Disruption or Acceleration?

By

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Global GDP is likely to fall by 3%[1] in 2020. This is the largest economic downturn since 1945, albeit not at the same magnitude than at the time or during the 1929 crisis[2] (see Table 1). As in any situation of severe crisis, over-reactions – both in actions and fantasies – are strong and will continue to be so in the coming months. The temptation to think that anything not be achieved in the past is now possible will be limitless.

However, the only reality is that *the world has become considerably poorer over the past two months*. Governments have played all their hands. If there are any left, they will be used during the rebound. By 2021, they will have no more room for maneuver. At that point, they will have to make choices that they should have made in recent years, when they believed that they were rich.

The same reality prevails for businesses. Additional credit will not compensate for losses in capital and value. The only companies to come out of the crisis stronger – or simply to survive it – are those that focus all of their resources on their strengths, as long as those strengths also match *the growth trends of tomorrow*.

Unless we wish for an Argentinian scenario, the most rational thinking today is to bet on a forced and brutal return to reality. What is this reality?

1. Accelerations

Need to make strategic choices

The current crisis is extraordinarily strong; its consequences will be as well: strong differentiations between businesses and geographies; strong restructurings of certain industrial sectors (physical non-food distribution, automotive, air transport, hotels, tourism, aerospace, oil and gas equipment and services, engineering, banking and insurance, etc.); strong differentiations between winners and losers within each sector. Companies will have to make quick, major choices in their investments, by making clear bets on 2021-2025 (as substantiated as possible).

Choosing target countries

The trajectories of the world economies are increasingly diverging. Some countries will emerge stronger from this crisis. Others, including those among today's major economic powers, will emerge weakened, with unsustainable debt, zero growth, industrial sectors not catching up with their pre-crisis level and major national leaders losing their positions on the world stage. Current GDP growth expectations for 2020 are + 2% for India, + 1% for China, - 6% for the United States, - 7% for Germany, - 7% to - 8% for France and - 9% for Italy[3]. Major crises amplify major long-term trends *(the impacts of the current crisis by country are correlated with long-term growth rates and amplify the differences between them – see Tables 2 and 3).*

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[1] GDP growth excluding inflation according to the IMF forecasts of 14 April 2020.

[2] Excluding inflation, the GDP of the United States decreased by 13% in 1932 and by 12% in 1946 (Measuring Worth / Bureau of Economic Analysis), compared with 6% in 2020 (IMF forecasts of 14 April 2020).

[3] IMF forecasts of 14 April 2020 (GDP excluding inflation).

For companies, the geographical component of portfolio strategies will have to be strengthened (both in a scenario of continued globalization and in a scenario of partial limitation of this globalization): the choice of target countries will become even more critical, including within large mature countries. The traditional trade-off between countries based on potential growth versus risk is no longer relevant: *large growing countries, and in the first place China, are the ones that will emerge from this crisis having demonstrated greater resilience (see Table 2).*

Acceleration of major growth trends

This crisis is not linked to a change of the industrial cycle (a major industry matures – telecommunications in 2000, financial services in 2008... – while another emerging one is not large enough yet to drive the economy as a whole – digitalization and mobile internet in 2000 and 2008); nor is it linked to the emergence of a new major geography in the world economy (Japan in the 1970s and 1980s, China in the 1990s and 2000s). *It is the mere consequence of a choice made by countries to manage a health crisis.* Major current growth trends have been abruptly stopped for two months but nothing *structural is calling them into question*. They will therefore continue as soon as the recovery takes place, or even increase, because the economic constraint will force discrimination.

In terms of business, *digital penetration* will continue to increase: e-commerce and online already account for 10% of distribution and media in Europe, 13% in the United States and *30% in China*. They should represent 15%, 20% and 45% respectively in 2025 (see Table 4). Digital in all its forms, streaming, businesses based on artificial intelligence, cloud computing, the Internet of Things, software, sharing models, related equipment and infrastructure (including data centers), will account for 10% to 15% of the global economy by 2025. Remote interactions – remote medical diagnostics, teleworking, etc. – could grow strongly (Teladoc Health, the American leader in telemedicine, has grown at 50% per year for the past five years[4]).

In those businesses, which represent the strongest growth trend of the world economy, European groups are marginal compared to American or Chinese GAFAs: in 2019, the 5 US leaders had a 25% market share of the American and European digital economy. At the current growth rates, they will have 48% by 2025. The 8 Chinese leaders have a 27% market share of China's digital economy. They will have 42% by 2025 (see Table 5).

Businesses related to *population ageing* (health, food, well-being, leisure, services, residences, etc.) will only continue to grow in a scenario where target populations remain solvent with or without transfers from the government (see chapter 2 below).

