In Practice

Embracing Global Megatrends

Changing Demographics, Power Structures, And More Data Create New Oversight Issues

By Dean A. Yoost and D. J. Peterson

Megatrends are not predictions but certainties—events with ramifications that are significant, already unfolding, and affecting businesses. Many megatrends are global in scale in that they impact business in multiple geographies and in various ways. And although global-scale shifts can be intimidating, they present unique and transformative opportunities for boards and management who are able to grasp their impacts and adjust strategies, especially for firms that aspire to global status.

Many directors spend the bulk of their board time on regulatory reports, audit reviews, budgets, and compliance instead of concentrating on longer-term global strategies crucial to the future direction and prosperity of the business. By habit, some directors tend to concentrate on mature markets they know, rather than those that may be up and coming or far away.

Corporate governance arguably suffers most when boards spend too much time looking in the rear-view mirror and devote insufficient resources and effort to scanning the horizon ahead. In an information-rich technologically enabled world, this has put corporate survival and sustainability at a premium. *The Economist* estimates that by the year 2025, the average lifespan of S&P 500 companies, based on company exits, will be only five years.

As with most other matters, the board and its designated committees should, along with management, lead in identifying and responding to business-relevant megatrends. But many management teams are tempted, if not compelled, to adopt a short-term view.

There are times when the CEO and management are the last ones to see big changes coming.

While management grapples with the immediate challenges of volatile and unpredictable markets and day-to-day operations, it is imperative for directors to remain cognizant of what is over the horizon. In short, boards need to spend time looking to the future—and to global megatrends—and to raise flags when necessary.

There are at least three global megatrends that directors should have on their radar

ROY SCOTT/ILLUSTRATION SOURCE

screens—demographic changes, shifts in economic power, and the proliferation of information. The interplay between these three is and will continue to profoundly impact virtually all businesses.

Demographic Changes

Within the next decade, the world's population will be 10 percent larger, but it will also be different with the rise of middle classes in emerging markets. Another and often less-appreciated demographic megatrend is that of the aging population.

Countries have very different demographic trajectories. Some countries are young and growing, creating ever larger labor forces and consumer markets. Their economies are expanding. Others are aging rapidly and their workforces constrained as a share of the population. Their economies are shrinking.

Due to economic growth and demographic changes, the global consumer demand is shifting dramatically toward the emerging country markets. It is estimated that one billion people will enter the middle class by 2020. HSBC forecasts that two-thirds of the global middle class will live in emerging country markets within 35 years—an increase from just under one-third in 2012. Real GDP per capita globally will grow in the next 10 years by more than 20 percent from today, while the average person in the emerging country markets will see incomes grow by 50 percent.

Many boards and management are only beginning to grapple with the complexity of developing products and services dedicated to the middle class in the emerging country markets and that are better than those of their local competitors. Businesses will need to understand the types of products and services these new consumers seek, because preferences often vary. Capitalizing on these new consumers often requires companies to go beyond the conventional approach of selling products and services or reducing costs and then exporting affordable, scaled-down versions. This adds complexity, which can be difficult to manage.

Reaching these new consumers will require investments to develop relevant skills and capabilities. Boards and management must re-think their business models; re-evaluate their approaches to marketing, R&D, branding, logistics, and other core business functions; and focus carefully on getting the model right.

Changes in demographics serve to reinforce the precept that talent is and will continue to be the main engine of business. U.S.-based companies consistently cite talent as their top constraint to growth. Despite the expanding global population, however, the availability of "skilled workers" is actually shrinking as business and economic opportunities grow. The war for talent is becoming increasingly acute in a number of important sectors, which require high skill levels and advanced education.

The need for knowledge-workers will continue. Recruiting, training, and retaining suitable talent is becoming a critical and daunting challenge, particularly in emerging country markets where businesses are growing fastest.

Population aging, which translates into not having enough workers, exacerbates the problem. McKinsey & Co. predicts that by 2025, every one of the major world economies, except India, will have crossed or be in the process of crossing an inversion of their age pyramid, with a higher percentage of their population above 65 than below 14.

In aging economies, the workforce needs to be retooled to address the growing mismatch between the skills employers need and the talent available. Older workers will need to learn new skills and work longer.

