

# ARGO ASSOCIATES

**Briefing 28 August 2018**

*Why tech companies now sit at the crossroads of  
business and politics*

It has become commonplace to argue that we are on the brink of a multidisciplinary technological revolution that will affect every aspect of our lives – work, transport, healthcare, entertainment, even perhaps reproduction and mortality. If we are indeed on the cusp of such significant changes, then inevitably the companies that will be responsible for these advances will become increasingly wealthy and commercially dominant. This is a phenomenon that we are already seeing as technology companies have been driving global stock markets and attracting a huge proportion of the available investment in countries such as the United States, China, South Korea, Finland, Sweden, Japan, Israel, Singapore and other technologically advanced economies.

Within the United States a small group of companies – the so-called FANGs: Facebook, Amazon, Netflix, Google (now Alphabet) – were until recently the key driving force behind the rise in equities in the U.S. During the first six months of the year the so-called NYSE FANG+ index rose a little over 25% before dropping back somewhat; if you include Apple and Microsoft to produce the almost unpronounceable FAANMG set of stocks then this small group basically accounted for the entire first half gain of the S&P.

Equally, the Chinese economy has been driven by tech giants such as Tencent and Alibaba, while investors have been lining up to pour money into new Chinese tech ventures, creating a bubble that has been driving increasingly implausible valuations. In the second quarter of 2018, China's start-ups reportedly received 47% of all global venture capital, as compared with 35% that companies in the U.S. and Canada cumulatively received. In mid-August of this year, in an article in the *South China Morning Post*, Andy Xie, a Shanghai-based economist, recently claimed that "China's tech bubble is very similar to the US dotcom bubble in 2000." The perceived importance of the technological companies has led to local governments in China handing out subsidies and "competing on how many unicorns they have" in Xie's words. Perhaps unsurprisingly, according to industry data provider Pitchbook, a startup in China reaches unicorn status about 18 months quicker than its U.S. equivalent on average.

But life is looking tougher for the tech companies. Regulation in Europe and potentially the U.S. will act as a constraint and some are even talking about breaking up the tech giants. At the same time, geopolitics has become increasingly important in the tech sector as governments are starting to form their own national strategies in areas such as Artificial Intelligence, autonomous cars, the Internet of Things, and 5G networks. China made this particularly explicit when it issued its *Made in China 2025* plan, which aims to shift China's economy into advanced manufacturing sectors, including robotics, aerospace, electric vehicles and pharmaceuticals (there was also a separate development strategy for Artificial Intelligence, published in 2017 in which China planned to become the primary innovation centre for AI by 2030). This was seen as a direct threat to American supremacy and national security by some hawks in the Trump administration, and particularly the U.S. Trade Representative Robert Lighthizer, who told a Senate committee in March that "these are things that if China dominates the world, it's bad for America."

These national strategies tend to see other countries as competitors and are now making it more difficult for companies to make cross-border investments, especially Chinese companies into the U.S. and vice versa. Recently, Donald Trump signed into law the Foreign Investment Risk Review Modernization Act (FIRRMA), which expands the power of the Committee on Foreign Investment in the United States (CFIUS) to further scrutinize foreign investment into critical technology companies where there are national security implications. Before FIRRMA, CFIUS reviewed foreign investments when they resulted in foreign control of a U.S. entity, but minority investments have been essentially outside its scope. At the same time in Europe, which has been more welcoming to Chinese investment in the past, the rules have also been tightening and there is a proposed EU-wide investment screening mechanism, which would allow for greater scrutiny of foreign investment. Earlier this month, the German Government vetoed the sale of machine tool manufacturer Leifeld Metal Spinning to China's Yantai Taihai Corporation on security grounds; in July, the proposed takeover of British aircraft component maker Northern Aerospace by a Chinese rival Gardner Aerospace also collapsed, after the U.K. Ministry of Defence flagged up national security concerns.

The irony is that the tech sector has traditionally regarded itself as internationalist – companies saw themselves as hiring the best from anywhere in the world and investing into the most promising technologies wherever they were. The sector's supply chains have also been deeply international, as is best illustrated by Apple, which assembles iPhones in China, using components from Taiwan and Korea, to American specifications and designs.

Instead, the tech sector is now suffering a kind of balkanization, which is particularly problematic for Chinese investors. As we have noted, they have been essentially cut out of the U.S. market, while also facing a bubble in valuations in China itself. Even Europe is becoming less hospitable. What is the answer for Chinese investors? One solution would be for them to focus more on regional investments, in Korea and Southeast Asia for example. Even here there are difficulties – China was Korea's biggest customer but is now becoming its most serious competitor – but these are manageable and there is still complementarity between the two economies. Korean companies can also still gain from investing into some of the technological development in China. Some areas of Southern Europe – for example, Greece, Portugal and Spain – are also still more open to Chinese investment, but unfortunately do not always boast the most sophisticated tech sectors. Israel has an advanced infrastructure for tech startups but remains small by global standards.

