Digital Decolonization

Imagining the Next Phase of Globalization

PRINCE STREET
Capital Management

Executive Summary

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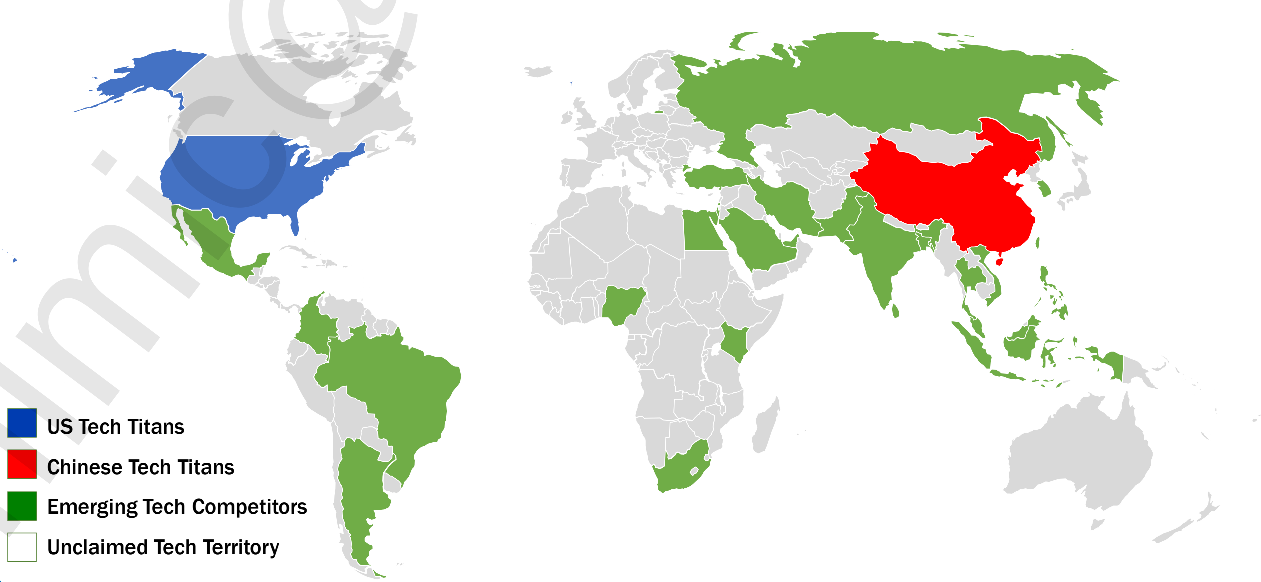
At present, five US tech stocks command market caps of more than $500 billion: Microsoft (MSFT) – $967 billion, Amazon (AMZN) – $897 billion, Apple (AAPL) – $823 billion, Google (GOOGL) – $788 billion, and Facebook (FB) – $516 billion, for a total of more than $3.99 trillion. Three Chinese companies, Alibaba (BABA) – $401 billion, Tencent (TCEHY) – $396 billion, and Baidu (BIDU) – $40 billion, combined are worth just under $1 trillion. These titans known as “FANG-BAT” are valued a total of $4.8 trillion. Adding in the next generation of emerging American and Chinese emerging titans including Netflix (NFLX) – $154 billion, PayPal Holdings (PYPL) – $129 billion, Uber Technologies (UBER) – $70 billion, and Ping An (HK2318) – $138 billion, brings the total to $5.3 trillion of market capitalization for the dominant internet platforms covering a quarter of the world’s internet users.

By contrast, the emerging and frontier tech ecosystem has virtually no market cap. The three largest companies (Samsung, Reliance, Naspers) combined are worth $500 billion, implying that the US and Chinese titans are worth 11 times the value of the best tech companies in the rest of the world. Even these three emerging-world giants are valued based on drivers other than their consumer internet platforms (hardware for Samsung, petrochemicals for Reliance, Tencent shareholding for Naspers).

Four billion people around the world use the internet, spread across 18 billion internet-enabled devices and based in little less than 200 independent countries. Of these 4 billion users, a mere fifth reside in China, while less than 8% are based in the US. Yet these two markets – China and the US – make up the vast majority of tech and e-commerce investment, innovation, management, profit, and market capitalization.

