

Opportunities and Challenges for 2018

Introduction

After a decade of post-financial crisis restructuring, 2018 is a year of general optimism around the world, despite financial market volatility and political uncertainty. Companies however need to be increasingly aware of the importance of digital disruption and to carefully consider the competitive environment within their industry to prepare for both innovation and rapid change.

Mergers, acquisitions, joint ventures and divestments both domestically and internationally are all possible in a business environment of low interest rates and plentiful supply of funding for attractive transactions. We will explore the economic environment, the strategic options a business needs to consider regarding digital disruption and the financing opportunities available.

The Economic Landscape

There has been an active start to 2018 with growth in both the developed and the developing world accelerating for the first time since the financial crisis. The IMF recently increased its forecast of global GDP growth to 3.9% for both 2018 and 2019 from 3.1% in 2015 and 3.6% in 2017

The policy of quantitative easing by the major central banks is reversing with interest rates beginning to rise moderately. There are signs of increasing commodity prices and wages, albeit limited. Furthermore, stock markets continue to be very active and volatility has increased.

There remains a heavy debt burden across the world economies and this may impact the price of assets particularly if interest rates rise too quickly.

In the US, recent tax cuts, expected increase in Government spending and positive earnings from corporates continue to support the market although uncertainty with international trade relations persist. In Europe, stronger growth, employment prospects and a relatively stable political environment is improving confidence.

China continues to grow strongly with a debt overhang, over-capacity issues and the threat of a trade conflict with the US and Europe. However, growth is expected to slow during 2018 as the dollar remains weak.

In the UK, the uncertain political environment due to the divisions regarding Brexit as well as the increasing level of inequality has left the current Tory Government with no clear majority. This may lead to an early general election with the potential for a tax and spend Labour Government. This uncertainty has led to slower UK growth than in Europe. Following Brexit in 2019 and a minimum 2-year transition period, we believe that with goodwill from both the Europeans and the British, a mutually beneficial trade and a services agreement can be eventually negotiated.

The recent rise of populism since 2016 in the US and the UK has, in large part, not been replicated in other major economies. With rising inequality, there remains a risk of nationalism spreading with forthcoming elections as in Italy. However, the improving economic environment in Europe should temper this trend.

The key global relationship going forward is between the US and China which will impact trade and potential conflict zones such as North Korea and the South China Sea. Overall, stability both economically and geopolitically will have a positive influence on global markets.

Digital Disruption

The pace of change within industries is accelerating and businesses need to carefully consider their strategies and respond effectively. The developments in big data analysis, cloud computing and artificial intelligence have already had a significant effect on a variety of industries. Innovations in mobility and sensors are likely to speed up growth and productivity and create new opportunities for consumers and entrepreneurs. Significant change is anticipated with workers in certain industries replaced by robots and forced to adapt to a new environment.

Digital disruption is now a universal phenomenon affecting all sectors including, energy, finance, government, healthcare, hotels, legal, music, newspapers, retail and transportation. Companies should carefully consider their strategic responses and their focus on customer service. This will avoid the fate of Kodak and Blockbuster, leaders in their respective industries, but failed to adapt to the new business environments and to anticipate the requirements of their clients. This led to their ultimate demise.

It is the ability to both measure and to analyse data from clients and to provide targeted products and services that will allow companies to enhance their product and service offerings and to retain a strong market presence.

Some of the crucial questions to consider are as follows:

1. **How will technology impact my business?** Blockchain will improve connectivity between different markets. In finance it will have a significant effect providing a ledger in the cloud and therefore an ability to execute multiple transactions simultaneously with the potential to disintermediate financial institutions.
2. **How will logistics and customer service affect my business?** As an illustration, mid-sized retail businesses are increasingly unable to compete with on-line stores benefitting from significantly lower overheads. Maplin a UK discount electrical retailer with 200 stores and over 40 years' experience recently filed for administration.
3. **How can I increase my understand of customer requirements and enhance my competitive position?** Data analysis techniques are improving rapidly and can be employed effectively to provide the necessary decision-making information.

A careful review of the competitive environment facing a company is required annually or in certain fast developing situations quarterly to carefully monitor the opportunities and threats to their businesses. In the US, the Amazon, Berkshire Hathaway and JP Morgan collaboration in the healthcare sector to reduce costs for their almost 1 million employees through new technology will lead to pressure on profits for middlemen in the healthcare supply chain. This is leading to M&A activity in the sector. The car industry globally is also facing challenges from electrification and driverless cars plus the move away from diesel fuel. The major companies are reacting by acquiring technology, investing in relevant start-ups or merging with competitors as the business environment shifts. With rapidly evolving disruption the key strategic options are as follows:

- a. Expansion via Internal growth;
- b. Acquisition of companies and/or new technologies;
- c. Divestiture of legacy businesses;
- d. Joint venture or strategic alliance in new markets; and

e. Reduced headcount in certain markets.

Above all, flexibility is required, to adapt to the new market opportunities and threats.

Financing

Notwithstanding the modest increase in uncertainty in the financial markets, there continues to be an abundance of financing available for attractive projects. Banks are lending although the loan to value ratios offered are less aggressive than during previous cycles. New challenger banks such as Virgin Bank or OakNorth have been opened to cater for small and medium sized enterprises and have been able to capture an increasing market share. Financing remains available for cash generative businesses with attractive growth prospects.

Equity investment for earlier stage businesses is available particularly in the growth sectors of artificial intelligence, blockchain technology, cyber security, data analysis and health. Attractive tax breaks for investors and funds including Venture Capital Trust (VCT) and Enterprise Investment Schemes (EIS) in the UK. Businesses will need to satisfy certain criteria typically a technology focus and less than 7 or in some cases 10 years since the launch of the product or service. Furthermore, the opportunity to invest via crowdfunding platforms has attracted many investors to these sectors

For businesses with strong sales growth and approaching break-even there are increasing amounts of **venture capital and private equity funds** available. This has often delayed the requirement for these businesses to raise equity on the public market allowing the initial growth phase to occur with less onerous regulatory requirements.

For larger businesses and for equity buy-outs, financing is available through **large funds** with several billion dollars under management, the ability to raise equity and access the debt markets in scale. Co-investments with insurance companies, pension funds and sovereign wealth institutions provide access to additional funding sources.

There continue to be large number of share buy-backs by companies as well as private equity funds de-listing companies. However, the **public equity markets** remain available for larger businesses, typically those with £50m plus of sales and a positive and growing level of earnings before interest and tax (EBITDA). The AIM market in the UK and NASDAQ in the US cater for the faster growing businesses but the availability of private finance together with costs of listing and the regulatory requirements have delayed the number of companies accessing the public markets. For companies requiring the ability to raise large amounts of capital relatively quickly as well as providing a currency for acquisitions, the public equity markets remain available.

Conclusion

The economic environment has improved following the financial crisis and simultaneously there is an increasing amount of disruption in many industries. Senior management needs to be cognisant of these developments to ask the right questions and to prepare their businesses for the next decades.

At DC Dwek Corporate Finance, we have over thirty years' experience and a solid track record advising domestic and international companies to analyse, review and execute the strategic opportunities for expansion or restructuring together with the necessary financing required through venture capital, private equity, debt and the public markets.

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