Within these businesses, certain trends will get stronger, regardless of the macroeconomic scenario. Different models of managed care, backed by databases as well as micro-segmented and predictive analysis models, should become widespread as a critical lever in the efficiency of resource allocations, optimization of service providers and expenditure management. These developments will be accompanied by a high concentration. In France, for example, the number of health insurance companies has been divided by 3 in the last 15 years and will be divided by a further 5 in the next few years taking into account the pressure on contributions and the evolution of optimization technologies such as the automation of processes through robotics (RPA) or investments in predictive tools and customer relations.

In China and major "emerging" Asian countries, current major trends will continue: *growth of the middle classes* and related markets (consumer goods, B to C services, financial services, telecommunications, infrastructure, capital goods, B to B services, etc.). The accelerated recovery of the luxury market is an emblematic illustration of the resilience of these economies. Major movements initiated before the crisis (e.g., the systematic automation of industries in China) will accelerate (the global market for industrial robots is growing at 13% per year and is driven at 80% by "emerging" Asia[5] and above all by China).

[4] Its revenue is $0.8B in 2020F and its market capitalization is $14 billion (as of 24 April 2020).

[5] Major Asian economies which were emerging in 1950. China, Hong Kong, Taiwan, India, Indonesia, Malaysia, Philippines, Vietnam, South Korea, Singapore and Thailand.

Some immediate responses to the crisis will develop (hospital equipment, diagnostics, general hygiene and food chain, robots for personal care services, cleaning products and equipment, health insurance). Their long-term potential will need to be confirmed or challenged.

Decline or transformation of mature businesses

The decline of mature businesses in Western markets will accelerate (physical distribution *excluding differentiated concepts,* automotive, steel, industries with low technological content or innovation, etc.). The impact will be all the more important for countries whose economies are anchored on historic manufacturing industries, first and foremost Germany (whose manufacturing sector still accounts for more than 20% of GDP, vs.10% or less for France and the United Kingdom).

In several sectors, the segmentation of physical distribution should be accentuated, between highly differentiated concepts, with a reduced number of points of sale (luxury, added value, customer experience, point-of-sale services, coupling with online) and simple intermediate storage points in a last-mile logistics.

Continued growth in Asia's major "emerging" countries

Large emerging countries will come out stronger from this crisis in relative terms. In 2020, "emerging" Asia[6] will be the only growing geography (at an average of + 1%[7]). It accounted for 6% of the world economy in 1980, 9% in 2000 and 17% in 2010[8]. It will account for 25% in 2020 and, at the current rate, *45-50% in 2030*. Intermediate emerging countries, on the other hand, show great vulnerability (in 2020, Latin America will decrease at - 5%, Eastern Europe including Russia at - 5% and Sub-Saharan Africa at - 2%).

As for large Western countries, they are entering a cycle of non-growth (they will have grown by less than 1% per year between 2008 and 2021, including the impact of the 2008 and 2020 crises)[9]. In these countries, the level of the trough (in terms of positive or negative growth rate versus the long-term trend) decreases during each major 10-year crisis (the US GDP was down - 2% during the 1982 recession, 0% in 1991 and 2001, - 3% in 2009 and will be at - 6% in 2020).

For large European and North American corporations, trajectories will be increasingly different: those which have shifted a large part of their income and investments to major "emerging" Asian countries will be able to grow strongly post-crisis; those which have remained in their historical geographies will face the restructuring or disappearance of their traditional industries, if they are not positioned on major growth trends.

Continued polarization of markets

In Western countries, the polarization of markets and consumer segments is expected to accelerate, on a basis which is either comparable to historical dynamics (squeeze of the mid-range in the West) or complementary to them (large metropolitan areas vs. medium-sized cities): further development of the luxury and low-cost segments; development of customer behaviors and business models complementary to straight low cost (subscription, rental or sharing services vs. full ownership, second-hand vs. new products, etc.).

In some segments, the core of the market should even disappear: for example, the travel agency market should get polarized between a low-priced industrialized entry-level segment and a high-end tailor-made solutions. In others, second-hand and rental segments should continue to grow to reach a significant market share: second-hand in the core apparel market like in

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[6] Major Asian economies which were emerging in 1950. China, Hong Kong, Taiwan, India, Indonesia, Malaysia, Philippines, Vietnam, South Korea, Singapore and Thailand.

[7] IMF projections as of 14 April 2020 (GDP excluding inflation).

