# Pottinger
PERSPECTIVES

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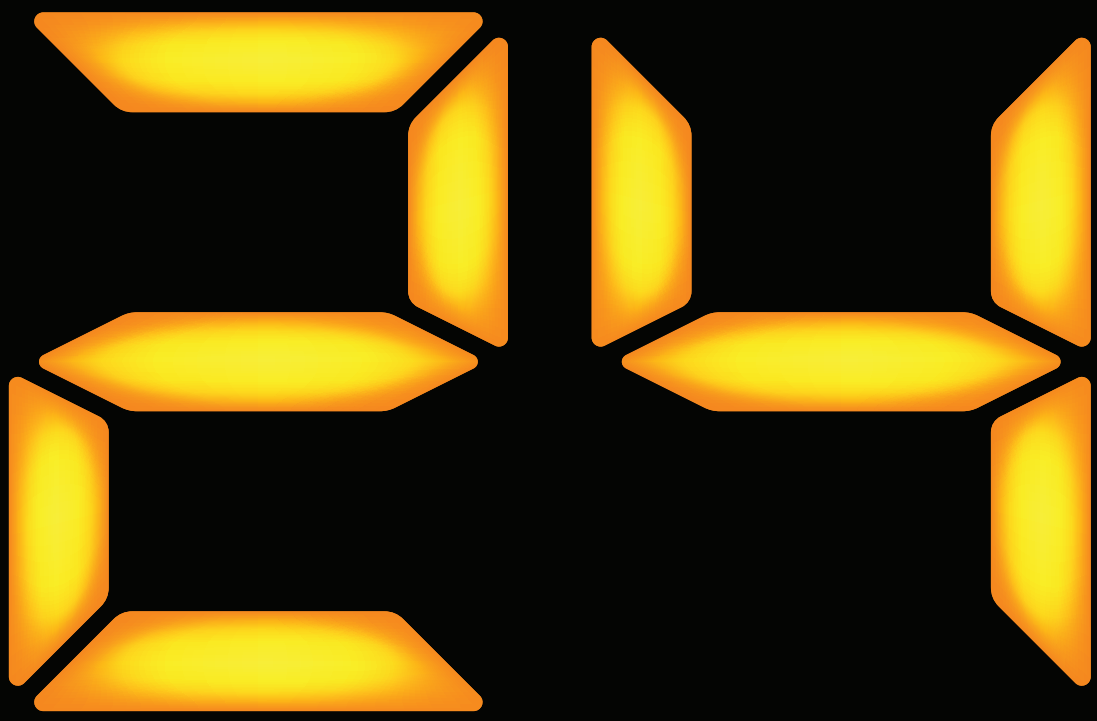


# THE TIME IS NOW

Australia | China | India | Japan | Middle East
New Zealand | South Africa | Spain | UK | United States

Once again the world stands at the brink of economic disaster. Just ten years after the first signs of the financial crisis emerged, similar warnings are etched across financial markets. The cost of debt remains at record levels – even lower than seen in 2006. Indeed the Bank of England's chief economist recently flagged that rates had reached a 5,000 year low.

The cost of equity appears cheaper than ever too, with major markets having achieved long term highs over the last twelve months. The FTSE 100 has passed its peaks of December 1999 and mid 2007. Nasdaq floated briefly above its previous all time high (March 2000). Both the NYSE composite index and Nikkei index have achieved similar markers (although of course the Japanese market remains over 60% lower than it's all time high achieved nearly 25 years ago).

In the West, the US and UK economies may have returned to solid economic growth, but the longer term trends remain downward. Meanwhile Germany has briefly achieved growth not seen since 1990, and down under Australia has continued its unbroken run of 24 years without recession, not withstanding a clear slowdown in China. For many other countries however, the outlook appears much bleaker, particularly for younger members of society.

Looking East, many are fearful of the implications of declining Chinese growth. Looking West, many struggle to see how the existing challenge of mountainous national debt, increasing healthcare costs and crumbling infrastructure can ever be overcome. So, despite the obvious positives of cheap capital, it is unsurprising that many corporate and political leaders remain anxious about the outlook.

But is this a realistic view of the world?

**Back to the (Asian) future**

Twelve months ago, Asia was the strategic buzzword on nearly everyone's lips. In North America in particular, there was excitement about the prospects of long term, systemic wealth creation in the region, driven by huge populations, and the twin wealth creators of industrialisation and urbanisation.

In truth, nothing fundamental has changed over the last year. Chinese growth may have slowed, and forecasts of Chinese growth may have been wound back. But the underlying demographics remain the same. Asia is home to three billion people, and this total will continue to rise in an entirely predictable fashion over the coming decades. The large majority of people who will be alive in 2050 have already been born. There is demographic certainty.

Similarly, the wealth effects are inescapable. Education levels will continue to improve, economies will continue to industrialise and urbanise, and birth rates will slowly decline. The rise of the Eastern economies is a mathematical certainty over the long term.