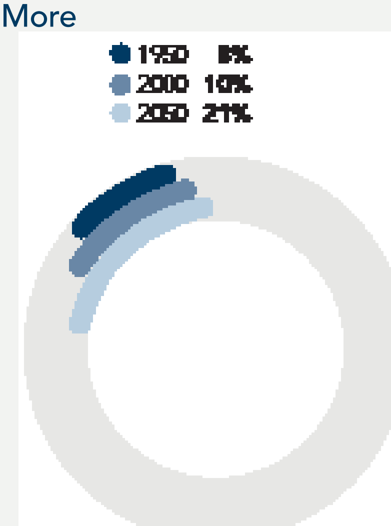
A number of strategies are being deployed by proactive companies to address the aging workforce. For example, policies and practices are being considered or put into place to assess the impact of retiring workers, address skill shortage challenges due to attrition, create an environment that attracts talent of all ages, manage a multi-generational workforce, and build an employer brand that attracts and retains top talent.

None of these strategies are easy to implement, but all of them have become essential.

Shifts in Economic Power

The IMF World Economic Outlook released its latest forecast in October 2014, indicating that emerging country markets will continue to be the drivers of global growth. While emerging economies' growth overall has slowed, through the end of 2015, they will average 4.5-5.0 percent growth, compared with 2.3-2.5 percent for advanced economies. As a result, the

Proportion of the World Population Aged 60 Years or More



Source: United Nations

relative weight of North American, Japanese, and Western European markets is diminishing.

For boards and management, a shift in global economic power is triggering major adjustments in strategic thinking. The distinction between the developed and emerging world has blurred. "Emerging country markets can no longer be treated as a sideshow, but making them core to the business may require difficult adjustments. "Directors need to be vigilant," says Brian Cullinan, partner with PwC. "We live in a world where decisions and events in one part of the world impact the opposite end. The old order is dissolving along with many previously 'safe' assumptions about the global environment."

A realignment of global economic and business activity is transitioning growth countries from centers of labor and production to consumption-oriented economies.

This is not just about China. By 2050, India will become the world's third largest economy, while Brazil's economy will rank fourth in size, according to a PwC prediction. To varying degrees, ASEAN, Latin America, and Africa, are helping drive this economic shift, as well. And, as indicated above, the shift in consumer power is likely to be even greater. While incomes have stagnated for many years in many advanced economies, incomes, and the size of the middle class are growing rapidly in emerging country markets.

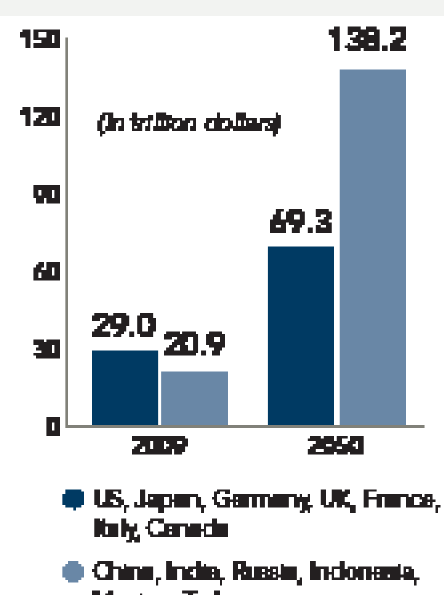
This shifting center of gravity is creating a new level of complexity that boards and management must navigate.

Emerging country markets are not homogeneous and whereas all seemed to be rising in unison several years ago, their performance increasingly diverges. Growth in China is slowing as the leadership seeks to shift the economy away from a dependence on capital investment and low-cost exports towards domestic consumption and innovation. India is looking to boost foreign investment and low-cost manufacturing. Brazil, meanwhile, is facing stagflation. Each market has unique characteristics and needs that management and boards must understand and prepare to meet.

The economic shift accompanies the rise of powerful new political actors and business practices, standards, and values that are decidedly not Western. Many important economic and trade linkages are decreasingly led by or dependent upon Western participants. In many emerging country markets, Western firms face local incumbents that enjoy state sponsorship, and the shift in economic and political power is making it easier for these upstarts to compete both at home and abroad.

