Ten sources of growth

By

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For a company with revenue in the millions of euros, there are almost always new sources of growth available, provided it is willing to change its perspective on the market and redefine its business model. For a European group with revenue in the billions of euros, the issue is different. For such groups, it is difficult to find sources that can significantly impact the growth of the group outside of the sources that hold the key to growth for the decade.

Today, there are ten sources of growth for a large European group.

Emerging markets

Now, and for many years to come, emerging markets represent the most obvious and significant source of growth for Western groups who are already leaders in their Western markets. Emerging markets are growing at 8% in value[1], representing 38% of the current world economy, and are projected to represent 45% in 2020 and 50% in 2025. Currently, they already contribute to 55% of global growth. China, alone, represents 30% of this emerging economy.

In emerging countries, the infrastructure and capital goods industries have grown at 10% to 12% per year (this growth is not over, in spite of its inherent cycles). These countries are at the beginning of a growth cycle, which will last between fifteen and twenty years for most consumer goods markets. They will be followed, only with a short lag, by the development of all types of services.

Today, the middle class of these countries represents 43% of the middle class worldwide. It will represent 67% in 2020 and 73% in 2025 with a constantly increasing purchasing power. In ten years, they will have increased by 1,4 billion individuals. Historically, this will be the strongest large-scale development of middle classes in the world, much stronger than the development in the USA during the 50s and 60s, of that in Europe during the post-war economic boom and of that in Japan during the 70s and 80s. For mass consumer markets, as well as the manufacturing industries upstream to these markets, the future is Asia.

For example, the Chinese market is the largest market worldwide for new car purchases. This market is growing at 12% per year, while the European market is shrinking at 4% per year. China is also the world leader for mobile phones, small domestic appliances and diaper consumption. India is the largest market for razor blades and dairy products. Indonesia's mineral water market is twice the size of France's. Out of the top 50 companies worldwide[2], with the highest TSR[3], in the last ten years, 18 companies come from emerging markets (Tencent, Baidu, Cnooc, Petrochina, Reliance, Banco do Brazil, China Life Insurance, Vale, Tata Consulting, …) (cf table 1).

[1] Estimation of average future annual growth (2012-2018) by the IMF, in current currency.
[2] Market capitalization of more than 20 billion euros in 2012.
[3] TSR : Total Shareholder Return annual: profitability of an investment, for its shareholders, in terms of dividends, allocation of bonus shares, value of shares, …

