Demographic slowdown hits company results

Ageing populations mean companies must implement new strategies to sustain growth if they hope to survive and prosper in the new economic reality

PAUL HODGES INTERNATIONAL ECHEM

Rex Features

As the western population ages, economic growth is slowing

Are you an employee in the chemical industry, aged in your 30s or 40s? Have you noticed that while you are spending more money in the post-crisis years, your parents are spending less and less? Then you may have spotted the reason for the more difficult economic conditions that your company is now encountering.

In their 2012 third-quarter financial results, major players in the chemical industry all reported difficult market conditions and weaker profit forecasts:

- Germany-based major BASF warned that "the outlook for the world economy has not improved"
- Dow Chemical, based in the US, suggested "the new reality is that we are operating in a slow growth and volatile world"
- Unilever described "continued high levels of competitive intensity, depressed economies and increasing global imbalances and uncertainty"
- South Korea's LG Chem saw a "slowdown of [the] world economy"
- PetroChina reported "prolonged weakness in the domestic petrochemicals market"
- India-based Reliance Industries said there was "weakness in global economies and the resultant margin environment"

Many had simply assumed that once the global economies began to recover from the downturn in 2008-2009, growth would inevitably then return to a normal level of 3-5%/year. But as we discussed in our free ebook "Boom, Gloom and the New Normal", the period between 1982 and 2007 in fact represented a unique economic "super cycle" – never to be seen again in our lifetimes.

The cause was the major boom in Western births after the Second World War. By 1982, there were record numbers of people in the "Wealth Creator" age group (25-54 years old) that drives economic growth.

They were hungry for new cars and homes, and they loved the expensive new technological gadgets – mobile phones, computers, and video-game system – that began to become available. But today, these consumerist Baby Boomers are entering a new phase in their lives.

And at the same time, the number of people born in succeeding generations is plateauing. The ageing of the Boomers in the US and Western Europe means that between 2010 and 2030, there will be a 34% increase in the "New Old" generation of people 55 year old or older.

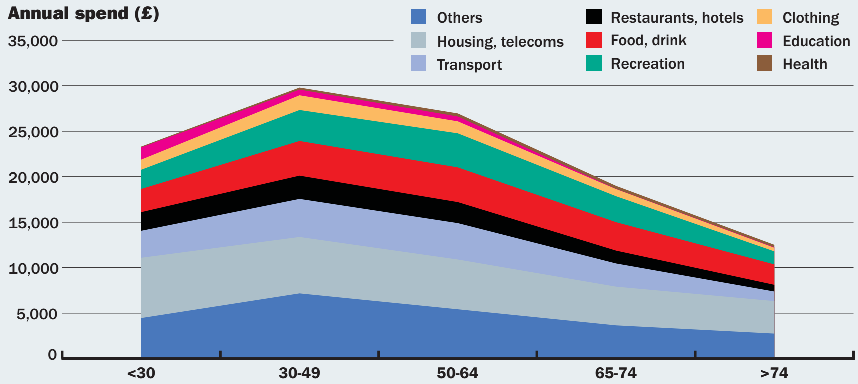
They will be 36% of the population. This will inevitably lead to lower – or maybe even negative – growth as they steadily reduce their spending.

This insight is confirmed in the two charts, based on US and UK government data for household expenditure by category. The surveys record the data in different age groups, but the overall message is the same: spending peaks by the age of 55 years, and then falls away quite sharply as people age:

- In the US, the only area of spending that increases after 55 years is healthcare
- In the UK, only recreation spending increases after 50 years – and then only till 65 years