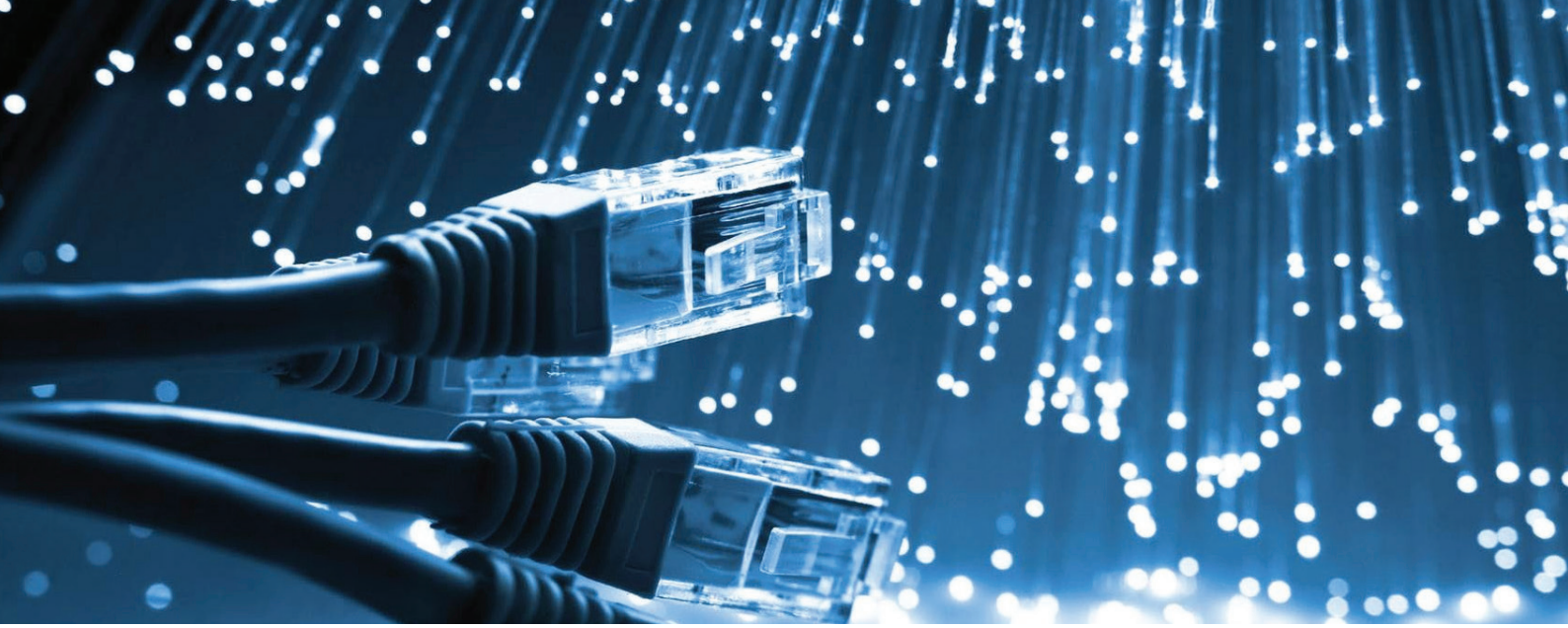
All this highlights three failings that beset the decision-making processes of so many companies and so many governments, as they struggle to escape the never-ending clamour for immediate results.

First and foremost, it is easy to forget that the long term is enormously more predictable than the short term. Some may find this observation obvious, and yet the implication is ignored all too often, and short term needs are prioritised over long term essentials. Thus Asia continues to offer significant opportunities – and the competition for them is lower now than for some time.

Similarly, last month, Australia reached a population of 24 million people. This is a trivial number of people compared to the populations of USA, China or Japan, but nevertheless this growth has placed enormous strain on the nation's economy. Why so? Over 90% of the people live in a small number of highly urbanised centres. Few if any of these have ever been properly planned to support significant long term growth, as evidenced by a chronic obsession with low density living and roads for transport.

Worse, these cities are islands in a continent the size of North America, yet remain poorly connected. Despite centres not much smaller than Tokyo and Osaka were in the early 1960s, there is still no high speed rail network, which would shrink the nation dramatically. Indeed Sydney – Melbourne and Sydney – Brisbane are two of the world's top twenty air routes and cover distances making them well suited to high speed rail, yet most believe this would simply never work in Australia.

Australia may have reached 24 million



slightly faster than anticipated 25 years ago, but it was truly no surprise. The infrastructure challenges of growth are familiar around the world. So, if the long term is so highly predictable, then surely actions should be taken in the near term that prepare for those inevitable futures?

**Beware – the soupe du jour's been poisoned**

Second, although the long term is highly predictable, both businesses and governments often adopt a wait and see attitude, rather than acting early to get ahead of long term changes. Frequently this turns into the death of a thousand cuts that has been the soupe du jour of a number of industries, as they struggle to adapt to new competition, declining profitability, and changing customer demand. Of course few CEOs last long enough to see the full horrors of such decisions.

The energy revolution unfolding around the world is a perfect example of this. Traditional electricity companies, generators and coal miners appear to have been caught dramatically off guard by a collapse in the world coal price. Some have seen their share prices literally decimated, as demand for coal has softened and investors have recognised that the outlook for the industry is bleak.

