

Multiple Perspectives. One Approach.SM

The new breed of global companies is creative, nimble and networked

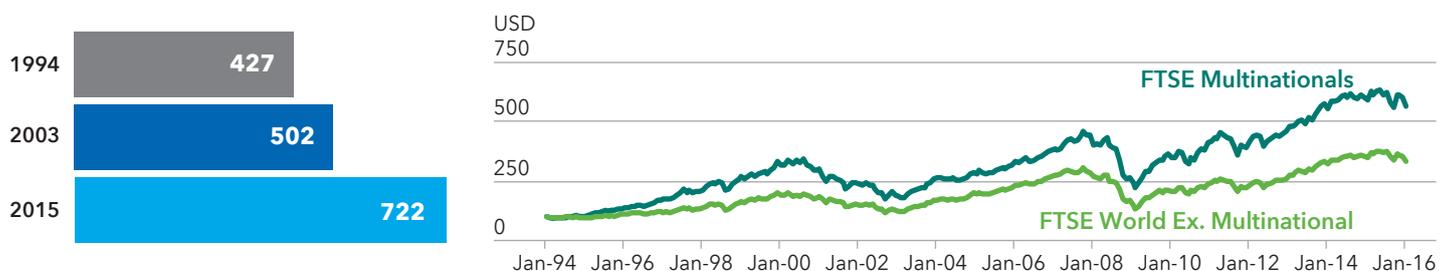
- There's been a shift in the makeup of global companies over the past decade to idea-driven companies
- Speed of product adoption is much faster, but competition is greater
- Marketing muscle and global distribution networks are crucial

The face of global business is rapidly changing. Sure, ExxonMobil, Coca-Cola and McDonald's are still giants. But a host of new global companies is rapidly emerging. Many of these are idea companies – think Google or Facebook – or firms with a unique solution to a global problem, such as diabetes or cancer. Often called multi-nationals, these companies play a vital role in the global economy. They account for 80% of trade, 75% of private sector research and development (R&D), and 40% of productivity growth worldwide.¹

Moreover, huge strides in technology, near-instantaneous communication and changing demographic patterns are creating paradigm shifts in the speed at which companies become global, how they do business and how they organise themselves. Product innovation and design are no longer solely the purview of firms headquartered in the US and Europe. R&D centres are being established in places like Bangalore and São Paulo. Marketing budgets for China or India can be larger than for Italy or Spain. New global giants have come out of Asia. As the investment universe evolves, so does our approach and how we cover these companies and invest in them.

Global companies expand their role in financial markets

Companies represented in the FTSE Multinationals Index have grown in number and have outpaced the broader market.



Sources: Capital Group, Datastream

As of 31 January 2016. Total returns indexed to 100 as of 31 January 1994.
Source: Datastream

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For technology companies, “the barriers to entry are lower because there are no distribution costs. The smartphone or tablet is the distribution mechanism.”

– Rob Lovelace

Portfolio manager

Technology is a game changer for global business

Technology has been a game changer. Product adoption is swift and the pace is quickening. It took four years for Apple’s iPod to amass 50 million users. Facebook hit 50 million users in one year, while Twitter reached 50 million users in nine months.

A major advantage for many technology companies is limited distribution costs. “The barriers to entry are lower because there are no distribution costs,” says portfolio manager Rob Lovelace. “The smartphone or tablet is the distribution mechanism.”

It’s no wonder that the composition of the world’s most valuable companies by market capitalisation has changed over the past 15 years. Amazon, Google’s parent Alphabet, and Apple weren’t listed among the top 20 companies in the MSCI ACWI (All Country World Index) in 2000. Until then, oil, mining and some consumer companies dominated the index.

Those companies are still a large part of the global investment landscape, but increasingly, the more idea-driven companies in the technology and healthcare sectors are showing greater profit margins.

“Profits are increasingly shifting from heavy industry to idea-intensive sectors that revolve around R&D, brands, software and algorithms. Sectors such as pharmaceuticals, media, finance and information technology have the highest margins. They are developing a winner-take-all dynamic, with a wide gap between the most profitable firms and everyone else,” said McKinsey in a report.¹

