy and all this. You know, before this there was a lot of utopianism in China, but also around the world. And so as some of this utopianism fades when you start to get a little bit more scrutiny and one of the main concerns on the credit side was if it's only these big Internet platforms that have enough data to do credit scoring then no one else can compete with them.

And then they add that to the bundle and become even more difficult to compete with for anyone in any other space because, you know, if you can use an Alibaba product and that gives them the data required to give you a credit score that you can use to get a loan, all from them of course, then you have an incentive to use that Alibaba product and not someone else who doesn't have ability that use that to contribute to your credit score. And so, it starts to look like a loyalty score instead of a credit score and looks like a conflict of interest because they have an incentive to try and give you loans so that you buy more things on their platform and pay for them on their platform where you make a payment fee as well.

So, it starts to be what was initially an exciting, positive flywheel of data and users and finance, started to look like instead of disrupting a moribund state system, it looked like it's going to create a new, unassailable set sort of duality of two super-apps that control everything and they started to get really nervous about it. When they asked these companies to share data with the government, something very surprising I think to most foreigners who had some idea of, you know, Chinese companies are just tools to the state, they would always have some excuse.

So, the state wanted to create its own credit bureau instead with all this alternative data and every time they ask Ant for the data, they said, we're still cleaning it (Peter laughs), we're still working on the data and this happened for years and the government system was not able to order these companies to give them the data. In part because these companies were also really powerful, you can't just order them around if you're some mid-level bureaucrat in the Central Bank and that's a fascinating part of China's political economy in this period is that there's this brewing backlash, but there's also still this residual raw power from their position in the system.

Peter: Right, right, okay. So, I want to get into the fall of the peer-to-peer lending space and maybe you could talk about Ezubao which was sort of the beginning of the end. I believe, you can correct me if I'm wrong, I think this is the second largest Ponzi scheme in history after Madoff. Tell us a little bit about not just the fall of Ezubao who I remember talking to other platforms at that time, many of them said Ezubao is a little bit fishy, some of the ones who were fishy themselves in the end. As I was interested in reading your book where you said that in your meeting with the founder you said that he actually seemed quite trustworthy, but it wasn't the case, tell us a little bit about their fall and the government response.

Martin: So, Ezubao gathered about US$7.6 Billion from around a million investors and the number could be actually much larger than that because they always have an incentive to kind of minimize those kinds of numbers to show that less people were defrauded. What I found so interesting about the Ezubao guy, like it's almost a joke I'd say, he would seem to be one of the most honest people I met in the industry because he didn't have any veneer about the techno utopianism. He said, all of these numbers that they're giving you at 2 to 3% default rate, that's false, it's more like 20 to 30. They're hiding it from you, you know, they say that there's some big data thing, there's no big data, we don't have access to big data, only the big tech companies have that and they're not sharing it with us so we're essentially doing old fashion loan sharking and then using that to create assets, often out of thin air.

So, his case, he offered these really high returns, at least 12%, I think sometimes it went all the way up to 20, depending on, you know, these promos trying to grab people and everything was 100% guaranteed. What's so interesting about Ezubao is that they got a lot of really positive attention from the government and from the government media, they held their annual meeting at one point in the Great Hall of the People. Now, can you imagine a peer-to-peer lending company in the US holding its annual meeting like in a meeting room with the US Congress or something. That's kind of essentially what this company was able to do and get lots of positive mentions from state media and that meant that a lot of Chinese people who, you know, not all of them are naive, they look at all these different platforms that are offering them some percent and they're trying to figure out which one of these is safe.

One of the best ways to signal that you're safe is to say, we are on the right side of the political line, which essentially means the investors expected to be bailed out if the thing fails. So, the thing looked really politically connected, but like you said, a lot of people in the industry thought this was too fishy. It went from zero to this, you know, $7.6 Billion number in only like two years, it was really extraordinary how fast this thing came up and then all of a sudden, the thing just exploded and it led to protests all across China because people said, look, the government was saying all these positive things about this company and about this sector and we invested because the government did that.

And that's really the tough part if you're the government officials is that you want to encourage innovation, you don't necessarily want to be responsible for the people who lose if something turns out to be not as innovative as you hoped for and that, you know, perception of these investors and these, you know, 12% guaranteed products was, these are gamblers. They want to gamble on the 12% and then if it doesn't work out, they want to come and complain that the government give their 12% back and like that's not how it works, we don't regulate this thing, it is up to you and most Chinese people were just not used to that so then they protest and the crackdown after the protest was quite intense.