At Prince Street, we posit that President Trump’s decision to pursue a more nationalistic foreign policy doctrine, will spur an emergence of a new breed of homegrown tech titans emerging and frontier markets that will compress the current valuation differential. **We define this dynamic as Digital Decolonization: a process whereby local political leaders, working with local entrepreneurs, will leverage regulation to defend local interests rather than allowing a “colonization” from foreign tech powerhouses. These local tech players will also cater to local tastes/needs due to their superior indigenous cultural edge which should foster their penetration of local markets.**

Prince Street Perspective on the Scramble for Digital Dominance



A New Vision for Globalization

On January 23, 2017, President Trump signed a presidential memorandum effectively withdrawing the United States from the Trans-Pacific Partnership Negotiations and Agreement (TPP), articulating in the process his preference for bilateral rather than multilateral bases for negotiating future trade deals. Drafted under the Obama Administration, TPP was a watershed document, intended as a blueprint for future trade deals that would continue to facilitate the leadership of US tech titans - often at the expense of rising local players. The vision was also to include Europe which, on a consolidated basis, makes up 10% of global Internet usage.

Without debating the relative merits and faults of this decision, the fact remains that the TPP document contained extensive provisions concerning electronic commerce (chapter 14, Office of the United States Trade Representative, 2018), which were negotiated specifically at the insistence of the United States. Significantly, these same e-commerce provisions were absent from the successor agreement to TPP, the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, signed in Santiago, Chile on March 8, 2018.

This crucial foreign policy decision was a milestone in global tech geopolitics given that, since the US withdrawal from TPP, Silicon Valley has changed the way it approaches the developing world. Uber, for example, was quite early to recognize the power of local competition. Operating a business model based on extremely local data sets (addresses, maps, traffic flows) and constrained by the skills of human drivers is challenging. Case in point, Uber has sold its local business in China (August 2016), Russia (February 2018), and Southeast Asia (March 2018). On the other hand, Uber announced in March 2019 that it was buying outright Careem, its Middle Eastern rival. Whether buying or selling or both, Uber appears to believe that too much competition in its vertical is bad for its income statement. In markets where Uber did not engage, local players have emerged in a dominant role underscoring Digital Decolonization in action (Bloomberg, 2019).

Other more recent transactions suggest that this pattern is likely to continue, and we believe the decision to withdraw from the TPP will have a lasting and cascading impact on winners and losers in the global tech ecosystem impacting the commerce, fintech, healthcare, logistics, real estate, and security sectors among others.

Although the United States subsequently announced formal interest in joining the successor agreement to TPP - these provisions - which effectively would have prevented signatories from protecting their nascent e-commerce and fintech sectors from global competition - are simply no longer in the text of that document. There may be no turning back.

A Move to Protect American Digital Dominance

The US made sure, however, that these same pro-American e-commerce provisions that had been dropped from TPP were subsequently included in the US-Mexico-Canada Agreement (USMCA), signed on November 30, 2018. Because of these provisions, the USMCA effectively establishes a North American Digital Trade Zone (Council on Foreign Relations, 2018). For example, Canadian Blackberry or Banorte, which is Mexico's largest independent financial institution, have limited recourse to defend against competition from larger and better capitalized US competitors such as AAPL and JPM among others. While these companies may manage to prosper based on their own innovation and successful exploitation of niche markets, as global M&A and economic consolidation continues, they look more like acquisition targets for US giants than they do potential rivals.

Looking forward, it is possible that the new "trade deals" planned for UK, Japan and other countries may include such provisions guaranteeing open access for US technology giants. Yet, it is not yet clear that these documents will ever come to fruition. In short, US tech companies today rule most of the world on a digital level and the five largest tech companies (MSFT, AMZN, APPL, GOOG, FB) command a market cap of some $4 trillion. The digital decolonization of the emerging markets world threatens a pernicious change in the operating environment for Silicon Valley outside the established North American Digital Trade Zone.

