A total eclipse?

Since the 1990s, US technology companies have had the edge in the race for global internet leadership. In 2018, that could change, says Siguler Guff co-founder, Drew Guff.

Drew Guff,
co-founder,
Siguler Guff

From the sunny uplands of their multi-year double-digit returns, investors in top-tier US tech stocks might be forgiven for feeling a glow of satisfaction. Stocks like the big four 'FANGs' (Facebook, Amazon, Netflix and Google)[1], boast extraordinary track records, with returns for some of them reaching above 200% in US dollar terms over the past three years. As they continue to innovate in everything from financial services to facial and speech recognition, the future of many tech giants looks bright.

However, what if today's disrupters – the current champions of the digital age – were themselves disrupted? Could their stars ultimately be eclipsed by a new breed of challengers? For Drew Guff, co-founder of private equity firm Siguler Guff, this is a key question – and one that points to emerging markets as a crucible for future progress in the technological realm.

For one thing, says Guff, there is evidence that tech companies in China and India are catching up with their peers in the US and Europe. Certainly, he says, the investable universe is growing fast as emerging market (EM) countries establish local centres of innovation. "It's not talked about as much as it should be but the EMs have their own Silicon Valleys," he explains. "China, for example, has some 40% of the world's artificial intelligence (AI) scientists. Of the 267 global tech 'unicorns'[2], 89 are in China and 11 are in India. Five of the top 10 most highly valued of these are Chinese technology companies. We think that gives a pretty clear indication of where future growth might come from."[3]

Global internet usage and e-commerce statistics paint a similar picture. In 2015, for example, India replaced the US as the second largest internet user population (China is number one). India also leads the world both in the growth of smartphone users and the number of e-commerce sales transacted on mobile phones.

At the same time, there is an argument to say the 'old world' regulatory regimes in Europe and the US have become increasingly stacked against the current tech incumbents in recent years. In Europe, for example, the European Commission has imposed numerous fines – sometimes reaching into the billions of dollars – against everything from monopolistic practices to tax evasion. US-based ride share companies – those arch-disrupters

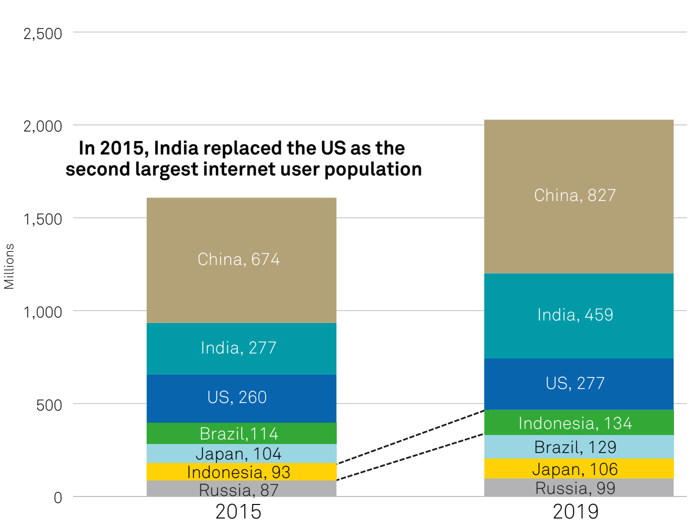
[1] The terms 'FANG' stocks refers to Facebook, Amazon, Netflix and Google (Now Alphabet).
[2] 'Unicorns' are defined as unlisted tech companies with a valuation above US$1bn.
[3] *Techcrunch:* 'Unicorn leaderboard', 25 September 2017.

of the traditional taxi business m odel – likewise, have run into multiple legal and regulatory headwinds in multiple jurisdictions.

"Increasingly we've seen a backlash against the US tech leviathans," says Guff. "Partly, that's through a fear of people losing their jobs and politicians worried about their voting constituents – but it also bleeds into areas such as data privacy."

The contrast, here, he says, is with the regulatory regime in emerging markets such as China where data privacy has traditionally been a low priority. He explains: "Since data is the lifeblood of AI it could make a huge difference to how successful some of those domestic companies are going to be. The reality is that Chinese authorities have been a big backer of AI all along – and having easy, open access to so much data could be a game changer for them over time."

COUNTRY RANK BY INTERNET USERS (M) 2015–2019, EST.



Source: eMarketer, 2015. For illustrative purposes only.

There's a wider point at play here too, says Guff. He notes how emerging market societies have experienced tremendous change over the past 50 years. On the whole, he says, they've benefited from those changes as globalisation has picked up pace, as they've industrialised – and as they've prospered. But for some of the more mature Western societies, the opposite is true. "As globalisation has gathered momentum they've seen similar levels of change but many of those changes are perceived as negatives – and that's where some of that regulatory backlash is coming from."

Meanwhile, the rise of the tech space is mirrored in the composition of emerging market listed indices as their constituent countries progress up the curve of economic development and away from their earlier focus on commodities. In the MSCI EM Index, for example, the presence of technology companies rose from 13% in 2007 to 23% by 2016. In contrast, commodity stocks fell from 31% of the index in 2007 to just 14% over the same time frame. Seven of the top-10 holdings in the MSCI EM Index are now technology companies.[4]

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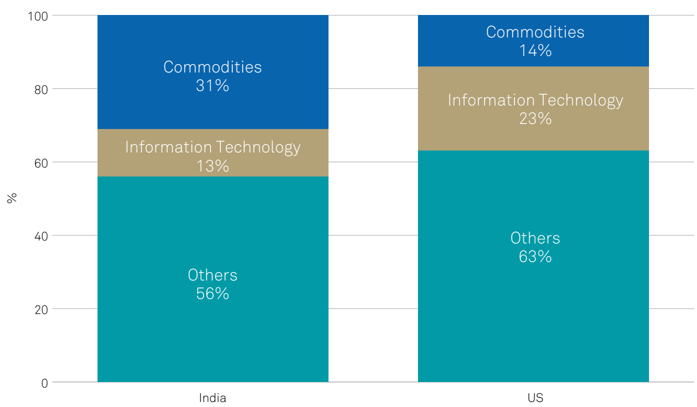
Yet even despite this growth, investors may still struggle to find suitable targets, says Guff – partly because most EM indices are still dominated by companies in a narrow range of sectors: energy, mining, banks, power generators and telecoms. But in developed markets too, the choice of listed companies well placed to tap into the growth of EM tech is similarly restricted.

Says Guff: "In China, for instance, the big beasts of the US tech arena have categorically failed to carve out a significant space for themselves. Partly that's because of cultural differences but we also think it's a deliberate policy on the part of the Chinese authorities as they look to create their own national champions. While we think US companies will find it very difficult to prosper in China the same can't be said for foreign investors offering capital through areas such as private equity. Indeed, China continues to absorb private global capital at an astonishing rate and we think that probably offers one of the most attractive routes for those looking to benefit from the future growth of EM tech."

MSCI EM INDEX: COMPOSITION 2007 VS 2016



Sources: MSCI, June 2017; Capital IQ, June 2017. Market capitalization as of July 12, 2017. For illustrative purposes only.

[4] MSCI, June 2017; Capital IQ, June 2017. Market capitalization as of July 12, 2017.
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