Peter: Right, right. We're going over time, but there's a couple of things I really want to get to because I haven't even mentioned the money market product from Ant's. I remember going to Ant's headquarters too in Hangzhou and that just incredible technology they had there and they had a running counter of what the balance was of their money market account which is pronounced Huabei, is that right?

Martin: Huabao.

Peter: Huabao, okay, okay, thank you.

Martin: Huabei is their consumer lending product.

Peter: Oh, that's right, yes, yes, I always get those mixed up. So, anyway, tell us a little bit about the money market product that grew to be the largest in the world and grew incredibly quickly.

Martin: So, Jack Ma, around the time that this political opening comes up in the middle of 2013 that is allowing these tech companies not just to provide online payments but also to become financial giants themselves, was looking for executive right beachhead to get in and finally start competing with the banks and he finds money market funds as the perfect way because banks have interest rates that are capped by the government, in this case the cap for demand deposits you could take out at anytime was .35% so pretty poor return, far below inflation.

And, he says, well, if you invest in the inter-bank market in China, you can get 6% right now so he essentially said, alright, we're going to sell shares and investments that are yielding 6% instead of what people were used to which was 0.35% and that led to a massive wave of money being yanked out of the banks and put right into Alibaba's money market fund. This was just amazing because you could buy one renminbi if you wanted, something that was not done before, and you could pull out your money whenever you wanted.

So, the money market fund industry was this moribund place and then Jack Ma shook it all up and turned it into this great arbitrage where he was able to offer this incredible product that then allowed people to get much better returns. In doing so, he forced the entire banking sector to shape up because the banks tried to ban it using their political influence, but the government said no, you have to compete so all of them had to raise their returns so even people who didn't invest in this fund, which like you said eventually became larger than anything from Vanguard or JP Morgan, even the people that didn't invest in that ended up making better money because of the actions of the fintech entrepreneurs.

Peter: Well they really changed the financial landscape there, but, you know, you talk about in the book how politics is such an important part of Chinese life, it seems, and the political elite did not like the fact that Jack Ma was becoming this larger than life figure. You have a chapter, I think it's called "The Costliest Speech in History," we all followed along, I think to do with the Ant Financial, what was going to be the largest IPO in the history of the world and then we have "The Costliest Speech in History," tell us about it.

Martin: Starting around 2017, the government started to regulate fintech. They put a lot of restrictions on it, you know, we talked about credit reporting in banks, but, you know, this was kind of tinkering around the edges and cutting out some of the excess, but it's still…fintech in China was just an incredibly positive growth story for a company like Ant Group so its valuation was just going up, up, up and that led to all this excitement around its IPO.

So many people wanted to invest in this company by around October 2020 that Hong Kong's currency was almost de-stabilized by the scale of inflows, people trying to bid for shares in this company. It was just this incredible global exciting thing because they were lending so much more, they were running so many payments, it looked like this company is going to drive the future of finance, but still the government is regulating a little bit more and more and Jack Ma is getting a little bit annoyed by all these new rules, even though they're not really affecting his company that much.

So, he goes to the stage, usually before an IPO the top executives of the company will be in a quiet period because they know that if you say some wrong thing right before the deal you could derail the deal, but Jack Ma goes up and he gives the speech and he is giving a blistering critique of China's financial system, its regulators and its banks. He says the banks are no better than pawnshops and the regulators are cutting off all the circulation of the system, China is like a polio patient, you know, and the Basel Committee the helps determine international rules for risk, they're a bunch of geriatrics with Alzheimer's. So, he's really laying it on thick in this and pissing off a lot of people and I think it's because he's just so confident that the thing is going to go through anyway, that's he's going to use this public intervention to quash any rules that are getting in the way of his company.

But, instead, what happened is the complete opposite because he's just contradicted Xi Jinping who is the real power in China, who's main priority, one of many, is financial stability and systemic risk. So, he starts to think, why is this fintech entrepreneur using his political influence to try and water down the regulations in ways that are going to make our economy at risk in the future and why does he think he's so powerful that he can openly criticize the party and try to get his way.