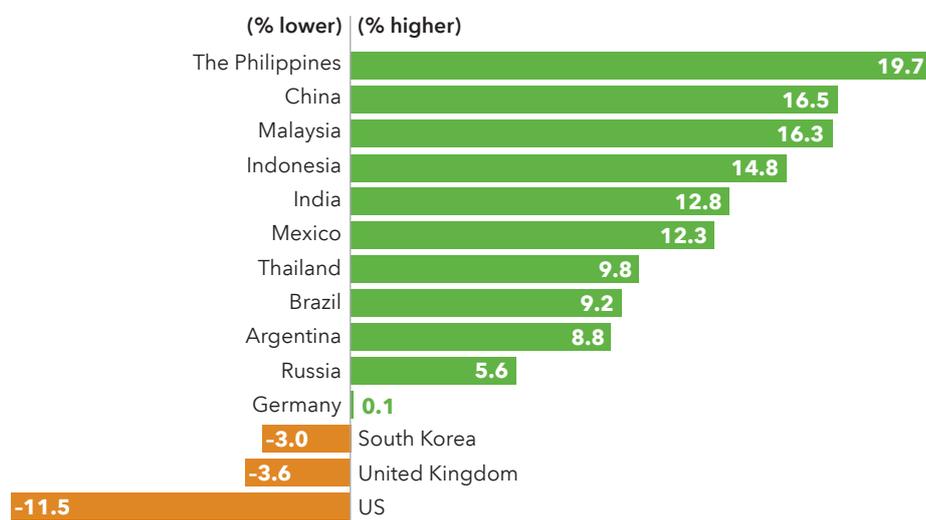
Consumers value the quality of the services the leading companies provide. That high-quality experience is what makes Google essentially the world’s search engine and Facebook the chatting and sharing platform for 1.6 billion people.

But what comes easy can go easy. “That’s why these technology companies are so focused on quality and invest so much money on the consumer experience. If they don’t, another company comes up with a better idea that threatens their viability and their very existence,” says Rob. “They have moats, but the moats can be shallow. Will Google and Facebook be the same companies in 10 years? Maybe, but I am not 100% certain. I am more certain that Amazon will be around, mostly because of the distribution network it has built in the US and, increasingly, around the world.”

Young people earn more in emerging markets

In many emerging markets, young workers earn more than the national average, which can influence purchasing patterns.

2015 average gross income of 25- to 29-year olds versus national average



Source: Euromonitor International 2016

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“These firms are multinational leaders in their respective industries, with strong balance sheets. They are also battle tested.”

– Jody Jonsson
Portfolio manager

Global companies have long runways for the right products

Technology's impact over the past 10 to 15 years has been profound in many ways. Cheaper and instant communications have allowed global tastes to converge. Enterprise software solutions, cloud computing and digitisation of manufacturing platforms are enabling firms to innovate new products and solutions in multiple locations, with faster speed to market. It is also allowing companies in less-developed markets to be competitive as upfront fixed costs become less important.

By building powerful digital platforms and networks, the biggest technology and tech-enabled giants have reached never-before-seen scale in users, customers, revenue and profits. These platforms can drive marginal costs to almost zero, enabling technology and tech-enabled firms to make rapid moves into new sectors.¹

“Today, if you have a good product, the world is your runway,” says portfolio manager Gerald Du Manoir. “For many products, you don’t need to tailor them very much. Whether I buy an iPhone 6 in Shanghai or São Paulo, it’s the same. And a BMW 7 Series is the same 7 Series in Moscow or New York.”

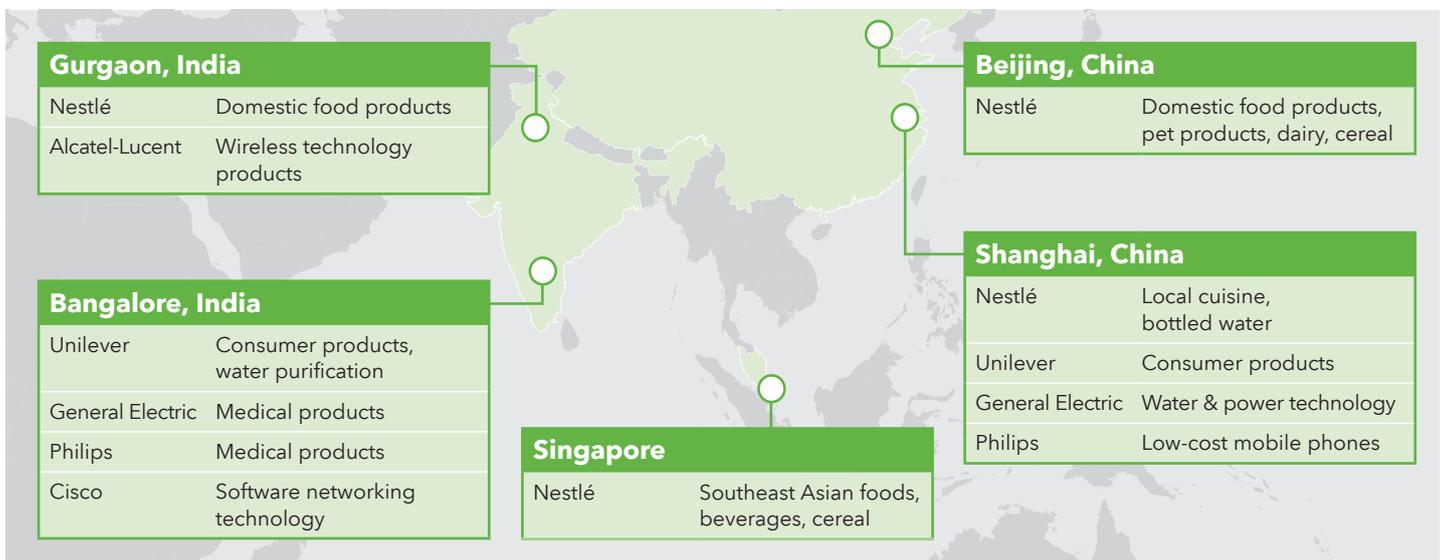
That convergence in demand is allowing for greater economies of scale in many ways. “It’s fascinating to me that Nissan and Renault actually share the same platform for this new car model. It is not just within a company, it is among companies. Globalisation is happening not just across consumption, but across production,” says Gerald.

