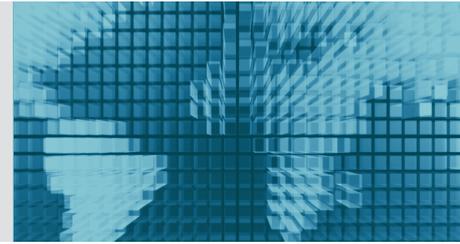


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The disrupted, the disruptors and the supercharged.

Key Takeaways:

- Every 10 to 15 years, Schumpeterian waves of disruption come along and shake up the business models of the most apparently solid companies. Since the start of the 2010s, companies have been facing an extreme form of digitisation, like a tsunami sweeping away some while propelling others to the highest ground. On the face of it, this Schumpeterian shock is pitting the disruptors against the disrupted.
- However, it would be naïve to think that all the disruptors will prevail over the disrupted. The buyer of 5-year growth must flee the battlefield where the disruptors are attacking and the disrupted are resisting, and look for the players flying under the radar, who are sidestepping the blows and will ultimately take the spoils. These players, quietly going about their business and passing unnoticed, can be categorised as extreme digitisation's suppliers, expanders and personalisers.

A wave of extreme digitisation is disrupting companies' business models and a battle between the disruptors and the disrupted appears to be joined. Who will emerge victorious from this battle in five years' time? It may not be who you think, according to Jean-Louis Scandella, Equity CIO at Ostrum AM.

As we all know, equities are about company stories, and the equity universe is ultimately split between buyers of quarterly results and buyers of long-term growth. When we buy, as we do at Ostrum AM, a 5-year growth scenario, we know what to do: we must focus on high-visibility companies, looking closely at their franchise, management, and balance sheet and analysing each of these three factors against a set of clearly defined requirements. This is our definition of "quality", and we strongly believe that the higher the quality, the more likely it is that the growth scenario will materialise and fulfil its associated return objectives.

Nonetheless, even if we focus on the best listed companies, every 10 to 15 years, Schumpeterian waves of disruption will shake the foundations of the most robust business models and threaten the most carefully constructed growth scenarios.

In the 1980s-1990s, a process of **financialisation** stemming from the requirements of US pension funds descended on European companies,



Jean-Louis Scandella,
Equity CIO,
Ostrum AM

forcing the survivors to deliver daunting levels of operational efficiency for shareholders.

In the 1990s-2000s, as the major socialist/communist economies opened up, **globalisation** drove companies that did not want to disappear to compete internationally, compelling them to operate globally and even more efficiently.

Since the 2010s, companies have had to deal with **extreme digitisation**, a third and even more powerful wave than the two that preceded it, which has already swept away some while propelling others to the summit.

There is an essential distinction to make here: extreme digitisation has nothing to do with digitisation, an innocent technological innovation that enabled companies to move into the online space. With extreme digitisation, companies are going full pelt into big data and processing it with artificial intelligence, into 5G and the ultra-connectivity of everything to centrally programmed software, and into the blockchain and the explosion of centralisation this brings.

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This third wave is like a tsunami, and it's no longer about anticipating who will have a successful or unsuccessful digitisation journey: the question is who will survive, and who will be blown away?

By its very nature, extreme digitisation is a classic example of Schumpeterian creative destruction, which in today's terms looks like a battle between the disruptors and the disrupted: just as it was better not to invest in stagecoaches when the railways came along, so now it would be better not to invest in physical stores when everyone is shopping online...When one world chases another, the buyer of 5-year growth should be more on the side of disruptive creation than disrupted destruction. If only things were that easy! As relevant as it is, a Schumpeterian analysis is better at explaining the past than predicting the future, and we will not really know who the winners are until extreme digitisation has played itself out, or at the end of the five years that we are aiming to model.

Of course, we've already seen a number of victims (toy stores, shopping centres, old-style advertising agencies), but it would be naïve to think that all the disruptors will triumph over the disrupted: in the automotive sector for instance, the disruptor Tesla is leading the way in electric and self-driving cars, but is it really on a better track than the disrupted BMW, whose extreme digitisation is backed by internationally renowned creativity and operating

efficiency? The battle will be hard-fought, and the eventual winners risk ending up with a Pyrrhic victory.

So what should the buyer of 5-year growth do? The answer is clear: while the disruptors are attacking and the disrupted are resisting and both are running on empty, our focus should be on – dare we say it – the winners of this war, who are biding their time, avoiding the heat of the battle and doing just fine.

We have identified three types of extreme digitisers: the suppliers, expanders and personalisers.

First, extreme digitisation needs suppliers. While the automotive disruption battle rages between Tesla and BMW, the producers of specialised semiconductors are rubbing their hands: the transition from fossil-fuelled cars to electric cars will double the number of semiconductors needed, while self-driving cars will require twice as many as that... However the battle ends, the TSMCs, Infineons and STMicroelectronics of this world will be victorious.

Second, extreme digitisation expands the horizons of the companies best placed to take advantage. While the likes of Atos and Tata Consultancy are wrecking part of their business (IT outsourcing, systems integration) as they deploy their new digital

technologies, Thalès seems to be offering a new business application for each advance: we are hearing about an air traffic control system for drones, driverless trains, pilotless aircraft...

Third, extreme digitisation personalises contact with the customer for the best-known brands. Far from the retail battle where the Amazons and Walmarts are locking horns, luxury and quasi-luxury brands such as LVMH, l'Oréal and Inditex are communicating directly with their customers through paid bloggers and YouTubers, making virtual passers-by salivate in front of digital shop windows, and are inventing a new dialectic between online sales and store sales, while cementing their relationship with the end customer.

In fact, extreme digitisation is almost as much a Darwinian revolution as a Schumpeterian one, where strong franchises get stronger and weak franchises disappear. For the buyer of 5-year growth, the path is clearly mapped out. There is only one way out of the maelstrom of extreme digitisation: shun the disrupted, take a critical view of the disruptors and seek out the players flying under the radar, by setting ever higher quality requirements for the franchise, management and balance sheet...

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