So, Jack Ma started to look not just like a financial risk or like a real political risk within China's system and that led to his high-level decision to say, we are scrapping that IPO and by the way, it looks like we had all these rules for the tech sector that we've kept on ice because of the political influence of these big tech companies, I think we're going to release those now. So, that's what led to everything we've seen since, this huge barrage of regulations around data use and competition and everything else and so that's what makes this speech the costliest one in history. It destroyed much of the value of Jack Ma's companies, but it also was not just this punitive thing that hit Jack Ma, it led to a backlash against the entire consumer Internet sector beyond fintech.

Peter: Right. And to this day, Ant Financial, Ant Group as they're called now, is still a private company and they have not been able to recover which is super interesting. So, anyway, I want to end up though with I'd like you to sort of take a step back and look at some of the lessons that the US or the West in general, what can we take from this rise of fintech in China, the massive successes and then this backlash that's happened.

Martin: It's a fascinating set of learning experiences for us and one of the things that I've taken away from the book is that in many ways, the flow of ideas has shifted. For a long time, Chinese entrepreneurs looked at what was happening at Silicon Valley and said, this is the future of whatever industry so looking over towards us would give us a vision for the future, but actually in fintech, China gives us a vision of a potential future. That potential future has a lot of really exciting convenience and inclusion and positivity, you know, if we were to allow super-apps to happen like Elon Musk had said last week, he wants to turn Twitter into a super-app and Google and PayPal and many others have ambitions to create a super-app like in China.

There are a lot of positive elements to it, but China has really harnessed to improve its economy and the daily lives of its people, but at the same time, the concentration of all that data and all those functions in one party creates a concentration of power which can make you really nervous. Mostly, one story about WeChat, one person, there were messages he was sending was locked out of his WeChat account which you know if you get locked out of Facebook/Messenger or something you'd say, oh, that's too bad, but this person relied on WeChat to run his business and he had his money invested in WeChat and he needed WeChat to process payments for the business. So, suddenly, he's locked out of this thing and can't do anything and he gets so freaked out about it and can't reach any human being because, of course, trying to reach someone at these tech companies is just about impossible if you don't have connections, and he jumped off a building.

And another story is about the way that the fintech apps that were used for COVID controls in that initially, it allowed China to exit a lockdown by giving people a green health code in their Alipay app if they were a low risk person and hadn't been around any infected people lately, but now, the system of QR codes within the super-apps is used to keep tabs on everywhere anybody in China goes at any given moment. So, you know, while we look at the positive elements of the model and how powerful those are, we also see that there are these potential really scary drawbacks of that model.

So, the lesson I'd take from that is we really want to be ready with the regulatory framework that will ensure privacy, that will ensure that these companies if the super-apps becomes successful. They wouldn't be able to be, you know, crush competition across the tech sector and financial sector so that means good competition policy rules and we can kind of predict how that might evolve by looking at what happened in China. And, instead of what China did which is pioneer and do this without really a regulatory framework in mind before, we know what the trade-offs are now much better and we can learn from the Chinese experience to try and tweak that and harness the positive benefits of the fintech innovation we've seen in China but avoiding some of the negative, scary elements for civil liberties and privacy.

Peter: Right, right, indeed. Well, on that note, we'll have to end there, Martin. Thank you very much, it really is a fascinating book, you've done a great service I think to the fintech community globally and I think everyone should go and read it, even if you're not all that interested in China, so many great lessons, it's just a great story, really. So, thanks again for coming on the show.

Martin: Thanks for having me.

Peter: As you can tell, I love Chinese fintech and this whole story of the development there, it was really one of the highlights of my entire career being involved in that industry there at that time. As Martin said, there's a lot that can be learned. The Chinese have gone from being really laggards in technology when it comes to fintech to being leaders, I mean, I remember at our last event that we had in 2018, we had an executive from a major American financial institution who's actually based in Singapore, she said, I like to come to China because that's where I see the future of finance, I get to see where it's going. And that is, I feel like, despite what some of the challenges that Chinese fintech has, it is really so interesting to see what is possible. And China has shown that, they still are, in many ways, the most advanced country in the world when it comes to fintech.

Anyway on that note, I will sign off. I very much appreciate you listening and I'll catch you next time. Bye.

(music)