Demography drives business volatility

Today's business climate can be characterised by four words – volatility, uncertainty, complexity and ambiguity – the so-called VUCA economy

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Demographics drive demand. And so demand patterns are now changing quite dramatically as the global population ages.

As the first chart highlights (page 8), life expectancy has nearly doubled in the western world over the past hundred years, from 46 to around 80 years. In the emerging economies it has more than doubled from 26 years to 70 years.

This, of course, is good news. The chemical industry can also congratulate itself on the contribution it has made to this achievement. As *Life* magazine declared in 1997, "the filtration of drinking water plus the use of chlorine is probably the most significant public health advancement of the millennium".

Plus of course, there have been vaccines and medicines, plastics to protect food, improved seeds to boost crop yields and many others. However, increased life expectancy means that populations are now getting older, particularly in the wealthier western regions of the world. This inevitably translates into slower, or even negative, rates for economic growth.

The reason is simple, that older people mostly only need to buy replacement products, as they already possess most of what they need. Equally, they have less money to spend, as they move into retirement.

Thus it should be no surprise that the ageing of the western BabyBoomers in particular is lowering potential growth rates for the global economy. They are the largest and wealthiest generation that the world has ever seen.

In the US, for example, there was an amazing 52% increase in births to 4m/year between 1946-64, compared to the 2.7m/year average of the previous 18 years.

Small wonder, then, that economic growth soared until recently as all these Boomer babies grew up and entered their peak consumption period between the ages of 25 and 54 years. This is when people typically settle down, have children, and build their careers. It even led to the phenomenon of "pent-up demand". If the US Federal Reserve raised interest rates to cool inflation, this only postponed people's purchases.

These were great years to be in consumer-focused industries. Demand for houses, autos, electronics and other core areas was growing steadily year-by-year. So companies could forget about the need to plan for downturns or to conserve cash on their balance sheets for a rainy day. Instead, they could focus on "stretch targets", and be confident that any downturn would be merely temporary.

Today, however, all this has changed. The miracle of increased life expectancy means that most of these Boomers are still alive. But

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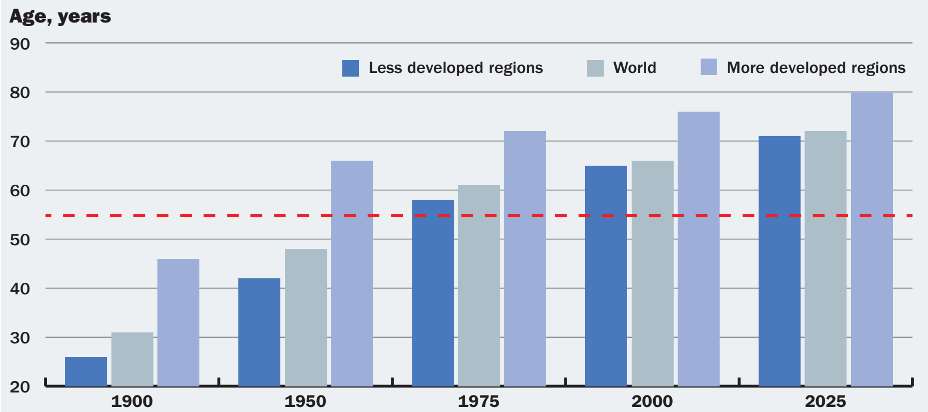
China's middle classes are booming, but wealth is still relatively low in per capita terms

» they have moved well beyond their peak consumption years. Instead, we are now seeing the emergence of a completely new generation. This New Old 55+ generation would likely have been dead even a hundred years ago. But instead, they can now hope to have an extra decade or more of active life compared to their grandparents.

The trade-off for this great success is lower growth. The second chart divides the major economic regions of the world between the New Old and the rest of the population. The result is quite striking:

- The under-55s in the West account for 43% of the global economy. Those in the BRICS (Brazil, Russia, India, China, and South Africa) are 16%, and those in the other emerging economies are 18%. In total, this age group is still 77% of the economy
- But the New Old now represent 23%, and their share is rising rapidly. In the early 1980s, for example, it was only 14%. Most of them live in the West, where they account for 18% of the global economy. But those in the BRICS are now 4%, primarily because China is now ageing fast due to the impact of its one child policy since 1978.

