

## Where China Can and Can't Innovate

Some new technologies may be developing too fast for official tastes.

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Tencent's messaging app is cutting-edge. Photographer: Justin Chin/Bloomberg

China's biggest tech companies are emblems of national pride. When the government decides upon a priority, [Tencent Holdings Ltd.](#), [Alibaba Group Holding Ltd.](#) and [Baidu Inc.](#) are often asked to help [devise](#) the technology to achieve it. The companies are generally spared from official criticism, let alone interference with their commercial operations.

Those privileges aren't absolute, however, as Tencent -- the company behind the WeChat messaging app -- recently learned. **Late last month, China's central bank [shut down](#) Tencent's fledgling credit-scoring agency after only a day. The decision was particularly surprising, given that the government had authorized the project in 2015 and had actively [encouraged](#) the company to proceed. At the same time, it's a good indication of what kinds of innovations will and won't be allowed to thrive in China's private sector.**

The need for a system like Tencent's hasn't diminished. It's long been easy for Chinese state-owned companies to borrow money from banks. Consumers and small entrepreneurs without connections, and even many private companies, face far greater hurdles. **As a result, they've opted for informal and shadow banking.**

To begin remedying this state of affairs, in 2014 the government proposed setting up a "[social-credit system](#)" that could flesh out whatever financial records existed with additional "social" data -- ranging from school to criminal records. Companies could in theory process that mass of data to devise a credit score. "In the future, perhaps there will be a ranking system for morality," Tencent Chairman Pony Ma [told](#) an audience in 2013. "If your friends have high morality, then your credit should be good, too. Otherwise, they naturally wouldn't become friends with you."**In other words, if you're a good citizen, you're probably a good risk for a loan.**

Thanks to China's mass adoption of mobile phones, online shopping and social media -- and the development of artificial intelligence to process all the data thereby generated -- such systems are more viable than ever. **In 2015, the government authorized eight companies to launch social-credit pilot programs while it prepared its own national system for launch in 2020. Tencent was one of the companies selected and -- along with Alibaba -- it was widely expected to become a leader in the industry.**

Since then, however, the notion of social credit has become complicated. The different pilot programs all have different standards. The government's own program -- which hasn't been released yet -- is incorporating some of them, and local governments are adding their own requirements. For example, **in Zhejiang Province, which just passed a local social-credit regulation, failure to recycle can hurt your credit. In Shenzhen, jaywalking can have the same impact. Meanwhile, Alibaba's social-credit program reportedly weighs financial information heavily, while Tencent's ill-starred experiment naturally emphasized social criteria.**

That diversity may have worried China's ruling Communist Party. Already, Tencent and Alibaba are among the most powerful entities in China, commanding the attention and loyalties of hundreds of millions of Chinese. At least some in the government probably feared that allowing multiple, independent standards of socially acceptable behavior could undermine the government's own program and standards.

More directly, the government is concerned about potential conflicts of interest. In theory, for example, Tencent could use the promise of better ratings to lure borrowers to its financial products, undermining the point of a social-credit system altogether. The risk isn't just financial, either: **In recent years, the government has been extremely mindful of ensuring that online frauds don't lead to social unrest. No innovation is worth potential instability.**

As recently as January, Alibaba had to apologize for causing a public uproar after its affiliate Zhima Credit was accused of misleading users into disclosing private information. Though Chinese internet users have long adopted a relatively lax attitude toward online privacy, at least by Western standards, the incident prompted an unusually fierce pushback. That clearly unnerved a Chinese government accustomed to having seamless access to citizen data. Going forward, if private innovations undermine the public's easygoing attitude toward data privacy, they're likely to be curbed.

Of course, this isn't the end of either Tencent or China's social credit system. Even China's biggest state-owned companies occasionally clash with the government, and social credit is far too important a political priority to cast aside. Indeed, in early January, the government announced that its national social credit initiative would move forward under the auspices of a state-owned company, with Tencent and other tech firms as minority shareholders.

**Meanwhile, Tencent will no doubt continue to innovate in other areas using its cutting-edge WeChat app.** There are real questions, however, over the degree to which features nurtured in an environment where official dictates take precedence over the desires of shareholders and customers can succeed globally. **Some innovations may not be pursued for fear of offending government sensibilities. Those that are might be viewed as lacking the robustness of**

**features found in similar products abroad. (WeChat has so far struggled to find overseas users.)** And, even if all else is equal, there will be inevitable reputational challenges overseas for companies viewed as working closely with an authoritarian government -- an issue that firms such as Chinese electronics manufacturer [Huawei Technologies Co. Ltd.](#) are already facing in the U.S. In different ways, China's tech giants may find themselves limited abroad as well as at home.