[8] Nominal GDP at current exchange rate based on World Bank and IMF data for the eleven economies: China, Hong Kong, Taiwan India, Indonesia, Malaysia, Philippines, Vietnam, South Korea, Singapore and Thailand

[9] Western countries including the United States, Canada, Japan, Western Europe, Scandinavia, Australia and New Zealand.

children's clothing, where it already accounts for more than 30% of volumes; rental in high-end clothing, whose share is quickly rising above 20%.

2. Possible disruptions

Limited risk of de-globalization

The globalization trend of the last thirty years, which has benefited the development of the world economy, remains the most attractive trend to ensure a long recovery. However, it risks being partially challenged by certain countries (strategic relocations, political pressures, trade wars) and by companies (partial relocations to limit the risks associated with the behavior of countries). This risk is limited. A real large scale "de-globalization" would result in major additional costs incompatible with any economic recovery.

Compared to the United States and China, Europe would have the most to lose from such de-globalization: no independence for energy resources or strategic raw materials, increasing industrial weakness, technological delay, lack of global leaders in industries of the future, low fluidity of resources[10].

For businesses, adjustments to supply chains may be necessary to adapt to potential risks, or even for larger chains to segment systems according to three or four core market groups. If trade-offs are necessary, overall optimization should focus on competitiveness vis-à-vis the large growing markets.

The international logistics businesses (maritime transport, deep-sea ports, long and medium-distance road transport, air freight, etc.), which are strongly impacted in the short term by the crisis, should therefore continue to grow in line with global economic growth, in a context of frequent changes in flows relative to the major growth dynamics of industries countries.

Ambiguity and limitations of public policies

The massive investments initiated by countries to change economic, social, environmental… development models cannot all be added on top of one another if they are not sustainable for the market: energy transition; infrastructure financing and renewal; social transfers; financing of pensions and dependency; increase in the sustainable risk level of health systems; relocation of "strategic" productions; support to the economy… *It will be necessary to make choices*. As for businesses, they will have to understand which growth trends are realistic in the long term and which ones are not sustainable.

In addition, no European country on its own currently weighs in the global economy (France represents 3% of world GDP, Germany 5% and these figures are decreasing). Their choices are not critical for the evolution of global growth trends. Europe remains a mosaic of competing interests on key issues. The United States and China are the two countries that determine the global evolution in the medium term on most of the critical issues. Their choices, given their internal political dynamics and geopolitical interests, will be decisive.

In particular, countries will be subject to even stronger trade-offs with regard to energy transition. Following the current crisis, recovery plans will deepen budget deficits. The continuation – or not – of energy transition programs will be differentiated by country, depending on how political and economic constraints play out. In Germany, more than 200 billion euros have been invested over 10 years in new renewable electric energy (wind and photovoltaic). These investments have reduced CO_2 emissions by only 1% per year since the 2008 crisis. They remain 2.4 times higher than in France[11]. The United States has achieved the same performance at a lower cost, by replacing coal-fired power plants with gas-fired power

[10] Europe (excluding Russia) only holds 4% of the world's energy resources (compared to 14% for the United States and 8% for China). Europe owns only 4% of the arable land (compared to 11% for China and 8% for the United States). It now files only 13% of global patents (compared to 40% for China and 16% for the United States).

[11] France: 303 Mt er year of CO_2 emissions; coal-fired power plant production: 1% of total electricity production; Germany: 717 Mt per year of CO_2 emissions; coal-fired power plant production: 35%; USA: 5,018 Mt per year of CO_2 ; emissions; coal-fired power plant production: 28%.

plants (in the context of the shale gas boom). In France, the government and the environmentalist movements will have to choose between reducing CO_2 emissions and abandoning nuclear power prematurely.

Risk of a return to inflation

A true disruption scenario, particularly for no-growth Western countries, would be the return of a large-scale inflationary cycle, like the one of the 1960s and 1970s, with its consequences on interest rates, savings, the respective value of the different asset classes and the solvency of different segments of the population, including retirees. Such a scenario is highly dependent on the duration of economic support plans and whether public policies are selective – or not. It can only be contained by a rapid return to a globalized economy which allows for continued increases in productivity and cost competitiveness.

In a scenario of a return to inflation, retirees and savers would be disadvantaged compared to "active" populations. In Europe, the great historical current of the last thirty years which saw the increase of the share of the elderly in the national fortune and the economy could be reversed. All goods and services growth linked to an ageing population (health, but not only) would be called into question. A segmented analysis of the solvency of health needs, by population segment, according to each country's systems would then become critical.

Beyond that, all the declining businesses in mature markets would be strongly impacted: rising input costs (raw materials, wages), rising capital costs, low competitiveness or insufficient differentiation to translate general inflation into prices, nominal growth below the economy average. The squeeze of those businesses and the companies that remain in them would be accentuated.