- Table 1 -
World leaders by growth and value creation

	Country	TSR [1] 2002-2012	Growth [2] 2002-2012	Market Capitalization [14] 2012 (M€)	Sources of growth
Tencent	China	65% [5]	66%	73 948	Internet, digitalization, Emerging markets
Apple	US	54%	40% [5]	325 359	Disruptive innovation
Galaxy Entertainment [6]	Hong Kong	54%	45% [5]	22 675	Emerging markets, hotels and casinos
Priceline	US	52%	14%	37 489	Internet, digitalization
Baidu	China	48% [7]	100% [7]	39 877	Internet, digitalization, Emerging markets
Salesforce	US	33% [7]	46%	21 893	Outsourcing B to B services
Sberbank	Russia	33%	19%	51 741	Emerging markets, general banking service
Jardine Strategic [8]	Hong Kong	32%	22%	28 437	Emerging markets, holding
ITC	India	32%	13%	32 231	Emerging markets, retail and food
Precision Castparts	US	32%	12%	24 627	Emerging markets, aeronautic
Celgene	US	31%	40%	44 457	Health, Ageing population
Google	US	30% [9]	56%	209 900	Internet, digitalization
Banco Do Brasil	Brazil	30%	13%	25 716	Emerging markets, banking
Amazon	US	29%	28%	100 285	Internet, digitalization
Reliance Industries	India	29%	19%	33 673	Emerging markets, petrochemicals
Cnooc	China	28%	25%	67 125	Energy and raw materials
AmBev [10]	Brazil	28%	17%	89 192	Emerging markets, beer
Monsanto	US	27%	9%	40 630	Disruptive innovation
Petrochina	China	27%	24%	171 321	Energy and raw materials
Novo Nordisk	Denmark	27%	12%	67 172	Ageing population, diabetes treatment
Bradesco	Brazil	26%	8%	47 779	Emerging markets, private bank
China Petroleum	China	25%	23%	63 821	Energy and raw materials
Express Scripts	US	25%	19%	36 884	Ageing population
Discovery Communications	US	24% [11]	10% [12]	20 716	Digitalization
Gilead Sciences	US	24%	31%	66 353	Disruptive innovation (HIV treatment)
BHP Billiton	UK	24%	13%	121 338	Energy and raw materials
Sabmiller	UK	24%	10%	56 161	Portefeuille Emerging markets, beer
China Life Insurance	China	23% [5]	17%	49 835	Emerging markets, insurance
Ping An Insurance	China	23% [5]	19%	38 583	Emerging markets, insurance
Vale	Brazil	22%	21%	58 997	Energy and raw materials
Softbank	Japan	22%	25%	63 849	Exclusive Apple distributor in Japan
Itau Unibanco	Brazil	21%	16%	52 504	Emerging markets, private bank
Oil & Natural Gas	India	21%	12%	28 228	Energy and raw materials
China Mobile	Hong Kong	21%	15%	160 269	Internet, digitalization
Occidental Petroleum	US	21%	9%	55 722	Energy and raw materials
National Oilwell Varco	US	21%	25%	24 471	Energy and raw materials
EOG Resources	US	20%	22%	34 390	Energy and raw materials
Blackrock	US	20%	28%	33 394	Fund management, ageing population
China Minsheng	China	20%	38%	31 080	Emerging markets, Credit bank
Richemont	Switzerland	20%	11% [13]	41 671	Luxury and premium
Tata Consulting	India	20%	23%	51 867	Outsourcing B to B services
Fast Retailing	Japan	20%	15% [5]	27 566	Fast fashion
Hermes	France	19%	11%	27 334	Luxury
Inditex	Spain	19%	15%	70 131	Low cost, innovation
ABInBev	Belgium	19%	18%	113 699	Emerging markets portfolio, beer
Freeport McMoRan	US	19% [5]	21%	25 116	Energy and raw materials
Starbucks	US	19%	12%	41 621	Cafés
Samsung	South Korea	18%	11% [5]	144 538	Innovation
Caterpillar	US	17%	9%	39 809	Emerging markets portfolio
Christian Dior	France	17%	9%	26 000	Luxury

Note : Companies listed in USA, Western Europe, Japan, South Korea, Brazil, China, Hong Kong, India and Russia, of more than 20 Md€ of market capitalisation in 2013 ; (1) TSR : Total Shareholder Return annual (capital gains or losses, dividends, bonus shares distributed); (2) Average annual revenue growth; (4) 2007-2012 ; (5) 2003-2012 ; (6) hotels and casinos in Macao ; (7) 2004-2012 ; (8) Holding companies in the construction, transport, insurance, distribution, food & beverage and agri-food sectors; (9) Real TSR from 2004-2012 and estimated from 2002-2004 ; (10) Subsidiary of ABInBev ; (11) 2005-2012 ; (12) 2008-2012 ; (13) 2005-2012 ; (14) Market capitalization
Sources : Bloomberg, analysis and estimations Estin & Co

LVMH, SAB Miller, Caterpillar, Schneider Electric are all examples of Western groups who have developed more than 40% of their revenue from emerging markets during the last ten years. 80% of their global growth is linked to these markets. These companies are growing at almost 10% per year even though their underlying markets in Europe and the USA do not grow more than 2% per year.