Almost by definition then, companies that become global are among the best. Portfolio manager Jody Jonsson calls these companies “global champions.” She says these firms are multinational leaders in their respective industries, with strong balance sheets. They are also battle tested. A study published in *Harvard Business Review* found that many of these companies are better equipped to deal with economic and financial shocks than their smaller domestic counterparts. “Being part of a larger multinational network, on average, was associated with superior economic performance during the [financial] crisis,” the report said.²

Jody cites e-commerce pioneer Amazon as an example of a global champion. “We’ve tried to avoid many companies that would have to compete with Amazon on either the retail or the technology front. Being Amazon-proof is something we look for in a lot of the businesses we cover,” she adds.

Ramping up innovation in emerging markets

Multinational companies have established R&D centres in Asia to be closer to consumers.



Sources: Capital Group, company reports

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“It is the capability to create global brands and put massive marketing budgets behind them that is the competitive advantage of global companies.”

– Georgios Damtsas
Equity investment analyst

The power of deep global distribution networks

The dynamics that drive companies to become global leaders can vary by industry. One of the most effective defences companies can build are distribution networks. It has been a hallmark of the longest surviving global companies such as Coca-Cola, which counts its fleet of trucks and relationships with retailers and bottlers worldwide among its distribution assets.

In much the same way, brewing companies have become global powerhouses through a series of acquisitions or joint ventures that extend their control of global distribution networks. The latest significant merger involves Anheuser-Busch InBev and SABMiller, which sell roughly 30% of the world’s beer, including brands like Budweiser and Stella Artois.

“Once you have the distribution networks, there are huge economies of scale to branding and marketing,” says equity investment analyst Georgios Damtsas. “It is the capability to create global brands and put massive marketing budgets behind them that is the competitive advantage of global companies.”

It is no surprise then that large pharmaceutical companies are following in the steps of consumer companies. Drugmakers are concentrating on treating certain diseases like cancer or Alzheimer’s as the practice of medicine has become increasingly specialised.

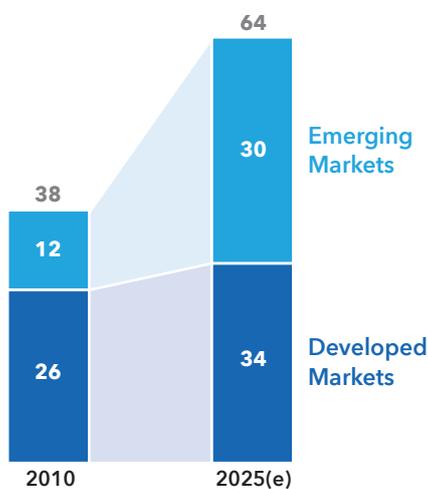
“They’re specialising in certain diseases so they can build a distribution network of doctors from around the world who know that disease,” says Rob. “There are parts of drug distribution that are very old school. The sales force is knocking on doors, establishing relationships and building trust. That is what the big drugmakers own. They all know that to be a strong and durable company over time they have to control distribution and specialise in it.”

Increasingly, big pharmaceutical companies are using their cash hoards to acquire smaller firms instead of putting more money into researching new drugs. Mergers-and-acquisitions activity in the healthcare sector was robust in 2015, with US\$724 billion in announced deals.