Change of model?

The world of the last century was characterized by highly structuring patterns of consumption and work: consumers moving to points of sale to make their purchases, employees moving to their workplace, audiences moving to places of entertainment, patients moving to places of diagnosis and care.

The health crisis and the imposed containment measures have amplified certain trends that, taken as a whole, and if they continue, could constitute a major change in behaviors in all aspects of economic and social life: e-commerce, online entertainment, e-learning, teleworking, remote medical diagnostics, home care, telepayment, services and home catering, home manufacturing (3D printer), etc.: consumers, employees, the public no longer move but nevertheless have access to the whole world while having the illusion of proximity.

Each of the evolutions described is in progress, either in a major way (e-commerce, online) or still in a minor way (3D printers). The impacts of such a model, taken as a whole, and if developed on a large scale, would upset the structures of commerce, entertainment and media, public and individual transport, residential and commercial real estate, healthcare, the structure of urban centers, etc.

Such a massive transformation scenario is unlikely to occur by 2025. It is a possible option after 2030. It would require a major change in business models across many sectors. It remains uncertain and would probably be segmented because it applies only to certain population categories, and only in post-industrial economies.

3. What post-crisis vision?

Accelerations or disruptions: the former take place before our eyes; the latter are uncertain or potentially limited.

Ultimately, the crisis has amplified in a caricatural fashion the two major structuring currents of the world economy over the past decade:

Major "emerging" Asian countries represent a growing share of the global economy (in 2020 China will grow by about 8 points compared to Europe and by 7 points compared to the United States; such a difference has never occurred in the last ten years);

Online and digital, will continue to grow as a percentage of the global economy, reaching between 10 and 15% in major economies, which is more than the share of financial services in the world economy in the 2000s or the one of automotive in the 1950s and 1960s.

Major crises set countries, businesses and companies apart. What can be done to benefit from the IMF's predicted 6% rebound in the global economy in 2021 and the next economic cycle of 2021-2025?

Beyond the words and the evolving context, the only reality for companies are the levers which they control: where to invest through the crisis and in its aftermath to emerge stronger? Should one strengthen their current activities or take advantage of the crisis to make a major shift towards other areas? Will current business models still be adapted, or should they be changed?

The sequence of analyses and actions under way within companies must quickly respond to short-term survival issues as well as to the conditions of survival and strategic success in the medium and long term.

As always, it is critical *to anticipate and to make choices*: the world has not changed.

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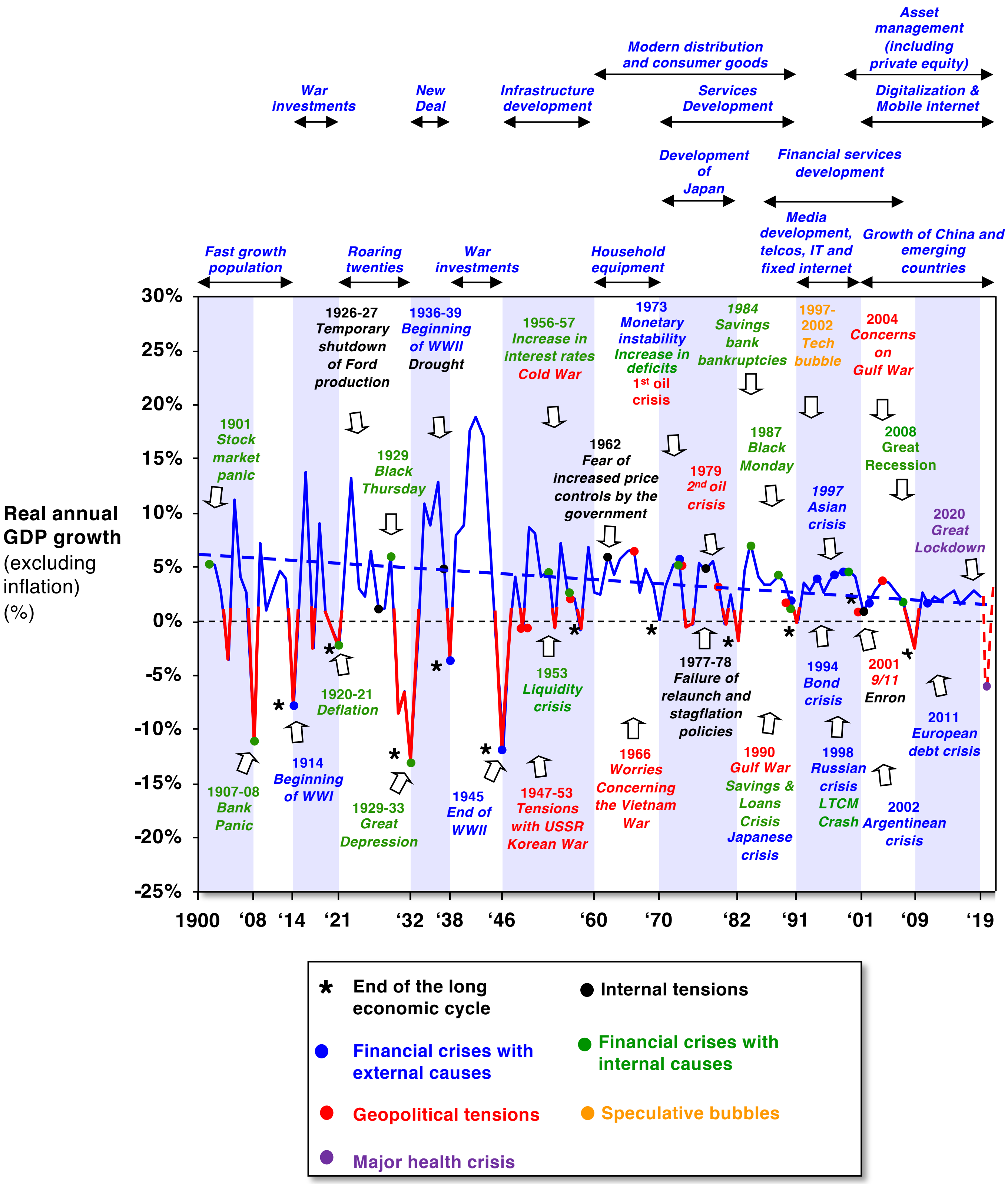
Estin & Co is an international strategy consulting firm based in Paris, London, Zurich, New York and Shanghai. The firm assists the management of major European, North American and Asian groups in their growth strategies, as well as private equity funds in the analysis and valuation of their investments.