For the same reason, numerous American, German, Scandinavian, Japanese and South Korean leaders in industrial equipment and construction machinery (Caterpillar, Komatsu, Terex…) have realized strong growth driven by these emerging markets.

Equipment and services for energy and raw materials

Global growth remains high (around 6% per year in value[4]) even if it risks slowing down (cf. above). Europe seems to be fading away from this growth (1% to 2% per year for the last ten years; with even lower projections of 0% to 1% for the next ten). This global growth entails a growth, in volume, of energy and raw material demand and will cause a growth in value of those materials that are not renewable, with a corresponding impact on all the industries and services that are linked to these needs, for example, the mining industry (equipment, extraction, transport) and the oil and gas industry (exploration, production, transport).

For the oil industry, the large players like Exxon or Occidental Petroleum are growing between 6% and 9% per year, faster than the world economy, driven by demand from emerging markets (China has become the largest importer of petrol in the world) and price increases. In China, Petrochina is growing at 24% per year.

For associated markets, the leaders in equipment for oil production (eg. National Oilwell Varco) and for related services (eg. Schlumberger) have grown at 10% and 20% per year.

For the mining industry, Atlas Copco and Sandvik, world leaders in extraction equipment, have experienced growth from 7% to 8% per year.

International logistics

During the last ten years, the growth of international trade has grown faster (10% per year) than the world economy.

This growth has been driven by globalization and the specialization of economies; globalization, with the reduction of tariff barriers and the World Trade Organization's inclusion of new important economies (China, Russia, …) ; specialization of economies, with the exchange of goods (and associated services) concerning raw materials (minerals from Latin America, Africa and Australia to China), consumer goods (from China to the USA and Europe) and specialized industrial equipment (from Germany to China).

As a consequence, and as 95% of international trade is carried out by sea, the international fleet of commercial ships (bulk-carriers, container ships, oil and LNG transport vessels…) has grown from 50 000 in 2005 to more than 83 000 in 2013 (growing at 8% per year).

This growth has been accompanied by technological advancement, allowing the development of larger vessels (with a maximum capacity of 18 000 containers per vessel, compared to 9 200 in 2004), of more efficient propulsion systems that reduce fuel-consumption, and of more modern and automated ports. This has the double result of unitary cost reduction of transport and decrease of delays.

[4] Estimation of average future annual growth (2012-2018) by the IMF, in current currency, compared to a historic growth of 8% per year (2002-2012)

Both transport operators (principally maritime, and, to a lesser degree, air and rail cargo), as well as logistics integrators, who benefit from their world network, are propelled by this growth, like Fedex (which has grown annually at 7% per year for the last ten years), Maersk (10%), DB Schenker (7%), Kuehne & Nagel (13%) or Cosco (25%).

Polarization of consumers in mature markets

During the last fifteen years, to various degrees depending on country and industry, the buying behavior of consumers in developed countries has polarized. Very high-end goods and services, on one hand, and « low cost » goods and services, on the other, have developed to the detriment of the middle range, which have stagnated and even decreased. This polarization will continue, and become more apparent, because it is linked to globalization and the pressure this exercises on the middle classes of mature markets.

Richemont, Hermès, LVMH and Burberry for luxury goods, Audi for cars, Dyson for vacuums, Whole Foods for grocery,… have all grown at 8% to 16% per year for the last ten years, in industries which, as a whole (fashion, automotive, domestic appliances, …) grow at 2% on average in mature markets (even shrink for automotive).

At the other extreme, Ryanair in passenger airline, Free for internet access, H&M in clothing,… grow at 10% to 20% per year, on average.

The most typical case is in aviation, where, in twenty years, the private jet business grew at 25% per year, the low cost sector grew at 20% per year and, between the two, the market share of regular companies decreased from 95% to 60% of the global market. Or those of mobile telephones, where in ten years, smartphones have grown at 40% per year, low price telephones have grown at 20% per year, and the market share of middle range telephones has decreased from 95% to 35%.

