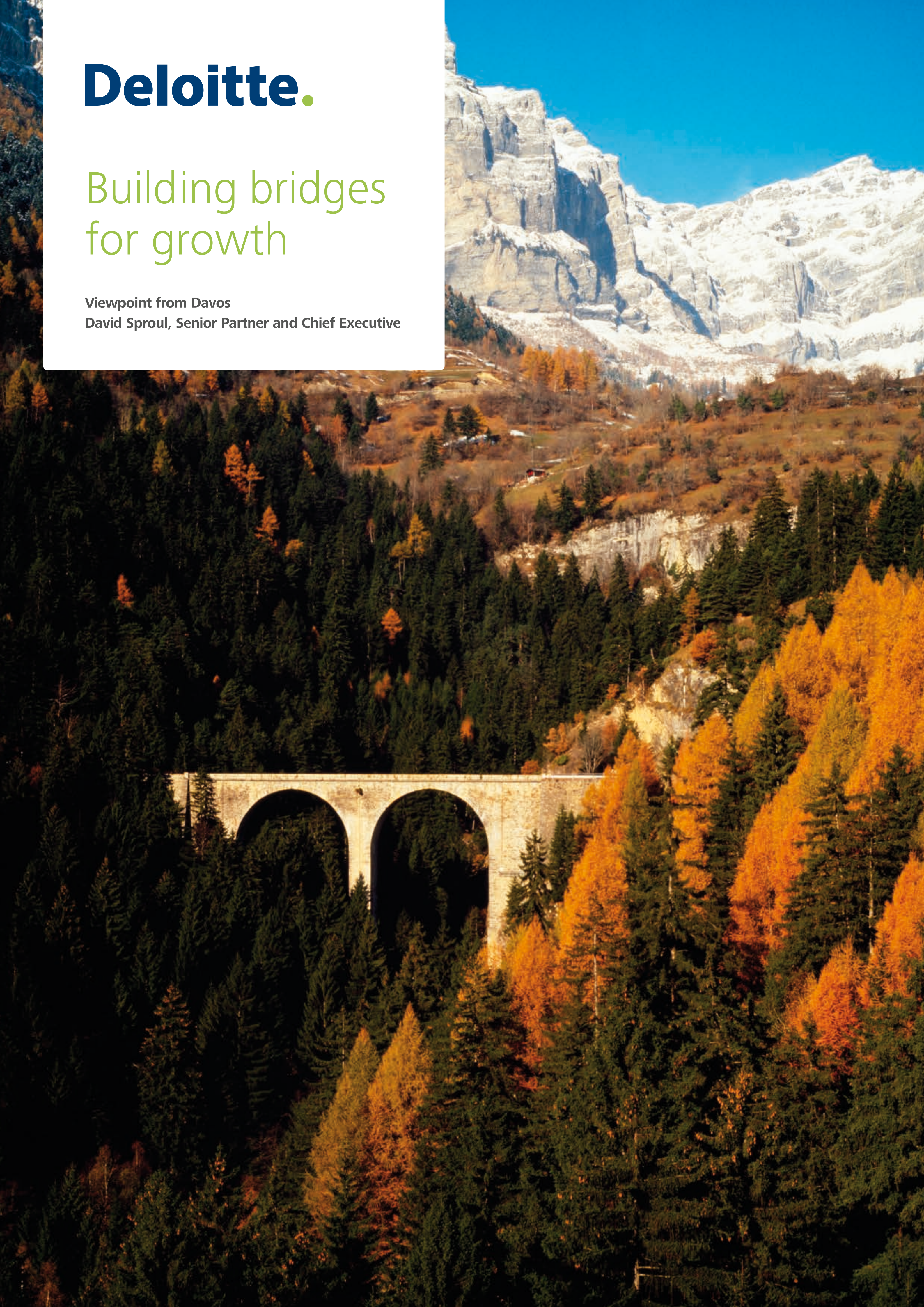
Deloitte.

Building bridges for growth

Viewpoint from Davos
David Sproul, Senior Partner and Chief Executive



Building bridges for growth

Trust, or the lack of it, between business, government and the public is now hindering momentum in Europe's economic recovery. Davos represents an ideal opportunity for governments and businesses to come together, to think hard about how they can drive benefits for all citizens. The role of trust will be key to building the bridges for growth.

Since the financial crisis began seven years ago, business has lacked confidence in governments to create the conditions for a sustained recovery, while politicians have despaired of seeing Europe's larger companies spend the €1 trillion they have amassed in their reserves.

The public, for its part, does not trust either business or government. The popular impression is that businesses are more focused on bigger dividends for shareholders and larger pay packets for chief executives than being the creators of wealth and opportunity for all.

That has to change. Recovery will not gather momentum without businesses growing and spending. It is time to think again about the relationship between government and business, and business and the public. This month's World Economic Forum in Davos is a good place to start.