- Table 1 -

The U.S. economy is slowing down in the long term, with a major crisis every 8 to 10 years and short cycles between these crises every two to three years

Real GDP (excluding inflation) - 1900-2021

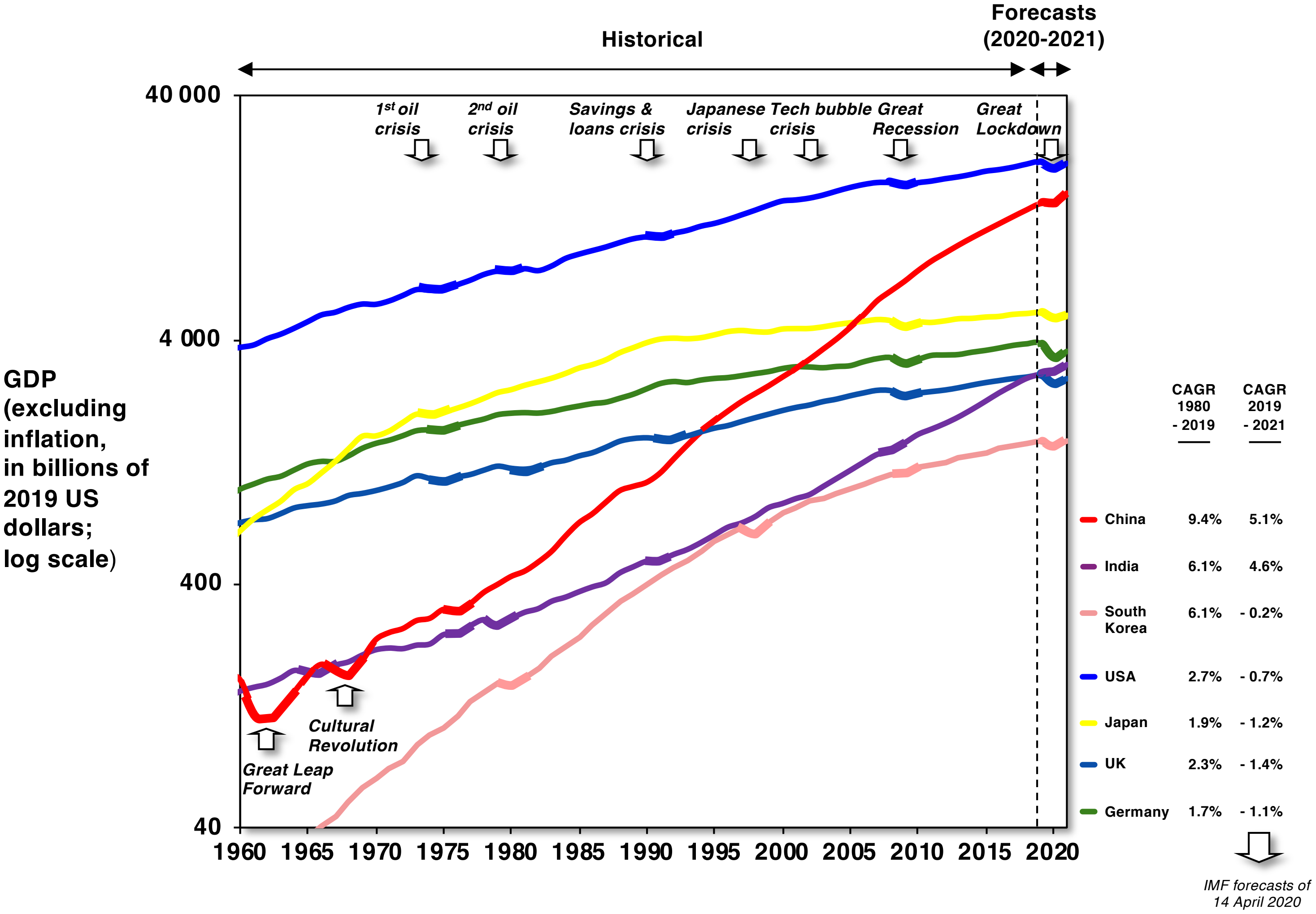


Sources: Measuring Worth, BEA, Historical Statistics of the United States Vol 3, GGDC, World Bank, IMF, Estin & Co analysis and estimates

- Table 2 -

Major "emerging" Asian countries [1] capture 30% of global growth [2]