This dynamic is progressing across all sectors and even includes financial services. *The explosion of the middle classes in emerging countries is accompanied by an erosion (in percentage) of those, as well as their purchasing power, in developed countries.*

Disruptive innovation

Western groups, stuck in their markets with no growth, dream of innovation that will revolutionize their industry.

Everyday innovation is a reality of economy, improvements in the functions of a product, reduction of costs, creation of new services or means of access to consumers that are better adapted to their needs, as well as modification of the product's characteristics, and their services, to renew their attractiveness. This type of innovation maintains the growth of the market – *no more* – and helps their innovators to maintain their market position and their margin.

The players who have created major, revolutionary innovations for their markets on a large-scale during the last ten years and, consequently have experienced high growth, are much less common: Apple (from 6 to 156 billion USD of revenues between 2002 and 2012, of which, moreover, 25% of this increase comes from the integration of distribution and not innovation) ; Google (from 0,4 to 50 billion USD) ; Qualcomm (from 3 to 19 billion USD) ; Amazon (from 4 to 61 billion USD) ; eBay (from 2 to 14 billion USD) ; Netflix (from 0,2 to 4 billion USD) ; Amgen (from 6 to 17 billion USD) ; Monsanto (from 3 to 13 billion USD) ; Zara (from 3 to 14 billion euro). In Asia, in a similar way, innovative market leaders are emerging: Tencent (portal and internet services; from 0,04 to 7 billion USD), Baidu (search engine; from 0,01 to 4 billion USD), Huawei (telecommunication equipment; from 8[5] to 35 billion USD), Samsung (semi-conductors and electronic equipment; from 46 to 190 billion USD)…

In total, the main innovations of the last ten years in media, mobile communications, computing, search engines, social networks, Internet distribution, biotechnology, micro-electronics,… that have profoundly changed their markets, represent roughly 4 000 billion USD of revenue in 2012, or 6% of world economy, with products and services that did not exist ten years ago.

A large part of this is built on the digitalization of the economy and the development of the Internet (cf below).

The digitalization of the economy

The digitalization of the economy has been made possible by the rapid development of new technologies. It is demonstrated in the development of new activities, or business models, where fixed and mobile Internet have played a decisive role. In close to 10 years, the share of the population who has access to the Internet has risen from 14% to 80% today in France. The penetration of smartphones is close to 60%.

In the media, digitalization allows the development of new supports for communication which are taking the place of traditional media. In a market with limited growth, digital platforms have grown at more than 20% per year. CDs and DVDs are being replaced by digital downloads. In Japan, the e-book has witnessed strong growth and has reached a penetration of almost 10%; more than 60% of Mangas are read through this medium. The development of the Kindle has contributed to 15% of turnover and to 30% of profit for Amazon. Apple's iTunes store has generated more than 15 billion USD. In television, Discovery Communications has grown at 10% per year during the last ten years by transforming from a terrestrial television provider to digital (20 niche programs, present in more than 40 countries) and by developing their digital education programs.

In networks, Facebook, created in 2004, has reached revenues of more than 7 billion USD in 2013 (of which, close to a half is generated by mobile) and more than 70% of ROCE, reaching almost a billion users. Linkedin, the professional social network, realized close to 1,5 billion USD revenue. Twitter, in information exchange, realized 1 billion USD of revenues at 200 millions active users. This phenomenon is not limited to developed countries. In China, Tencent (close to 7 billion USD of revenues and an ROCE of higher than 60%) knows the same growth as Facebook in developed countries (more than 60% annual growth in the last 5 years).

Finally, in a context of increasingly varied content, the development of the Internet has enabled improvements to the flow, security and speed of exchanges. EMC, the world leader in « cloud » computing (23 billion USD in revenue) has grown at more than 10% per year by developing a new technology and consolidating the industry.