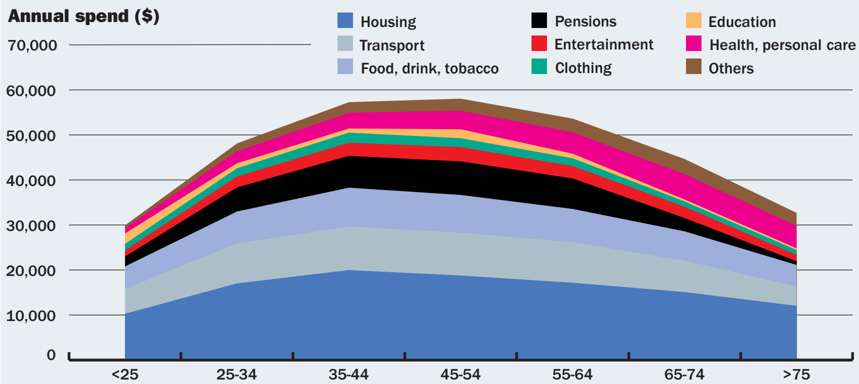
The underlying reason is simple. People

UK HOUSEHOLD SPENDING BY AGE GROUP AND CATEGORY, 2010



SOURCE: IeC; Family Spending, 2011 Edition, Office of National Statistics

US HOUSEHOLD CONSUMER SPENDING BY AGE GROUP AND CATEGORY, 2011



SOURCE: IeC, Household Consumer Expenditure Survey 2011, Bureau of Labor Statistics

need to buy new products when they are young and their families are growing. But once they reach the age of 55, they mainly buy replacement products.

Household consumption averages between 60-70% of GDP in most Western countries. Thus Western consumers represent a remarkable 40% of the global economy, as the West accounts for 61% of total global GDP. Their spending thus equals the total GDP of all the emerging economies.

This last point will surprise many, who have been misled by the idea that major emerging countries such as China and India are home to a large and growing middle class that will contribute significantly to consumer spending. These countries certainly saw their own economic boom during the super cycle, but from a much lower base: 20 years ago, 60% of China's population earned less than $2/day, the official definition of poverty. Today only 6% are in this position. But 96% still earn less than $20/day. In the West, this would hardly pay for dinner for two, let alone feed a family and provide a roof over their heads.

In addition, global population trends are following the Western pattern. The 0-24 age group has already plateaued, while growth rates for the Wealth Creator generation are slowing fast. As in the West, the major growth globally is in the New Old 55 and older group, whose numbers will jump 71% between 2010 and 2030 to 1.8bn. They will be 22% of the population.

This may also come as a surprise to many, who have been fed media stories of a coming population explosion. But fertility rates are declining worldwide. What we should have been discussing was instead a health explosion, based on increased life expectancy. In the West, this has increased from 65 years to 80 years since 1950, and in the emerging economies from 45 years to 70 years. Today's population explosion is due to more people living longer, not to more babies being born.

THE MYTH OF CONSTANT GROWTH

Companies have similarly been misled by wishful thinking, this time on the part of central banks.

The story has been that wise and far-sighted policymakers have taken control of the economy, so that previous cycles of boom and bust have been replaced by constant growth. One clear flaw in the argument – the lacklustre performance of Japan since 1990 – was explained as being caused by the complete failure of local officials to use the tools available.

The result is that, until recently, few companies have focused on the demographic area within their budget and strategy processes. Most worryingly, they do not have someone at board level responsible for alerting colleagues to the importance of this issue for future sales and profits. Yet demographics are now mission-critical for most businesses as they are creating a major paradigm shift. Many executives will now have to unlearn much of what they have learnt as they climbed the corporate ladder during the super cycle.

"If you build it, they will come" is no longer a viable strategic mindset. Over-optimistic market assessments will not be rescued by seemingly constant growth and the arrival of "pent-up demand".

Instead, they will need to learn new tools with which to sustain growth. Business model innovation will be essential to meet the needs of those market sectors with future growth potential. So will technical innovation, as the successful products of the future are likely to be based on needs, rather than wants, as seen in the super cycle.

All the evidence suggests that this transition to the New Normal is now accelerating rapidly. The governor of the Bank of Japan has made his position clear, based on his earlier experience of these trends: "The implications of population ageing and decline are very profound, as they contribute to a decline in growth potential, a deterioration in the fiscal balance, and a fall in housing prices. Other developed countries will face the same problems despite some differences in timing and magnitude."

Companies must not continue to ignore the generational shifts now underway. If they do, they may wake up one morning to find worsening economic conditions have ruled out the option of any second chance. ■

PAUL HODGES

Paul Hodges is chairman of International eChem (IeC), trusted advisers to the chemical industry and its investment community. With John Richardson, he co-authored "Boom, Gloom and the New Normal", published by ICIS over the past year. IeC/ICIS now offer strategy workshops to help boards tackle the demographic issues. Visit iec.eu.com/strategy-development.