Real GDP (excluding inflation) at constant exchange rates – 1960-2021

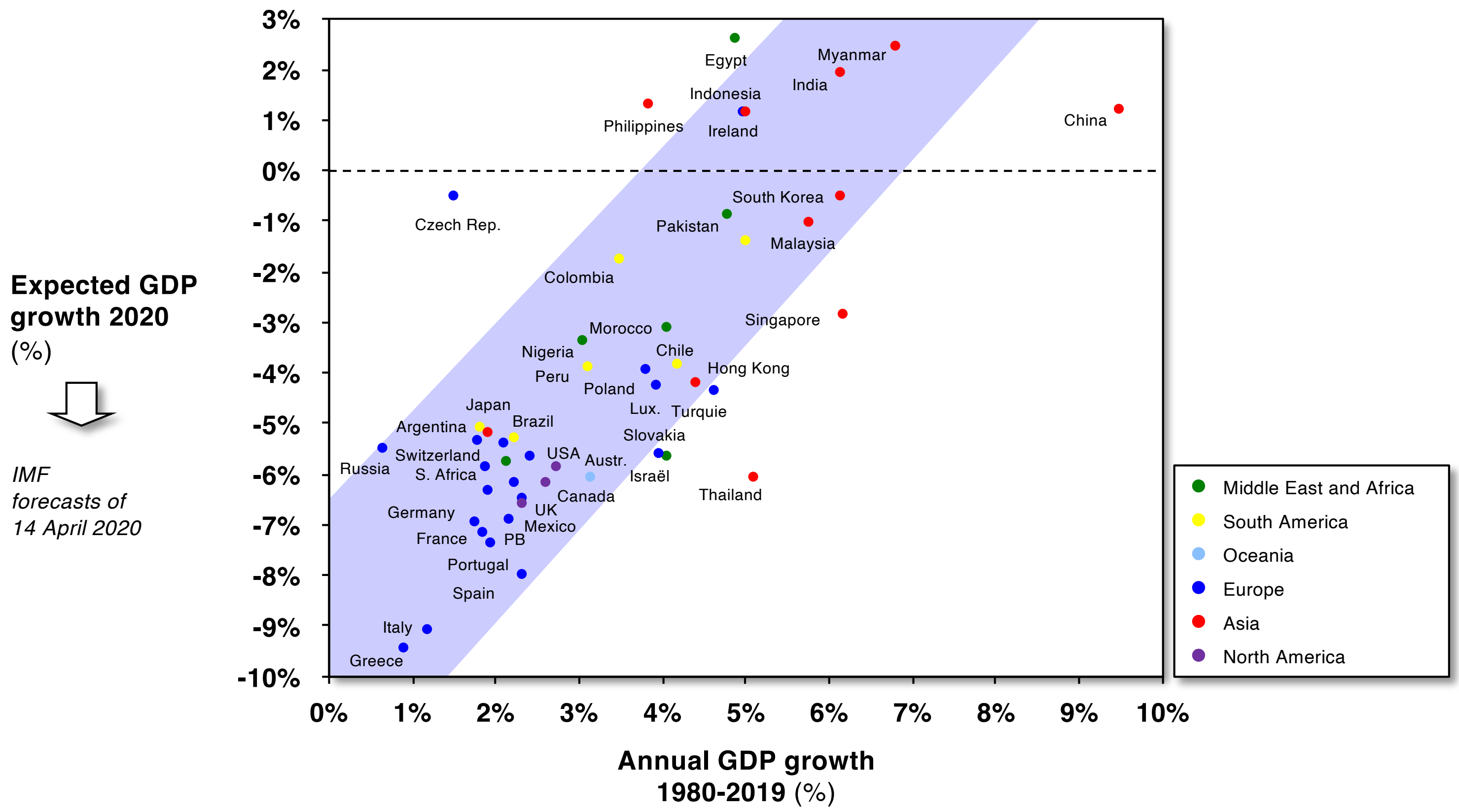


"Emerging" Asia [1] accounted for 6% of the world economy in 1980, 9% in 2000 and 17% in 2010. It will account for 25% in 2020 and, at the current rate, 45-50% in 2030.

Note 1: 1960-2018 according to World Bank data
Note 2: 2019-2021 according to the IMF scenario (14 April 2020)
(1) Major Asian economies which were emerging in 1950. China, Hong Kong, Taiwan, India, Indonesia, Malaysia, Philippines, Vietnam, South Korea, Singapore, Thailand; (2) Based on 1980-2019
Sources: World Bank, IMF, GGDC, Statistische Bundesamt, Estin & Co analysis and estimates

- Table 3 -

The expected impacts of the crisis on each country are correlated with long-term growth rates and amplify the differences between them