LIFE EXPECTANCY AT BIRTH, 1900-2025



SOURCE: IeC analysis, Maddison, UN Population Division

Note: A generation of people aged 55+ is now alive for the first time in history

> **Virtually every media report confuses the concept of "middle income" with "middle class"**
>
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Equally, today's vastly lower fertility rates – in every major region of the world – mean there are fewer children now available to do the heavy lifting for economic growth. US births fell 14% in the 18 years after 1964 to average just 3.5m/years. Lower fertility is not, of course, necessarily bad news. Greater life expectancy means women no longer have to have lots of children in order to ensure some will survive to look after them in old age. So half the world's population can now begin to fulfil their own potential as human beings for the first time in history.

However, from a business management viewpoint, it means the challenges – and opportunities – have suddenly begun to change quite dramatically:

- Volatility is increasing quite dramatically in terms of the economy, as there is no more "pent-up" demand to provide underlying stability
- Uncertainty is also increasing, as a surprisingly small number of policymakers currently appreciate the key importance of demographics with regard to economic growth
- Equally, markets are becoming more complex, as the needs of the New Old generation are largely unknown due to it having only recently come into existence
- And so business management itself is becoming more ambiguous, as the certainties of the last 20 years are replaced by a need to plan for a variety of quite different future scenarios.

Some commentators, of course, have argued that slower growth in the West should not be a major concern. Instead, we should simply focus on the BRICS and the emerging economies, where growth is set to go into overdrive. This would be wonderful if it was true. But it is based on a profound misunderstanding about individual wealth in these countries.

Thus China is often thought to have a larger middle class than the US. Yet the facts on the ground are quite different. The great achievement of China's economic transformation since it reopened to the world in the 1980s was to move the vast majority of its population out of poverty. Today, only around 5% still have to survive on less than $2/day.

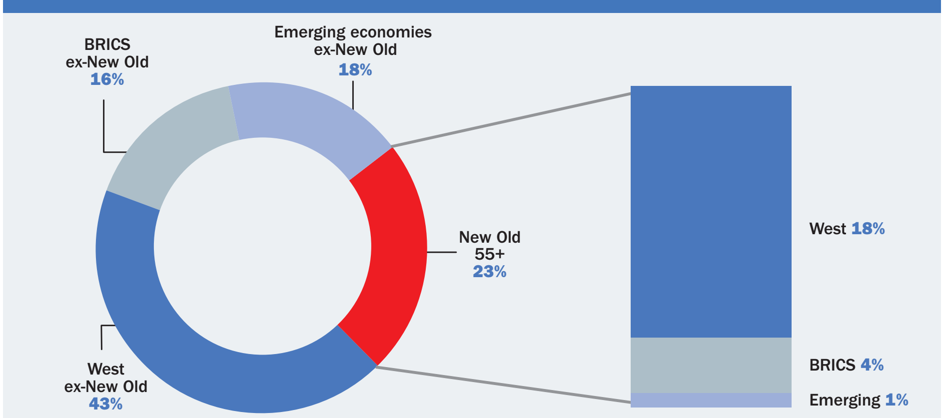
Instead, the vast majority now have some spending power for the first time in history. Around 70% earn between $2 - $10/day, and another 20% earn up to $20/day. But only 5% earn more than this – the same proportion as those still living in absolute poverty. And $20/day, or $7,300/year, would not be regarded as being a "middle class" income anywhere in the western world today.

Managing a business in this New Normal therefore requires companies to develop their own response to the VUCA economy:

- Today's increased volatility requires a clear vision for the future
- Uncertainty means a strategic understanding must be developed
- Growing complexity makes clarity over implementation plans essential
- Ambiguity means agility is necessary to respond to unforeseen events.

Human beings dislike change, as it challenges previous certainties. Change on today's scale is also unpleasant as it will create winners and losers. There will be few second chances for businesses that bury their heads in the sand. But the opportunities for the winners to carve out major new sources of profit growth for the future have probably never been greater. ■

GLOBAL GDP 2011 – $70TR, % SPLIT BY REGION AND NEW OLD 55+



SOURCE: IeC analysis, IMF

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