“Scientists work better in small setups. So the big companies buy the innovation,” says healthcare analyst Eu-Gen Cheah. In the process, they are strengthening their grip over their distribution network.

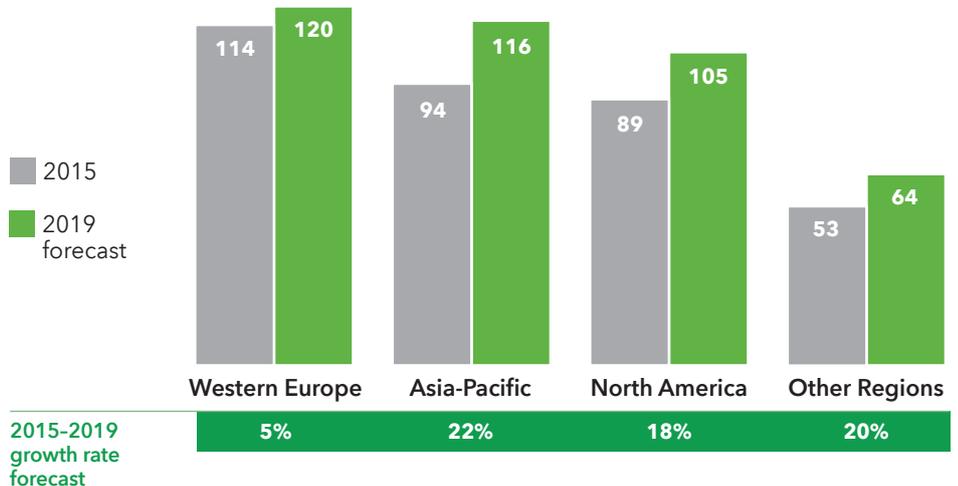
Consumption is rising in emerging markets

World consumption, USD trillions



Luxury goods market

Retail value (in constant 2014 dollars)
USD billions



Source: McKinsey & Company³

Source: Statista

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Developing economies provide springboard for innovation

Developing economies are becoming a formidable force – no longer just satellite markets, they are central drivers of growth for many global companies. The global consumer base has increased to roughly 3 billion people today from 1 billion in 1980. Emerging market consumers have fuelled and reshaped demand, with younger consumers in some countries earning more than their parents.

Emerging market consumption is estimated to reach US\$30 trillion in 10 years – or roughly half of all global spending. Traditional measures such as GDP growth or per capita GDP are no longer reliable indicators of a company's expansion prospects. Company-by-company fundamental research is essential.

"It used to be that, as an economy grew, consumers' needs and desires grew in line with per capita gross domestic product. Now, whether the aggregate per capita GDP is \$5,000 or \$30,000, aspirations and needs are growing independently," says Gerald. "If a global company has a product or solution that is ubiquitous, it will appeal to consumers in many different markets. A company's ability to deploy that product in a number of markets is what we are looking for."

To thrive, global companies must understand consumers in emerging economies and how to develop and market brands in those countries. Nestlé and Unilever, two of the most successful global consumer product companies, have some brands that are global – including Nestlé's Nespresso and Unilever's Knorr – while others are made to serve just local markets. They also use global and local supply chains.

In addition, multinationals have found success developing products in emerging markets. Unilever's Pureit water purifier was developed in India before being sold in Brazil, Mexico, Indonesia and Nigeria. Unilever also created a Knorr-branded bouillon jelly in China that became popular around the world.

In emerging markets, homegrown companies have become more competitive, especially on price. They can survive on thinner margins and are taking share at lower points, says Georgios.

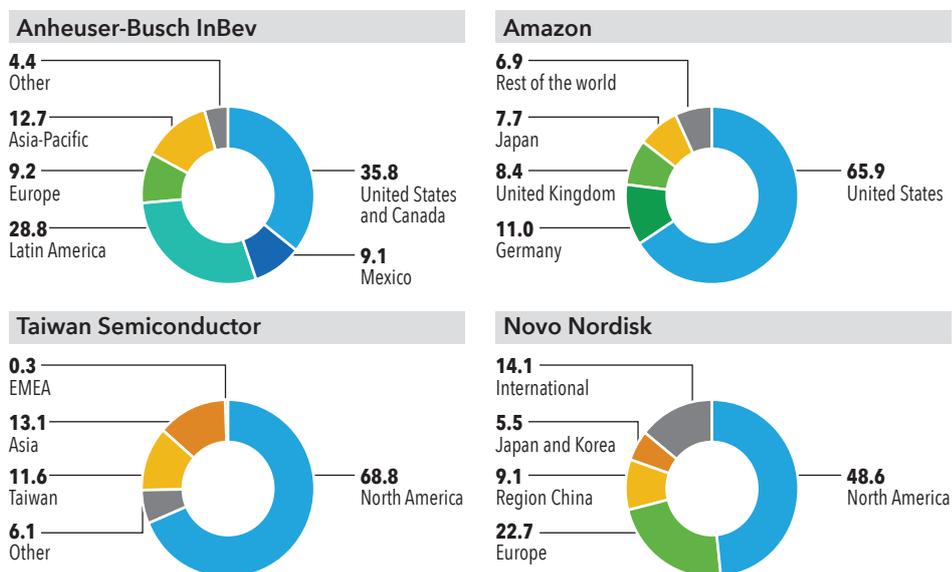
"Local companies will be there to exploit niches. Multinationals need to be in the local markets to develop products," says Georgios. "They can't afford to increase R&D in the US and Europe and think they will be fine and be able to export those products."