But this change is not an overnight phenomenon. The cost of solar energy has fallen consistently for the last five decades. Plotted on a log scale, the line is almost straight. Of course, once upon a time the cost of solar PV was extremely high compared to coal. But these cost efficiency Moore's Law jaws of death have continued inexorably, and are now chomping down on the ever-increasing costs of power from fossil fuels.

Similar pain has been felt in the media industry. Print editions of newspapers continue to be shut down, as the inevitable shift online continues. Management cut back on experienced editorial staff, in favour of lower cost copy writers who are adept at creating click-bait headings for their articles, to attempt to keep the remaining business afloat. Pay walls are erected, and major titles expect consumers to pay at least US$200 to US$250 a year to access their content (twice the price of Netflix!), much of which is reducing in quality as pressure on journalists continues to increase. Time and again, this has turned out to be a losing strategy. It's a new game, with different rules, and so unsurprisingly a different mindset and new strategy and tactics are needed.

Again, this is nothing new – news commenced its transition online over twenty years ago, but few media companies have been able to reinvent themselves quickly enough. At the simplest level, think about how slowly traditional print media companies have moved to translate their products into audio and video content.

**A titanic navigational failure**

Third, for all the talk in boardrooms and management consulting briefs about the pace, inevitability and complexity of change, the love for the status quo remains ardent.

In 1980, AT&T commissioned McKinsey to forecast cell phone penetration in the US by 2000. The consultants predicted that 900,000 subscribers would be achieved, somewhat less than the actual figure of 109 million. Errors of the same magnitude are still made today – often as a result of ignoring clear evidence of ongoing reductions in cost and implications for increased demand.

Ten years ago, Australia embarked on a program to construct a national fibre network, to provide the large majority of households with access to fibre internet connections. Immediately swept up in political hubris and hysteria, debate around the so-called National Broadband Network or NBN has been mired in short-termism and plain ignorance. Yet day by day, month by month, consumer demand for data transfer both to and from their homes continues to increase, and in a few short years is already well beyond levels that opponents said would never be reached.

I'll leave the detail of all this for now, but the fundamental point is this. Faced with such apparently difficult, long term choices, too many boards and ministers hold on to what they know best. They stick with the devil they know, even when it comes to advice on how best to deal with all the change. The voices of vested interests are, understandably, much better represented in the relevant circles, and their voices are easy to hear. In contrast, the smart money goes out of its way to listen to those who don't own a place at the top table.

And here's the rub. The fans of the status quo have an unerring ability to look the wrong way as the effects of change and innovation are felt. Like the captain of the Titanic that failed to see an enormous iceberg, the repercussions of short-sighted navigation can be fatal.

*The clock is ticking. Just like the TV-drama 24, an unerring focus on the end goal is critical, and those that fail to act run the risk of being swept up in the heavy collateral damage along the way.*

*For the world as a whole, current anxiety over the outlook for China seems misplaced, as underlying growth drivers remain strong. But deeper issues remain – the West is close to the limits of its ability to continue to pursue the giant 20th century ponzi scheme of borrowing from future generations to pay for life today.*

*Yet, as Western society once again creaks at its foundations, opportunities remain for those that have the vision to reach out and grasp them. If you think this all sounds too bold, you may be right. Trust in your rear view mirror, and ignore the tarmac unfolding in front of you at an ever greater pace. If you think it sounds exciting, but you're worried about how to navigate, give us a call. We have an amazing track record in making the right long term calls in uncertain times, and helping our clients to mitigate the risks of pursuing them.*

# Latest issue from Pottinger Perspectives:


The menu of the restaurant on the terrace of the iconic casino in downtown Monte Carlo is printed in French, English, Italian and Russian, in that order. Even with my rusty French, I can be certain what type of starch will come with my schnitzel, that definitively Monegasque dish. Our waitress, who is as bronzed as the sun-drenched yacht crews swilling around Port Hercules just across the bay, moves seamlessly between all four languages, behaviours and courtesies as she works the room.

http://www.pottinger.com/would-you-like-fries-with-your-foie-gras.html

## About Pottinger

Pottinger is a multiple award-winning strategic and financial advisory firm.

We de-risk M&A transactions and strategic transformations by integrating strategic insight, transaction expertise and data analytics, enabling leaders to make decisions that stand the test of time.

We work with clients who are ready to think differently and act differently. Our assignments typically relate to one or more of:

- Strategy and public policy
- Mergers and acquisitions
- Partnerships and joint ventures
- Restructuring and capital advice
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Together our team has advised on over 200 M&A and financing transactions, as well as many significant strategic advisory assignments. Our experience covers most of the world's larger economies, and we enjoy the complexity of assignments that extend across borders and cultures.

We are regarded as an industry leader in productivity and as a role model for investment in our people. We have been recognised by the Australian Government's Workforce and Productivity Agency as a benchmark for effective skills development and for seven consecutive years we have been awarded "Recommended Employer" by the Australian Business Awards.

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