This year's Davos theme is the "new global context" for decision-making, marked by a continuing erosion of trust in public and private sector institutions and a deteriorating dialogue between government and business globally.

There is concern too about income inequality and a "generational shift from societies sharing common values to those that are primarily interest-driven, and the related rise of sectarianism, populism, nationalism and statism".

It is not just Thomas Picketty's best-seller Capital in the Twenty-First Century that has fed debate about inequality. Recent research by the OECD, the group of mainly rich nations, argued that rising income inequality over the past 30 years has damaged growth rates in developed countries by limiting educational opportunities for poor children.[1]

There is concern also in some countries about whether growth is over-concentrated in successful cities such as London and failing to reach poorer cities and regions.

Commentators and stakeholders from Oxfam to Credit Suisse have recently pointed toward levels of inequality and the concentration of wealth.[2]

It raises the important question, can economic growth truly continue if we do not see a corresponding decline in inequality?

Eurozone weakness

The global economic picture is not too gloomy. The World Bank has cut its forecast for global growth from 3.4 to 3 per cent in 2015 – still up on 2.6 per cent last year. The International Monetary Fund believes lower oil prices could add between 0.3 and 0.7 per cent to economic output. But growth in the eurozone remains weak. The European Commission forecasts 1.1 per cent this year after 0.8 per cent in 2014.

The eurozone is also courting the danger of deflation, leading to a further weakening of demand if consumers and businesses hold off from spending in the expectation that prices of goods and services will fall. Core inflation, excluding energy prices, is just 0.8 per cent. Slow growth and years of austerity are fuelling the rise of populist political parties of left and right.

On top of that, European companies are losing competitiveness vis-à-vis counterparts in the US and Asia. A net balance of 41 European companies has dropped out of the Global Fortune 500 since 2010, the sharpest fall on record.[3]

Even Pope Francis is worried. He told MEPs in Strasbourg in November that the continent was now like "a grandmother, no longer fertile and vibrant".

Recovery will not gather momentum without businesses growing and spending. Companies are sitting on cash that could be invested to boost growth, which requires governments to create an attractive environment.

Confidence to invest

Businesses, are sitting on large amounts of cash that could be invested to boost growth. Deloitte research in September 2014 found that listed companies across Europe have €1 trillion stored up in reserves, having added an extra €50bn in the previous year, despite an improving economy. The total is up from more than €700bn in 2007, before the financial crisis.[4]

That is starting to look like a structural shift, suggesting both a lack of confidence in growth prospects and a fear that, if conditions worsen again, liquidity will not be available from the banks as in the past. But cash sitting on balance sheets does not create jobs and distribute wealth. In order to stay competitive, companies need to rediscover their ambition.

With tight public finances across Europe and austerity still the order of the day, governments do not have resources to pursue the expansionary fiscal policies we might have seen in previous decades. A sustainable recovery needs businesses to invest, which in turn requires governments to provide an attractive environment, particularly in terms of taxes and regulation.

Grounds for optimism

There are signs that some companies are becoming less cautious. Among 271 big businesses contacted by Deloitte, 59 per cent of those with cash surpluses planned to invest for growth over the next year, though only one-third of planned investment was expected to be financed from companies' cash reserves.[4]

Lower energy costs and a fall in the euro have given corporate chiefs grounds for optimism. Almost half of listed European companies' sales are made overseas, leading UBS to estimate that a 10 per cent fall in the trade-weighted euro results in a boost of about 6 per cent to European earnings.[5] Low inflation, while reducing companies' pricing power, has also curbed wage pressure.

Cheap finance available to Europe's multinationals in the bond markets has allayed fears that companies would hit a "refinancing wall" of corporate bonds. Smaller companies also appear to have been able to take advantage of easier borrowing conditions.

Multinationals have diversified their activities beyond the continent so as not to be so dependent on its slow growth.

Initial public offerings of European companies raised $68bn in 2014, up by 87 per cent on 2013, according to Dealogic.[6] European mergers and acquisitions doubled from $300bn in the first nine months of 2013 to more than $600bn in the same period of 2014, according to Deloitte data.

The missing element is investment, which has continued to stagnate despite the need to replace ageing capital equipment as well as embark on new projects. Many companies expect to see double-digit revenue growth in the years to come, but it will be hard to achieve this without significant investment.

In the UK, Deloitte's latest survey of chief financial officers of big companies found that concerns about policy change after May's general election had risen significantly and were seen as the biggest risk facing business in 2015. Second came deflation and weakness in the euro area, followed by a UK referendum on EU membership and emerging market weakness. CFOs believed the level of threat posed by each had risen over the past three months.[7]

Further political volatility in some European countries may be unavoidable, but a more frank and open dialogue between business and government is essential to foster investment. Each needs a better understanding of what they can contribute. As economies become more complex and digital, more expertise may exist inside companies than in government ministries.