Overall, M&A has got a lot harder and there are more factors to consider. Companies need a greater understanding of the geopolitical considerations that are underpinning the shifts in the tech sector and they need to understand how to present their investments and acquisitions in a way that promotes the benefits to national or local governments and provides safeguards against the potential perceived risks. This means that assessments of any given target company need to become more multi-dimensional and investors need to have a more granular understanding of how that technology will fit into different national infrastructures and policies, not just now but also in the future. What role does the technology have for the government of the country in which it was developed, and what role do the individuals involved in developing that technology have within government institutions and strategies? The argument around cross-border tech investment has often got bogged down in just a debate about increasingly strict CFIUS oversight. Of course – as outlined above – this is an important element but it is symptomatic of a wider shift that has to be acknowledged and dealt with by investors and companies within this crucial sector of the economy.

Historically the tech sector has tried to see itself as above politics. In some sense, Google's old motto "Don't be evil" was the exemplar of that. It is noteworthy that "Don't be evil" was downplayed in 2016 as Google Ideas was relaunched as Jigsaw with a mission to "tackle the toughest geopolitical challenges", led by John Cohen, a former member of the US State Department's Policy Planning Staff, serving under Condoleezza Rice and Hillary Clinton. (Ironically, just as the gulf between Chinese and American tech firms widens, Google itself has been considering re-entering China.) In reality, politics and national security issues have always been the bedfellows of tech companies; after all, the internet started as a military communication network. And, in a world where even soybeans can become politicised it's hardly surprising that the companies that will dominate the economy of the 21<sup>st</sup> century are central to geopolitics.

Despite the bubble valuations and the somewhat desperate claims of some companies to be in the tech sector, it seems likely that in the medium to long-term the sector will continue to outpace all others in its growth. Indeed, even talking about a "tech sector" as opposed to other areas of activity will in itself ultimately be misleading as all areas of commercial activity will be moulded by changing technology (even if they define themselves in opposition to it, as we see in the rising popularity of artisan and handmade goods and foods). Companies and investors should therefore become more engaged in understanding the geopolitical currents which are pushing them in various directions. Whatever happens with the U.S. – China trade war, these issues are here for the long term.

# About Argo Associates

Argo Associates is structured around a single overriding purpose: providing our clients with the information and intelligence that will allow them to navigate acquisitions, investments, disputes, or frauds in a clear-sighted and rational way, minimizing risk and maximizing opportunities.

Information gathered may clarify the profile and background of key business people and managers; it could illuminate the operations of a company or demonstrate a history of fraud or mismanagement; or it could help our clients to assess the political situation in a given jurisdiction and how it may affect their investments or business operations.

Headquartered in Hong Kong, Argo Associates assists clients across Asia and – through international partners – globally.

## Intelligence Gathering

“Intelligence” is central to making sense of the world and to decision-making. Argo Associates has developed a network of well-placed human sources across Asia and – through our partners outside Asia – globally. This network provides insights beyond what is available publicly – into leadership, operations, strategy, corruption, red flags, political connections and so on - and is supplemented by extensive research and analysis of publicly available sources – corporate filings, litigation filings, regulatory communications, media articles, social media postings and so on. In a world in which information is increasingly commoditized, high-level intelligence and analysis provides the insights that give our clients an edge over their competitors.

## Fraud, Corruption and Disputes

Our intelligence-gathering techniques and in-depth research and analysis have also helped our clients uncover frauds within their operations or in those of a portfolio company or recent acquisition. Our professionals have provided numerous reports for arbitration or legal proceedings to recover the proceeds of fraud. We have also assisted clients in tracing assets globally when bringing a high-value claim against a company or individual. In high-profile disputes we have assisted a number of top law firms in gathering information, evidence and intelligence in support of their clients’ cases.

## Political Risk

Our political risk work has developed naturally out of our intelligence and investigative capabilities. We see political risk as an important part of the evaluation of many investments, mergers and acquisitions, as well as a key element of commercial disputes in many markets. We have helped our clients look at political risk in a new way, not just in terms of the broad outline of potential political developments in various countries, but with a focus on the impact on their businesses. For example, will growing frictions between two countries lead to tariffs that could impact the specific sector in which a portfolio company operates? Or, how will rising protectionism in a country alter the possibility of a fair result in an ongoing commercial dispute? Frequently, politics is local as much as national and we understand the importance of drilling beneath the widely-circulated opinions to a real understanding of what is happening.