Additionally, risks in these markets often are downplayed as a result of their high growth rates. Western ideals and regulatory and legal requirements governing transparency, corruption and bribery, and diversity and inclusion are becoming harder to drive on a global basis.

Country GDP



Source: PwC

While many companies describe themselves as global, in reality they are multi-national, and such organizational complexity spurs new risks. Boards and management will need to concentrate on those markets where they have comparative advantages and where the risks can be properly identified, calibrated, and mitigated. They also will need to redouble efforts to imbue a uniform culture and operating principles even as the number of geographies and cultural orientations of staff and management expand. In short, strategies need to become simpler and more focused, especially as companies navigate the nuances of a greater number of markets.

Proliferation of Information

Technology, with its emphasis on digital, continues to drive the acceleration of innovation, interconnectivity, and investment. It is spurring the proliferation of information. Boards and management across all sectors are grappling with how breakthroughs with the Internet, mobile devices, data analytics, and cloud computing are transforming business, and how this is impacting consumers in different geographies and cultures.

Nicholas G. Moore—who serves on the boards of Bechtel Group Inc., Wells Fargo & Co., NetApp, and Gilead Sciences Inc.—has witnessed this proliferation in multiple industries. "Satisfying the technology needs of consumers and businesses is leading to an explosion in the growth in information and analytics, new competition, and the disruption and realignment of industries," he says.

Directors need a wide lens. The technology spurring the information revolution has lowered the barriers to entry in many industries and sectors. Some of the most disruptive new players are coming from completely unexpected quarters. However, in some sectors, particularly financial services, the required investments associated with information and technology can be obstacles to entry, differentiation, and sustainability. The development and storage of information has become complex and costly. Only those institutions that regularly make substantial investments in new hardware and software, new data analytics tools and storage, security, and skilled staff can realistically aspire to remain competitive and relevant.

In PwC's 2014 Annual Global CEO Survey, 86 percent of respondents cited technological advances as the global trend most transforming business. The survey cited business analytics as the area attracting the greatest investment.

The digital push has put more power in the hands of more people than ever before.

McKinsey & Co. estimates that the amount of data will quintuple in the next five years, forcing corporate executives to transform their business models to optimize performance. Cloud computing and mobile technologies have become mainstream, while mobile devices are increasingly replacing personal computers. Analytics and social media are reaching into every aspect of business.

The ability to gather and analyze data in real time has become a significant and critical competitive advantage and of imperative importance. Research reports, records, and sensors embedded in cars, appliances, and even clothing, make up an increasing percentage of the business value in many products and services. The proliferation of information has given birth to a new generation of consumers. Technology raises the expectations of consumers, sharpening their demands for personalized information that is tailored to their specific needs. Consumers are swapping information and advice on the virtual airwaves. They now want ever more accessible, portable, flexible, and customized products, services, and experiences.

While consumers want more powerful devices and applications, businesses seek more powerful and cost-effective solutions to harness the onslaught of data. Technology is driving the transformation of the delivery of goods and services. Although technology and information will not always deliver massive cost reductions, they can allow for much better results at similar costs. Access to information and systems can enable the flattening of organizational structures.

Along with the opportunities, a world filled with an abundance of information and new technologies poses additional and often significant risks, such as breaches of security and the misuse of information. This is especially the case in the area of cyber security where corporate reputation is increasingly connected to market performance.

Information and technology have clearly moved from the back office to the corner office and now to the boardroom. Irrespective of the industry or sector, all companies have become technology companies.

Key Questions for Directors

Strategy

- What opportunities and risks are presented by the megatrends? Are the long- and short-term strategies relevant, given these trends?
- Does the company have a clear view of the global competitive landscape, including non-traditional challenges from other markets, sectors, or companies? Are appropriate strategies in place to respond to competitive actions?
- In what way are the operating model and costs being aligned with changing markets and responsive to consumer demands?

Demographic Changes

- How are products and services modified to fit new consumer markets?
- How well prepared is the company to find, attract, and retain tomorrow's workforce while dealing with today's talent challenges?
- How are demographic factors such as the percentage of working-age population, education levels, and skill bases addressed in resource planning?