Unless favourable conditions for investment are created, more countries may be tempted to follow the example of South Korea, where the government recently announced plans to increase taxes on excess corporate profits in order to force companies to increase investments, wages and dividends.

Winning back trust

In Europe, companies desperate to see politicians adopt a growth agenda have welcomed the emphasis by Jean-Claude Juncker, the new European Commission president, on growth and jobs, as well as his restructuring of the commission to break down "silos" perceived as hindering progress.

Mr Juncker has also promised a €315bn investment plan which relies heavily on private investment, given the paucity of public funds. It remains to be seen whether this will turn out to be yet another public works programme using official guarantees or if it will foster the growth potential of smaller, younger companies that create employment rapidly.

Deloitte's research suggests that companies have little faith in government incentives. Only 22 per cent say these would give them confidence to spend their money.[8] For many, the priority is stability and a degree of regulatory certainty. Companies frequently complain that Europe's political, legal and regulatory environment lacks predictability and consistency, both of which are fundamentally important to investment. Regulations should serve to improve competitiveness, they argue.

If governments and business can agree on what is needed to unlock investment, it would go some way to winning back the public's trust. According to the latest Edelman Trust Barometer, the proportion of people who trust business ranges from 84 per cent in India to 38 per cent in Ireland. For governments, the range is from 65 per cent in the Netherlands to 26 per cent in Spain.[9]

According to Deloitte's latest global Millennials Survey, three-quarters of professionals born since 1982 believe businesses are too focused on their own agenda rather than helping to improve society.[10] These young people want businesses to concentrate not just on products and profits, but on developing the talents of the people who work for them and being clear about their social purpose.

Millennials want more from business than might have been the case 50, 20, or even 10 years ago. This is not only affecting the way companies are viewed by the public – young people are also making career choices based on these values, so companies will need to make significant changes if they want to attract the most talented staff. The new generation is sending a strong signal to the world's leaders that they want to see a new approach to doing business.

Companies complain that Europe's political, legal and regulatory environment lacks predictability and consistency. It is time to rethink the relationship between government and business. They need to work together.

Rebuilding trust

For a sustainable, balanced recovery to take hold, governments and business must work together and not treat each other as the enemy. And to win back the public's trust, they must focus on two key building blocks of economic growth that can create the conditions for long-term prosperity. The first is access to education, with governments and businesses working together to ensure that young people have the skills to contribute to society, to increase productivity and reduce income inequality.

The second is investment in infrastructure, to ensure that the benefits of growth can be spread across countries and regions. As the world becomes more interconnected, there is an increasing need for more and better infrastructure, both physical and digital. Governments and business need to work together, spreading the cost and sharing the capabilities needed to deliver complex projects.

Davos represents an ideal opportunity for governments and businesses to come together, to think hard about how they can drive benefits for all citizens.

Contacts

David Sproul
Senior Partner and Chief Executive
dsproul@deloitte.co.uk

Chris Gentle
Partner, Insight
cgentle@deloitte.co.uk

Endnotes

1. http://www.oecd.org/els/soc/Focus-Inequality-and-Growth-2014.pdf
2. http://www.ft.com/cms/s/0/8e771978-9d99-11e4-8946-00144feabdc0.html?siteedition=uk#axzz3PH2sjvMU
3. http://www.ft.com/cms/s/0/9477fb0-3984-11e4-83c4-00144feabdc0.html#axzz3PH2sjvMU
4. Deloitte – Cash to Growth (September 2014): http://www2.deloitte.com/kr/en/pages/about-deloitte/articles/emea-research-cash-to-growth.html
5. http://www.ft.com/cms/s/0/59692ae2-4f0f-11e4-a1ef-00144feab7de.html#axzz3ObqYAU7E
6. http://www.ft.com/cms/s/0/bac33eea-85ec-11e4-a105-00144feabdc0.html?siteedition=uk#axzz3ObqYAU7E
7. Deloitte CFO Survey Q4 2014 – http://www2.deloitte.com/uk/en/pages/finance/articles/deloitte-cfo-survey.html
8. Deloitte – Cash to Growth (September 2014): http://www2.deloitte.com/kr/en/pages/about-deloitte/articles/emea-research-cash-to-growth.html
9. 2015 Edelman Trust Barometer - http://www.edelman.com/insights/intellectual-property/2015-edelman-trust-barometer/
10. Deloitte Millenials Survey 2015 – http://www2.deloitte.com/global/en/pages/about-deloitte/articles/millennialsurvey.html

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom. Tel: +44 (0) 20 7936 3000 Fax: +44 (0) 20 7583 1198.

Designed and produced by The Creative Studio at Deloitte, London. 41211A