The development of the Internet as a means of access to the consumer and as a media

E-commerce has experienced strong growth in the main category of products. The number of clients, as well as the average size of their baskets, has grown. It should continue to grow at more than 10% per year. More than 60% of technical and easily comparable products, such as computers, are currently sold through this channel in the USA. For contact lenses, this rate is 25%. On the other hand, it is not yet 7% for food.

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[5] in 2006

Competitive businesses have developed with a strong generation of cash flow: Amazon, as a multi-product multi-range generalist (61 billion USD revenues in 2012, 38% annual growth since 2008), but also Ventes Privées (1,3 billion euros, 20%), in stock clearing. This phenomenon is followed by the traditional distributors with their multi-channel formats and by well-known brands. John Lewis, the large English department store realized close to 15% of their revenues on the internet by offering the option to order in store (with designated areas) or remotely (usually at home) and offering both home and store delivery.

This phenomenon is identical in services, in particular with the development of comparison websites. Players like Expedia (4,7 billion USD of revenue) have grown more than 10% per year. In the same manner, for hotels, the penetration rate of price-comparison providers has reached close to 80%, with booking.com as an example. This company (4,7 billion dollars of revenue) has grown at more than 60% per year since 2008.

Finally, the Internet has developed as a new media for communication. In the United States, Internet advertising should continue to grow at 15% per year and reach 35% share of advertising spend in 2018 against 25% today (at the disadvantage of print advertising). Mobile advertising should represent more than 50% of Internet advertising, against 20% today.

Ageing population in developed countries

18% of the European population was over 65 years old in 2013. These 92 million individuals grow at 1,5% per year and will represent 23% in 2030. The markets and public expenses linked to services, housing and pastimes (serviced accommodation, organized holidays, home-catering, emergency assistance, ambulance transport…), equipment (home-automation equipment, healthcare beds, stair lifts…), medical equipment (prostheses pacemakers, insulin pumps,…), analysis and treatment (medical imaging, blood tests,…) for this ageing population should grow at about 8% to 10% per year in the next ten years in Europe and the USA. Investments, savings, and insurance policies that are anticipating the growth of these services should continue to grow strongly (Blackrock in asset management for example at close to 30% per year for the last ten years).

Groups who are focused on these markets maintain their strong growths, like Celgene (USA) in cancer treatment (40% per year), Medtronic (USA) in medical equipment (10% per year) Novo Nordisk (Denmark) in diabetes treatment (12% per year), Express scripts (USA) in the management of prescriptions and logistics of medication (19% per year).

The issue in this market is to segment the clients into those who can afford these services and within this, to understand the impact of fluctuations and the constraints of public policy as well as associated regulation.

Outsourcing B2B services

Globalization increases competition between companies. For each of them, the focus on their main competitive levers is essential. Reducing costs concerning the non-core functions and competences is a natural corollary.

It is often more economic to externalize secondary functions to a service provider who is capable of effecting them with lower costs, rather than to in-house it at a higher cost. It is a way to benefit from scale effects and experience of an external supplier of goods and services.

It is by developing this principle that certain companies achieved high levels of growth in the last 10 years, for example Salesforce in Client Relationship Management (more than 40% per year) or IBM and Accenture in Information Technology services (close to 10% per year), as well as Tata Consulting in India (23% per year).

Capita Group, of the United Kingdom, has followed this logic by taking charge of an entire set of functions for public and semi-public actors (such as the computerized management of the relations between citizens and local authorities). The result has been dynamic growth of close to 15% per year for the last 10 years; and accompanies the restructuring of public services with a more efficient and less costly service provided for the taxpayer.

Equipment and services linked to sustainable development

Because of its lack of growth, Europe is facing a squeeze. Higher prices of raw materials and energy, which is not followed by higher final prices for processed materials, reduce the value added by industrial activities. Public authorities are therefore searching for ways to optimize, and even reduce, the use of energy and raw materials, supported in this by trends of public opinion, sensitive to the issues of sustainable development.