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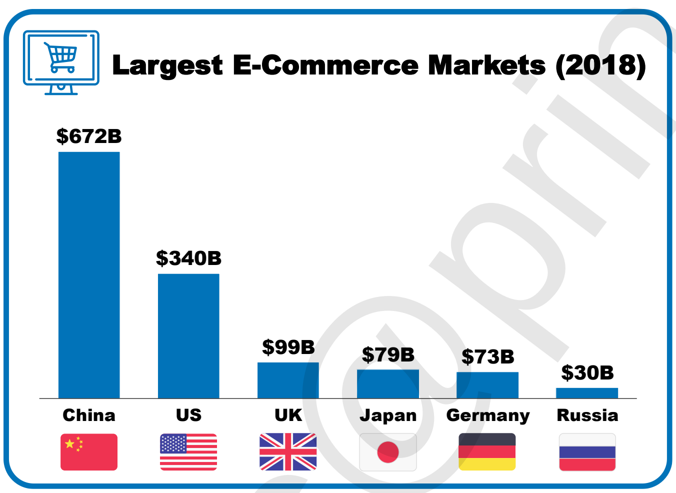
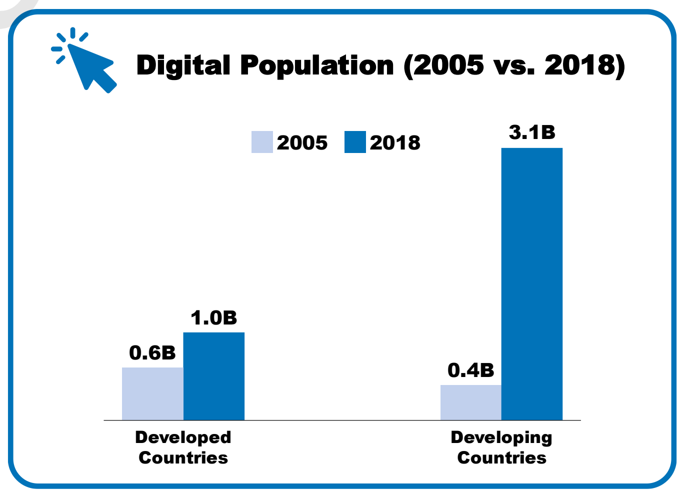
China Tech Strategy: Great Firewall of China

Meanwhile, on the other side of the world, in China, the globalization of technology is being considered from a very different perspective. Alibaba, Tencent, Baidu and other Chinese technology giants were founded and have flourished behind the so-called "Great Firewall of China", which effectively protects them from direct competition from Silicon Valley. Ant Financial, an affiliate of Alibaba, made a significant investment in Paytm of India in March 2015, marking the beginning of a Chinese challenge to Silicon Valley's domination of the e-commerce landscape in the developing world. Ant Financial has followed with strategic investments in Thailand (Nov 2016), Singapore (Nov 2016), Philippines (Feb 2017), Indonesia (Apr 2017), Malaysia (Jan 2018), and Bangladesh (April 2018), in addition to strategic partnership arrangements with local firms as far away as Nairobi and Buenos Aires. Reports vary from these different companies about the nature of Chinese involvement in management and the security of code and data. Regardless, it appears that China remains determined to challenge US dominance of the digital economy. With Tencent now following Alibaba in investing overseas, the potential for a multipolar digital world is increasingly clear.

As a result of China's decision to vigorously protect and foster the development of its own brand of vibrant tech titans, the leading Chinese companies stand alone among the EM players today. These Chinese titans are rivaling and in certain segments outpacing the US tech leaders in penetrating the daily lives of Chinese citizens. In important segment including e-commerce penetration, China's enjoys close to 20% compared to the US in the teens. Their unique approach to the market has delivered impressive results.



Source: The Global E-commerce Playbook, Shopify



Source: International Telecommunication Union

Evolution for the Rest of the Emerging World

China offers an inspiring alternative to a world fatigued of a unipolar world order in which the US acts as hegemon. The Chinese designed a coherent body of policy prescriptions that curtailed Google's ability to digitally colonize their market. This demonstration of "Digital Nationalism" enabled China's leaders to curtail Google's role in the lives of its citizens and protect its domestic platforms. Emboldened by China, Russia followed suit to protect its domestic digital territory. Vkontakte, the Russian equivalent to Facebook, was launched as early as 2007 and the Federal Service for Supervision of Communications, Information Technology and Mass Media (Roskomnadzor) founded the following year. Russia, which has kept its television broadcasts under tight control for decades now, and tightened its grip over the internet with the ban on the messaging service Telegram in 2018. Google and Amazon reported interference with their websites soon after. Both China and Russia drew a line in the sand to protect their territories from digital colonization.