Shifts in Economic Power

- Is the company prepared for emerging country markets becoming its core markets? How is the company positioned in each of these markets?
- Does the company have the right talent, cultural understanding, age profile, experience and skills to create credibility and relationships with critical stakeholders, such as regulators, company officials, and key business leaders in emerging country markets?
- How is the company managing the unique risks and higher risk-profile encountered with emerging country markets?

Proliferation of Information

- How does the company use information and metrics on performance, trends, customers, and competitors? What are the plans to deploy analytics to provide competitive advantage?
- Does the company have a digital strategy and the skills to execute?
- How is the company leveraging newer technologies such as social media and cloud-based services, data analytics, security and privacy, and virtualization solutions?

Advanced Economies

(countries listed alphabetically)

Canada
France
Germany
Japan
Singapore
South Korea
Taiwan
United Kingdom
United States

Emerging Economies

Brazil
China
Colombia
India
Mexico
Poland
Russia
South Africa
United Arab Emerates

Frontier Economies

Iraq
Libya
Mongolia
Morocco
Myanmar
Pakistan
Panama
Philippines
Sierra Leone

Source: Longview Global Advisors

Many directors feel uncomfortable or inadequate in this domain, but it is essential that they be sufficiently knowledgeable to ask informed questions in areas such as consumer and competitive trends, talent acquisition, and business process innovation.

Implications for Directors

The global landscape is changing rapidly as new customers and markets emerge, creating huge opportunities and, along with them, new competition and disruptors. The biggest challenge facing directors is not responding to what is known, but rather learning how to respond in an environment where the circumstances and competition are always changing. "Multiple business strategies are prudent and should be developed," advises James T. Morris, chair and CEO of Pacific Life Insurance Co. "Given the uncertainties and likely disruptions ahead, it is unwise to plan for a single set of assumptions or one scenario."

These megatrends are inevitably creating a far more complex and diverse operating environment. The future includes powerful new technologies, more information, and new actors. It is not a straight-forward rollout of Western products, practices, standards, and values. Understanding the sources of volatility and how to mitigate around them is essential.

In this new world, it is essential for boards and management to avoid having their company "die in good health." That is, the business possesses accurate financials with the proper disclosures, but is executing on an antiquated model. The most significant risk may be from "slow failures" or "creeping risks," where the long-term implications of the megatrends have been vastly underestimated or even ignored.

As boards and management look to the future, it is becoming evident that executing on an existing set of assumptions or strategies may no longer be sufficient.

The responsibility of directors is to engage in critical and relevant discussions, form independent opinions, and work closely with management to ensure goals are well formulated and subsequently met. Directors must gain sufficient insight to ensure they are in a position to provide thoughtful, meaningful counsel to management, and to exercise skepticism regarding the company's plans. This is accomplished by challenging the assumptions and critically assessing their implications for corporate strategy, which can be particularly difficult because global megatrends are often complex, subject to rapid change, and occur in far off places. Directors need not be experts on demographics, emerging country markets, and information and technology, but the ability and strength to ask informed questions is essential.

Directors can counsel management to either stay the course and attempt to deliver on current business models or adapt and adjust to the new, emerging operating reality. The response may be a matter of corporate survival. D

Rise of the Connected Devices

Year	2003	2010	2020
World Population	6.3 b	6.8 b	7.6 b
Connected Devices per person	.08	1.84	6.58

Source: Cisco Internet Business Solutions Group

Dean A. Yoost serves on the NACD Southern California Chapter board and is a director of three global companies. He is a retired partner of PwC, where he spent 17 years living and working in Asia and served as a member of PwC's Global Oversight Board. D. J. Peterson is a PhD, political scientist, and the founder and president of Longview Global Advisors, a consulting firm that specializes in market intelligence and global trends, strategic planning, and corporate and executive positioning.

Editor's note: NACD's ongoing Directorship 2020 (D2020) program focuses exclusively on the disruptive forces of megatrends, three of which are covered in this story. D2020 programming is provided exclusively to NACD members through webinars and in-person events scheduled as follows: March 3, New York; April 13, Atlanta; July 17, Seattle. For more information and updates about D2020 programing, please visit NACDonline.org/directorship 2020/.