This may lead to new sources of growth driven by the production of renewable energy (wind, photovoltaic panels, biomass, geothermal,…), materials for insulation, construction and renovation linked to the management of energy (buildings with low energy or positive energy, isolated heating,…), energy efficiency services (performance contracts for hospitals, schools, …) energy-saving equipment (low energy light bulbs LED,…) or avoided use of fossil fuels (wood stoves,…). *However this is uncertain.*

Currently, these sources have not sufficiently impacted large Western groups to accelerate their rate of growth. The largest companies following this source of growth and growing at more than 10% per year do not exceed 2 billion euros, yet: Nordex (Finland) in wind power, First Solar (USA) and Q-cells (Germany) for photovoltaic, Ormat (USA) in geothermal, etc....

Besides, this source of growth is essentially carried by regulations and subsidies, and not by clear economic rationale. The first companies who have operated in these markets over the last 10 years have met with problems of weakening growth and destruction of value, for example in wind power, with Vestas in Denmark and Gamesa in Spain.

In France, 'Le Grenelle de l'environnement' plans to spend 600 billion euros over 10 years in energy management (construction and thermal renovation of buildings,…), The evolution of the electricity generation mix, and the different measures for the development of economic use of fossil energy (rail transport, electric vehicles or rechargeable hybrids,..) These expenses alone are equivalent to 25% of the state budget (as a percentage of public revenue, on an annual basis). 60% of them have a longer payback than 20 years. A large part of these subsidies and investments are not clearly profitable in the mid or the long term. Therefore, it is not even certain that they will continue in a context where the budgetary constraints of European states can only continue to increase.

What to conclude?

In the last ten years the fifty largest global groups[6], by TSR and growth, are all (with two exceptions) carried by one or two of these ten sources of growth (cf. table 1).

For these large groups, choosing the right mix of activities and geographies for their business portfolio has been – *undoubtedly* - more decisive than choosing the right or wrong competitive strategies within their existing activities and geographies.

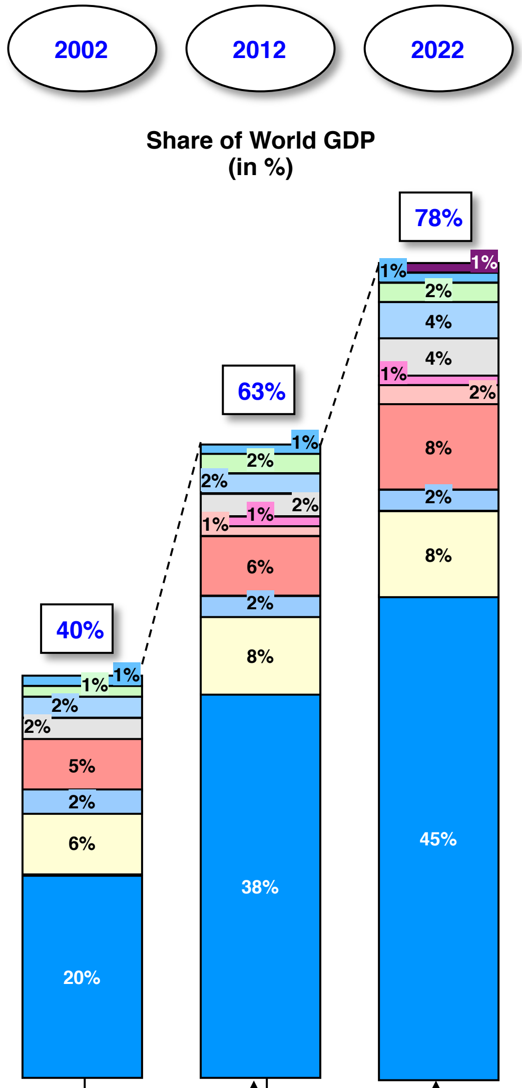
These sources constitute 63% of the world economy today (avoiding double counting) and 98% of its growth (see table 2). They are at work for the next ten to fifteen years at least[7]

[6] With a market capitalization of at least 20 billion euros in 2012.