## Our Founder – Jason Wright, Managing Director of Argo Associates

Prior to founding Argo, Jason was a Managing Director in Hong Kong for Kroll, the company that created the modern investigations and intelligence sector. Before moving to Asia seven years ago he worked for Kroll in Italy for five years and then briefly in London.

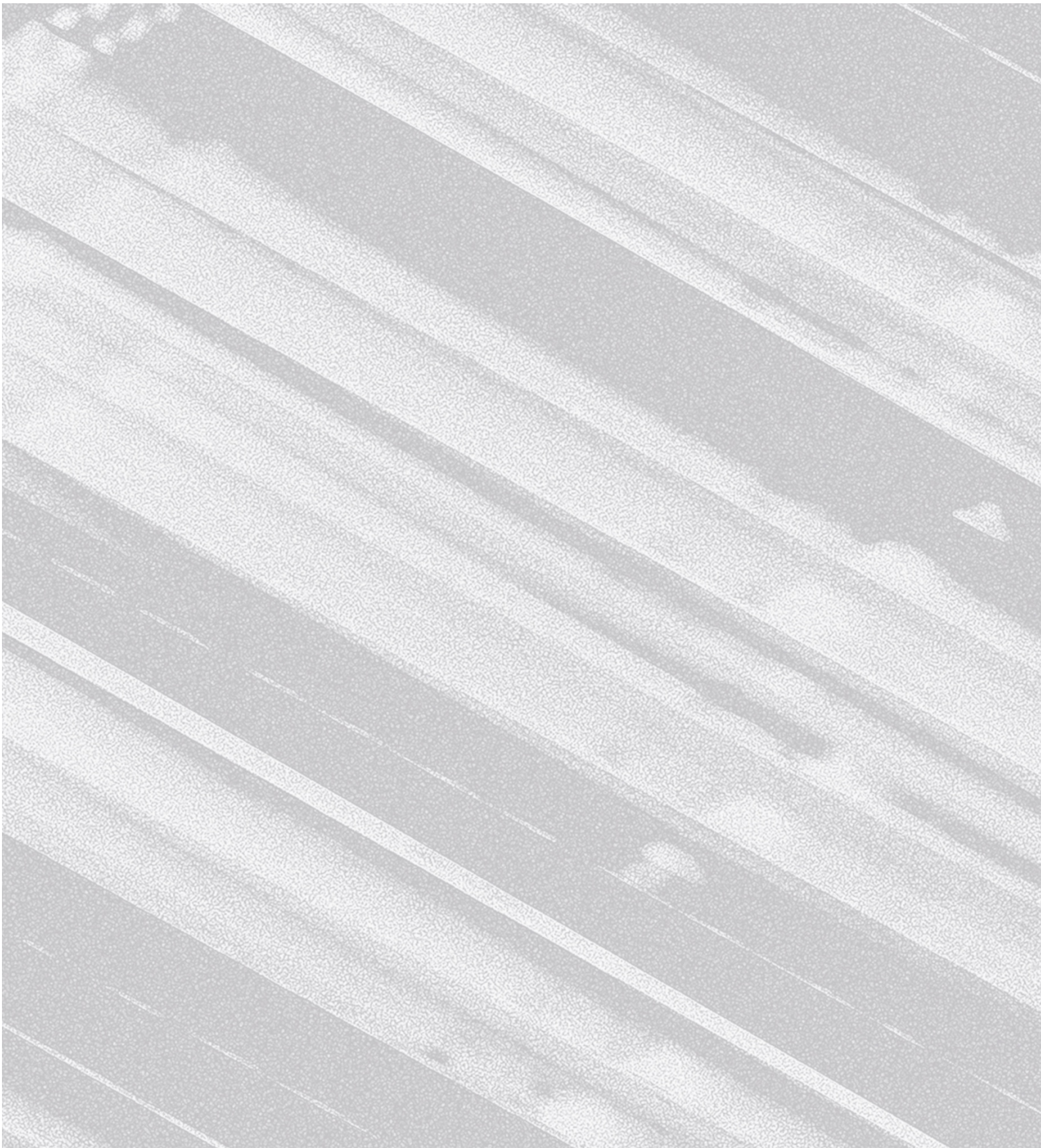
While assisting clients on numerous transactions, investigations and disputes in Asia and Europe, particularly for private equity funds, banks, hedge funds and special situations investors, Jason has also specialized in the analysis of political risk, whether that has involved examining the role of local politicians, regulators and other stakeholders, or broader geopolitical concerns.

Although he has managed projects across the whole Asia-Pacific region he has been particularly focused on Korea, China, and Southeast Asia, especially Indonesia, Vietnam, Malaysia and Thailand.

Jason is a scholar of St. Catherine's College, Oxford, having been awarded a Master of Arts (Oxon) in English Language and Literature, as well as a Master in State Management and Humanitarian Studies from La Sapienza University in Rome, Italy.



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