Real GDP (excluding inflation) at constant exchange rates - 1980-2020

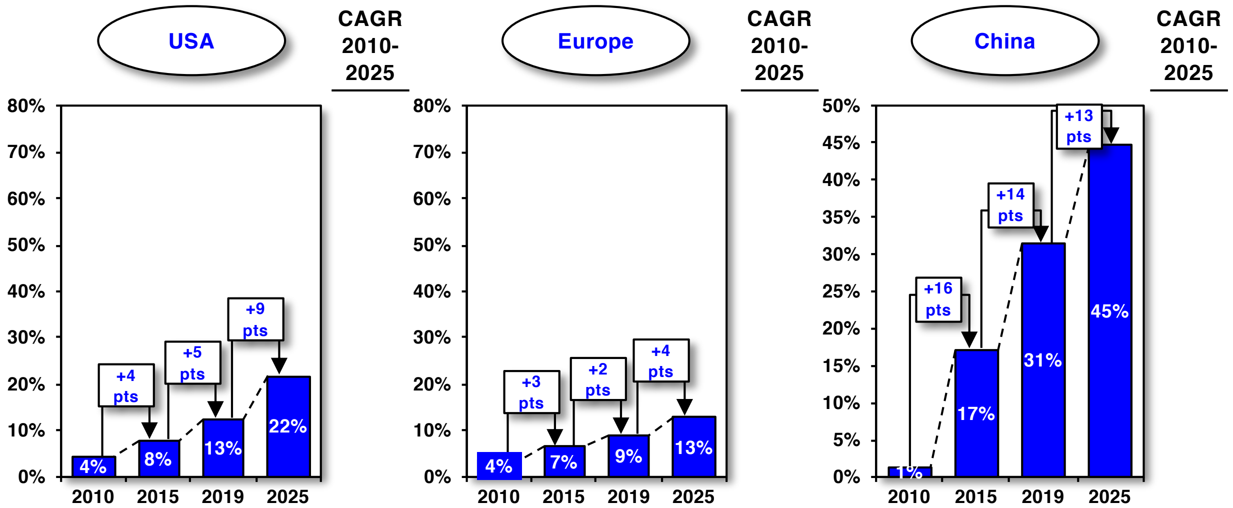


Note 1: 1980-2018 according to World Bank data
Note 2: 2019-2021 according to the FMI scenario (14 April 2020)
Note 3: annual growth of Russia from 1992, Slovakia from 1993 and the Czech Republic from 1995
Countries with a GDP of less than $50 billion in 2020 excluded; some unrepresented countries
Sources: IMF, World Bank, Estin & Co analysis and estimates

- Table 4 -

E-commerce and online media are growing at 20% per year worldwide. Their development is faster in China than in the United States and Europe

Share of e-commerce and online in distribution and media
(%)