- Table 2 -

Share of the 10 sources of growth in global growth

(without double counting)



	Share of global growth 2002-2012	Share of global growth 2012-2022	
Sustainable development[2]	0%	1%	
Ageing population[3]	1%	2%	
International logistics	2%	3%	
Outsourcing of B2B services	2%	5%	
Polarisation of Consumers [4]	3%	6%	
Digitalization[5]	1%	2%	
Internet [6]	2%	3%	16%
Innovation [7]	6%	11%	
Mature market industries driven by Emerging markets[9]	2%	3%	
Energy and raw materials [8]	11%	9%	66%
Emerging markets[10]	54%	54%	
10 sources of growth	83%	98%	
Rest of the economy	17%	2%	

	2002-2012	2012-2022
Share of global growth(in value)	83%	98%
Global growth[1] (in value)	7,9%	6,0%
Of which inflation	2,9%	1,0%

(1) Rate of average annual growth, current currency (including inflation) ; historical global growth; projected growth 2012-2022 on the basis of IMF projections 2012-2018; (2) Renewable energy (wind, solar, biomass, …), materials and services for thermal insulation, … ; (3) Retail sector; (4) Luxury and low-range; (5) Digitalization outside of internet (ex: digital cable, satellite communication, mobile payments, …) ; (6) e-commerce (ex : Amazon, …) ; (7) Innovation (Qualcomm, Amgen, Monsanto, Zara, etc.) and including Internet (ex : Apple, Google, Facebook, eBay, Netflix, etc.) ; (8) Oil & Gas (including shale gas), mining, … ; (9) Industrial equipment, construction machinery, aeronautic equipment…made in mature markets and exported to Emerging markets ; (10) Emerging markets such as those defined by the IMF: China, India, other countries in Emerging Asia (Philippines, Vietnam, Indonesia, Thailand, Malaysia), Brazil, other countries of Latin America (Peru, Chile, Columbia, Mexico, Argentina, Venezuela) Russia, Eastern European countries (Turkey, Ukraine, Romania, Poland), African countries (Nigeria, Egypt, South Africa, Algeria) countries in the Middle East (Kazakhstan, Iran, Qatar, Pakistan, United Arab Emirates, Saudi Arabia, Kuwait, Iran)

Sources : IMF, World Bank, OECD, Bloomberg, Work of Estin & Co (2011-2013) (with probable evolutions within each of them according to their actual variations, their operating models, etc…). Emerging countries alone represent 55 to 60% of this growth (by integrating the relevant part of the economy of mature markets that are directly driven by emerging countries[8]). Innovation as well as energy and raw materials represent 20%. These three main sources of growth represent 80%[9] of future world growth.

For any major Western group, a few simple questions arise. Is the group driven by one of these sources of growth? Is it sufficiently focused on it, with relevant investments? If not, what should this group do to capture at least one of them?

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This article is based on work done by our teams at Estin & Co during the period 2011-2013. It has been written under the hypothesis of the continuation of free trade and globalization of the economy. It has been written with the help of Jean Berg, Marco Mäder and Julien Deleuze.

Estin & Co is an international strategic consultancy firm based in Zürich, Paris, London, and Shanghai. The firm assists the boards of major European, North American and Asian groups in their growth strategies, and private equity funds in analyzing and improving the value of their investments.

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[7] Provided that free trade and globalization continue without major disruption (war or world epidemics, etc …)
[8] Goods and industrial equipment made in Western countries for emerging countries (construction machinery, aeronautical products, industrial equipment,…)
[9] It is difficult to separate clearly "disruptive innovation", "digitalization", and "internet", there is significant overlapping between the three.

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