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– Gerald Du Manoir
Portfolio manager

Global companies scour the world for customers

Revenue (%) by region



Sources: Capital Group, company reports

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Emerging markets spawn global firms in many industries

In just the past decade, we've seen global companies change in scope and competitive dynamics shift as rapid advancements in technology and growth in emerging markets have challenged the old ways of doing business.

Huawei Technologies, another Chinese company, has grown to become the world's largest telecom equipment maker and the third-largest maker of smartphones behind Apple and Samsung.

According to Boston Consulting Group, the number of companies with more than US\$1 billion in annual revenue increased sixfold from 2003 to 2013 to more than 1,000 in Asia, and almost doubled in Latin America, Africa and the Middle East, to more than 700.

For research analysts, it means that they must cover global companies alongside local companies that are becoming stronger competitors. Georgios, who covers European multinationals Unilever and Nestlé as well as Indian consumer companies such as ITC, says the dynamics of fundamental research also change. "As one example, you cannot just look at organic growth. That's OK in an era of low FX volatility. But in today's world, when currencies are so volatile, it can be misleading.

"For companies that have a large exposure to emerging markets, a large part of the topline growth is actually pricing, which can often be the inflation in emerging markets. That inflation is not free, because it generally comes out on the bottom line as devaluation of the foreign currency. So you have to be careful with the growth projections and have to build the currency dynamically into the models."

Finding inspiration in India

When it comes to innovation, companies are setting up shop in India, often cited for its lower operating costs and talented skill pool. Here are some products conceived there in recent years.

| Company | Products |
|------------------|---|
| Unilever | Pureit home water purifier |
| | Fair & Lovely cream |
| General Electric | Vscan Ultrasound device |
| | Lullaby Warmer for newborn babies |
| Philips | MobileDiagnost Opto digital X-ray machine |
| | Goldway video colposcope |
| Cisco Systems | ASR 920-O (low power consumption router) |
| | ASR 901 router (mobile phone site router) |
| Panasonic | CUBE air conditioner |
| | Solar LED lights |

Cincinnati-based Procter & Gamble (P&G) – home to Tide detergent, Pampers diapers and Gillette shaving products – struggled with price points and a more-centralised operation than its rivals. Faced with sluggish sales growth, P&G divested brands around the world to boost profitability.

Not identifying regional trends can be costly. Nokia, which once dominated India's mobile phone market, saw its market share decline after local upstarts rolled out phones featuring two SIM cards.

"Companies have to be multinational in their thinking and approach at all levels – the board, senior and middle management, and the field," says portfolio manager Nick Grace. "That's what we look for when talking to companies."

Some companies in emerging markets are becoming big players on the global stage. Tencent, China's biggest social networking and online gaming company, is one of the world's most valuable Internet businesses. It recently began expanding overseas and generates 7% of its annual revenue outside of China.

Global companies evolve

This new era for global business has changed how companies structure themselves and how they approach consumers. Technology is accelerating product adoption, GDP growth and consumer needs are no longer closely tied, and companies in newer economies have the tools to be fierce global competitors.

¹ Dobbs, Richards; Koller, Tim; Ramaswamy, Sree; Woetsel, Jonathan; Manyika, James; Krishnan, Rohit; Andreula, Nicolo. "Playing To Win: The New Global Competition for Corporate Profits." McKinsey & Company. September 2015. <http://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/the-new-global-competition-for-corporate-profits>.

² Alfaroy, Laura; Chenz Maggie. "Surviving the Global Financial Crisis: Foreign Direct Investment and Establishment Performance." Harvard Business Review. June 2010.

³ Adapted from "Winning the \$30 Trillion Decathlon: Going for Gold in Emerging Markets." McKinsey & Company. November 2012.

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