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Smart[im]: Market Note

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Smart Investment Management

Technology disruptors are nothing new

It is virtually impossible to be unaware of the impact that a number of 'new economy' companies, known as 'technology disruptors', are having on both investment markets and society as a whole. The BBC reported this morning (14 May) that about 10% of retail units in the UK are empty, as internet shopping continues to reduce footfall in the High Street. The big name in online shopping in the UK is Amazon currently but other disruptors have appeared in an array of sectors, challenging a range of longstanding business models. However, whilst the term is relatively new, such disruptors have existed through history, so are there any lessons that we can take from what has gone before?

In 1589, Elizabeth I declined to grant a patent for the 'stocking frame', an early knitting machine, on the basis that it would bring "my poor subjects … to ruin by depriving them of employment". Her concerns were arguably borne out some 200 years later during the Industrial Revolution when machines like the 'Spinning Jenny' made possible the mass-production of cotton. This allowed mill owners to use fewer and less skilled workers, and the resultant downward pressure on wages lead to social unrest in the form of the Luddites (it is a misconception that the Luddites were opposed to machinery per se). There has been much comment about the relatively small number of people employed by the current disruptors relative to their size because of their use of technology and, as the old economy businesses that they are displacing are generally more labour-intensive, they are probably reducing overall employment in the economy in the short to medium term. History tells us that economies adjust over time so the reported prediction of one former Facebook executive that half of the world's population will not have a job within 30 years, sparking revolt and armed conflict, will hopefully prove to be hyperbole. However, such change can be painful and problematic for governments. Whilst it is hard to make a convincing argument that this has led to the rise of populist parties in the West, as austerity and globalisation are almost certainly much greater factors, it is probably not helpful to governments that the companies showing the greatest growth employ so few people. However, what may represent a greater problem for the disruptors in the future is that, by using their global status to move profits around, they have been able to pay relatively low marginal rates of tax. This has become a political issue and, whilst we have not seen a Luddite-style rebellion, voters around the world can be easily won over by promises of action against such 'tax avoidance'.

What is clearly different this time around is the speed of change. It took over 200 years for the stocking frame to be superseded by newer machines like the Spinning Jenny. By contrast, the new disruptors mentioned in this article are all relatively young, from Amazon at 24 years old to Uber and Airbnb at just 9 and 10 years old respectively. When companies grow that fast, bumps in the road are inevitable, and Facebook's recent problems with the alleged misuse of user data caused a sharp fall in technology stocks as investors worried about the possibility of regulation being imposed on the sector. However, whilst regulation in their field is still just a possibility, other disruptors are dealing with it on an ongoing basis. Uber has experienced suspensions or even outright bans in a number of places where its model has conflicted with existing regulations. Similarly, Airbnb has had to deal with increasing regulation of short-term lettings in many locations as authorities seek to limit the alleged negative effects of such websites on locals, namely sharply rising prices and increased anti-social behaviour. Some of these new companies have not helped themselves, with Airbnb being fined €300,000 in February by the Balearic Government for letting unlicensed apartments and Uber being accused of being uncooperative by a number of government organisations around the world. However, leaving aside these mis-steps, the very strength of the disruptor is that their business model is different to the norm, so will often not fit existing rules. For them to succeed, it requires authorities to be convinced of the need to change the rules, and that requires them to have a reason. In theory, whether monarch or Parliament, those in power should act for the benefit of the people but history shows us that how that is assessed is unpredictable, with Elizabeth I's protecting of the hand weavers being in stark contrast to the brutal suppression of the rebellious Luddites. Fortunately, for the disruptors, the power of the consumer is greater than it has ever been and it is that fact that means that they are here to stay. That is not to say that they will be free to trade wherever and whenever they want, as certain regimes will always be trickier to deal with than others, as

Google's problems in China demonstrated. However, as long as their product or service is in demand, they will thrive and offer potentially enhanced investment returns for those prepared to take the rough with the smooth. That is, of course, until they are the old economy model in the equation!