India is perhaps the most interesting case. A country that prides itself on being the world's largest democracy and enjoying significant press freedom, with a massive domestic IT-outsourcing industry and a world class technological diaspora, India has been late to limit the power of foreign technology companies. However, 2019 has marked a turning point; within a few days of **Mukesh Ambani's** speech at the Vibrant Gujarat Forum where he **called India a victim of "digital colonization",** the Indian government began to more aggressively regulate e-commerce companies. The move prompted some to question if Amazon and Flipkart (recently purchased by Walmart) will be allowed to dominate the country's e-commerce landscape after all. Activists are now calling for tighter surveillance of these companies from the Income Tax Department, among other government agencies.

Indonesia and Brazil are two of the largest markets in the world where, at this writing, formal protection for local technology companies is in its infancy. Indonesia put some restrictions on Facebook following some deadly rioting in Jakarta in May 2019 (TechCrunch, 2019), but it remains to be seen whether these controls will expand to cover more financially competitive sectors such as e-commerce and fintech. We think this situation merits close scrutiny. We believe that Mukesh Ambani has fired the shot being heard across Emerging and Frontier Markets that is going to change the power balance between winners and losers in the tech powered ecosystem.

Risks to the Digital Decolonization Thesis

All of that said, the fact remains that Amazon stocks more different SKUs than any other e-commerce website in the world, and Alipay process more transactions faster than any other financial services company. The "FANG-BAT" technology giants have more programmers, more capital, more lawyers, more management consultants, better starting salaries, and cooler offices than most local EM technology start-ups can even dream of. Without the thumb of local regulators clearly on the scales, it remains to be seen if most local start-ups can face down the full force of Silicon Valley competition. **Likewise, most (although not all) of these companies are still in the investment stage, burning cash, and vulnerable to a correction in valuation if risk assets should turn lower.**

This is why the response from Silicon Valley becomes most important. As the policy risk from the so-called "Techlash" gathers pace, whether over privacy rights, political influence, antitrust issues, labor protections, or tax liabilities, the giant companies of the Valley are increasingly feeling pressure to manage their growth more carefully. Uber did decide to launch their bus product globally from a launch party in Cairo, but the Kinshasa launch may be postponed for a few years.

Battle for Talent

Likewise, from a management perspective, we note that now that most of the unicorns of e-commerce have grown into decacorns and hectacorns, the incentives available to local talent in the developing world are starting to look less compelling than what may be available from local start-ups. A job with Uber, Amazon, Facebook, Alibaba or Google in Jakarta, Bangalore, Lagos or Sao Paolo is increasingly not that different from a job with IBM, Procter and Gamble or Unilever. The most innovative local managers (and the most connected politically) would be wise to consider a job across the street in the local ecosystem.

Coding talent is likewise a real constraint for local start-ups in many geographies. While the corporate canteens of Silicon Valley buzz with conversations in Mandarin and Hindi, in some geographies there is not enough local talent to build competitive internet platforms. In some cases, they solve this challenge by importing talent from other markets, but we look for a further deepening of coding resources in places like Africa and South Asia before we can see a truly competitive internet landscape.

Politics and Economics

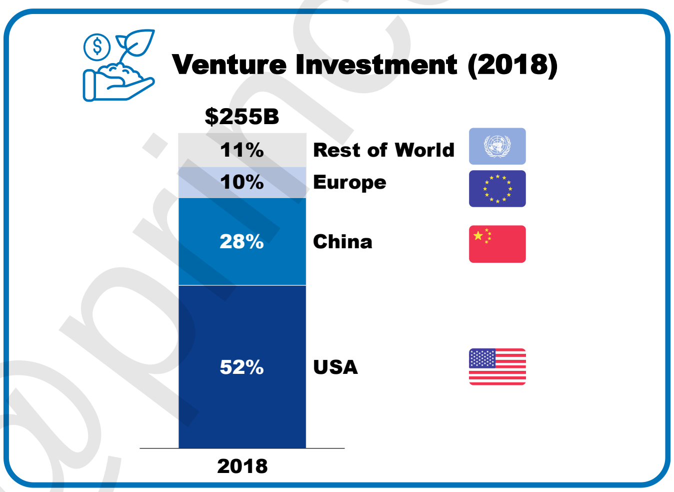
The political and economic consequences of digital colonization are becoming increasingly clear. Amazon, Alibaba, Walmart among others source products globally, favoring low cost producers and short delivery times; the result has been a huge concentration of manufacturing capacity in a few specific geographies (with important environmental consequences). Data security is an increasingly controversial issue; access to credit likewise remains not much short of a dream for most of the world's 4 billion internet users. Health care solutions are structured to treat the problems of wealthy people living in urban areas;

media concentration has likewise focused on the priorities of a few specific voices; Social Networks are proving remarkably vulnerable to manipulation for political purposes. In retrospect it is not surprising that Indonesia restricted Facebook, WhatsApp and Instagram four days after a riot.