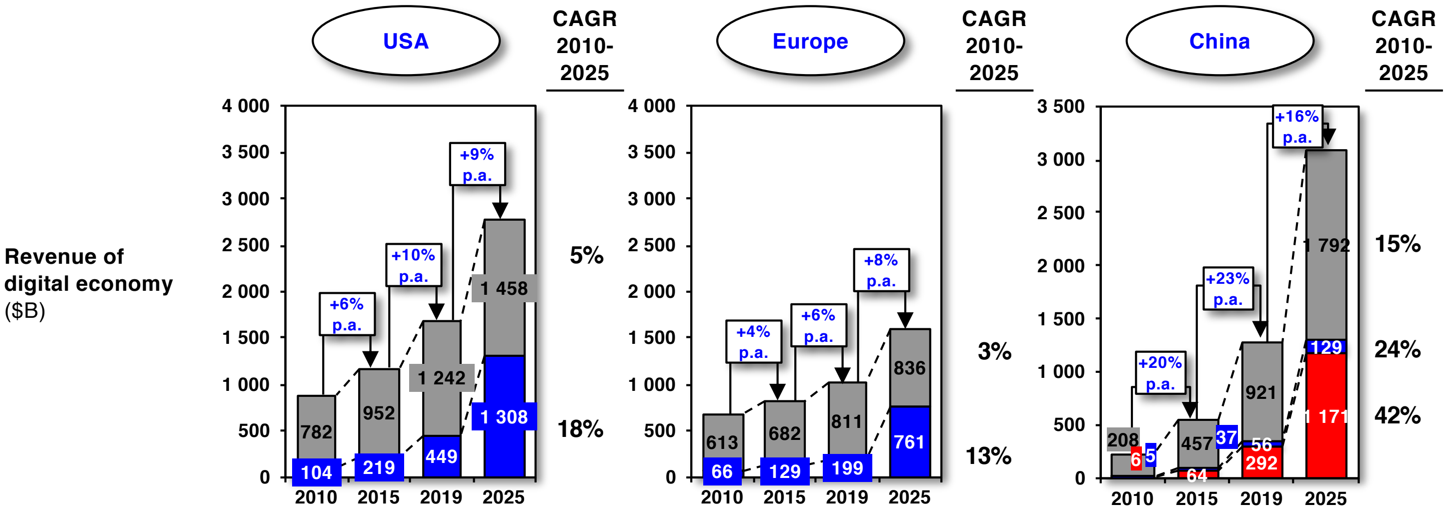


	2010	2015	2019	2025	CAGR 2010-2025	2010	2015	2019	2025	CAGR 2010-2025	2010	2015	2019	2025	CAGR 2010-2025
E-commerce and online media ($B)	186	395	716	1,440	16%	198	399	602	914	13%	15	334	851	1,801	56%
Total distribution & medias ($B)	4,208	4,974	5,724	6,593	3%	5,519	6,128	6,731	7,093	2%	1,128	1,944	2,710	4,031	10%

Sources: eMarketer, Estin & Co analysis and estimates

- Table 5 -

The digital economy is growing at 10% per year. It quickly concentrates in the hands of 10 to 12 American and Chinese leaders. It will account for 10% of the Western economy and 15% of the Chinese economy in 2025



	USA 2010	USA 2015	USA 2019	USA 2025	CAGR 2010-2025	Europe 2010	Europe 2015	Europe 2019	Europe 2025	CAGR 2010-2025	China 2010	China 2015	China 2019	China 2025	CAGR 2010-2025
Share of leaders (en %)	12%	19%	27%	47%		10%	16%	20%	48%		5%	18%	27%	42%	
Size of the digital economy ($B)	886	1,171	1,691	2,767	7%	680	811	1 010	1,597	5%	220	558	1,269	3,092	19%
Share of the digital economy in GDP (%)	6%	6%	8%	12%		4%	5%	5%	7%		4%	5%	9%	14%	

American leaders (Google, Apple, Facebook, Amazon et Microsoft)
Chinese leaders (Alibaba, Baidu, Tencent, JD.com, Meituan, Bytedance, Xiaomi et PDD)

Notes: (1) GDP with inflation; (2) BEA and OECD definition of digital economy: digital infrastructures (hardware including data centers, software, IoT, cloud…), e-commerce, digital media and social networks. The digital economy market also includes telecommunications operators (35% to 45% depending on the country). If those players were excluded, the concentration of the market would be even strong (more than 60% held by American and Chinese leaders in 2025)
Sources: annual reports, BEA (Bureau of Economic Analysis), BLS (Bureau of Labor Statistics), OECD, Bloomberg, IMF, China Center for Information Industry Development, Wind, Estin & Co analyses and estimates

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