It is absolutely true that Russia and China have led the world in closing off their societies from Western technology companies, just as they have been careful to protect their newsstands from menaces such as the New York Times and the Washington Post. Digital Decolonization in these places is just a natural extension of controls on freedom of speech. That said, as the so-called "Techlash" continues from Washington to Brussels, it would seem likely that more restrictions on global tech giants will become a matter of political banality.

Availability of Capital

We would argue that capital is really the main constraint for digital decolonization. At this writing, most of investment capital has been heavily concentrated in a handful of companies in the developing world beyond China, and in many large markets virtually no money has gone in at this writing. Where Amazon, Alibaba, Uber and so forth really focus their efforts, it is unlikely that local start-ups can survive. For better or worse, however, it seems that these companies have limited management resources to deploy even if their capital sources dwarf what is to be found in local venture communities. But capital, historically, has shown a way of finding its way to compelling opportunities for returns, and digital decolonization would appear to an important investment opportunity for the next 10 or 20 years.



Source: Venture Pulse Q4 2018, KPMG Enterprise

US – China Trade War: A Potential Catalyst for Digital Decolonization

Just as the Cold War set the stage for the political decolonization of the 1950s and 1960s, the US-China Trade War, a major geopolitical event started on Twitter (March 2, 2018), set to play an important role in digital decolonization. While urging trading partners not to do business with Huawei, Hikvision, or DJI may be a paramount strategic priority for the US, it may be difficult to also insist on unfettered access to local markets for Amazon and Uber. Indeed, the world is increasingly fragmenting into trade blocks, with US Free Trade Agreements complete with provisions on e-commerce, following along the same lines. To date, signed US FTA agreements cover about 13% of the Internet users in the world, and about 35% of world GDP.

Since early 2019, a series of announcements from the tech sector indicates a change in US tech titan's strategy for penetrating the markets of the developing world. In March 2019 alone, PayPal signed a partnership with MercadoLibre, Uber announced its acquisition of Careem, and Alibaba agreed to a partnership with Safarico. A subtle but perceptible shift in emphasis towards a less centralized vision of product leadership and management and share ownership in the internet space is evident. Stock prices of beneficiaries of digital decolonization such as MercadoLibre, Reliance Industries, Yandex, Safaricom, among others, have all outperformed both local markets as well as Nasdaq since the start of 2019. Silicon Valley managers, their friends in the VC community, and also Wall Street analysts appear to be reevaluating the potential for "home grown" local champions to face down competition from Mountain View or Hangzhou.

Longer-term Implications

Like its predecessor, political decolonization which took decades to unfold, we expect Digital Decolonization to be a political and economic process that will shape the investment landscape over a protracted time period. Political decolonization took more than a century, consider the Latin American independence movements in the early 19th century, the First War World or the Hong Kong Handover in 1997 (there are still a few stragglers around even into 2019). Governments rose and fell; two world wars were fought; dynasties were overthrown and new languages invented. Digital change occurs at the speed of light, of course, but given that people and governments are involved we can expect Digital Decolonization to take place over decades rather than centuries.

The outcomes varied widely in political decolonization. Some states (for example Singapore, Oman, Costa Rica) prospered under peaceful independence, while others (Cambodia, Yemen, Nicaragua) descended into chaos and violence. We should likewise expect Digital Decolonization to be uneven, irregular, and inefficient. Which we believe provides a constructive environment for active management.

Perhaps the most interesting space for investors and managers going forward will be the next generation business models, beyond just e-commerce, ride sharing, and fintech, all of which have received a disproportionate share of capital flows in recent years. From logistics and mapping, to e-health, e-learning and e-sports, the local and national champions in these sectors are often still in the start-up stage. While too early for exchange-traded portfolios to access in many cases, we believe these themes look particularly interesting for the future.

Investor consensus is that the technology sector concentrates value in the hands of the largest players ("winner take all"). Digital Decolonization would suggest a more complicated, more competitive and ultimately more prosperous world.

Please contact IR@princefund.com for questions regarding Digital Decolonization: Imagining the Next Phase of Globalization.

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