Technological Change

One of the key questions to consider when assessing the investment merit of a company is the likely impact of technological change on the company's business. This is far more subjective than the easier task of analysing a company's historical financial performance. As famed Yankees player Yogi Berra said…" It's tough to make predictions, especially about the future". We have to try though, so how should we approach the issue?

When it comes to technological change the question we ask is will technological change enhance the ability of the company to conduct its business and thus continue to compete effectively and earn the investor a sustainable return, or will it potentially disrupt the company's business, and if so, do we think the company can adapt to cope with this, or not. Of course, this only works for change we can reasonably foresee at any given time so we are shooting at a moving target. Often a company may be dealing with both disruptive change and change that is enhancing its ability to do business. Let's consider a historical example and then some contemporary situations.

Management's failure to adapt to disruptive change can be terminal as it was for Kodak. Once one of the world's largest companies Kodak had an employee, Steve Sasson, who invented the first digital camera in 1975. He was reportedly told by management "that's cute, but don't tell anyone about it". To develop digital cameras aggressively would kill Kodak's film business (ironically, one of Kodaks founders had previously made the right call by moving aggressively to colour film which killed off their very profitable black and white film business). By 1981 Sony was marketing an electronic camera but change was slow. Bill Gates captured the essence of this type of change when he said "We always overestimate the change that will occur in the next two years but underestimate the change that will occur in the next ten. Don't let yourself be lulled into inaction". Kodak's management were for some time and thought they would be able to adapt when change became more certain. Kodak sold for US$80-90 per share into the late 1990's before the tsunami hit. Their competitors had leapt ahead and by the time Kodak tried to play catch up it was too late. In 2012 the once venerable company filed for bankruptcy and the shares were worthless.

Today we live at a time in human history where technological change has never been faster. What changes will electric vehicles, driverless cars and trucks, and drones bring? Dominos is trialling the delivery of pizza by drone which may seem like a gimmick in 2017 but might be the norm by 2027. Freightways will need less staff if vans and trucks move freight autonomously which should lower their cost of business enabling it to compete more effectively as a logistics operation. What will we do with all the extra time if we don't have to drive while in a car? Electric vehicles may vindicate Gates' quote about the speed of change but does that make Tesla a good investment, or will the established large car companies adapt their superior supply chain logistics and manufacturing capability to crush the visionary upstart? Many established players are making large investments into electric vehicles – Toyota, Nissan, BMW, Volkswagen, and Volvo to name a few. Mazda though say it's not in their DNA, brave indeed. The attitude of management to change is key – does management seek to delay change to capitalise on an outdated business model, or do they invest time and capital in leading change, or at least adapting effectively in a timely manner for the future benefit of their investors – which of these is Sky TV?

It's quite understandable if you're thinking there is too much change to consider. It is hard enough to navigate the change we see coming, let alone the change we don't foresee. Next time we will look at some businesses that should prosper for decades to come with products that will likely look as they do today. One way of mitigating the possible effects of change on your investments is to identify businesses that sell essential products or services that we can reasonably expect to be similar in 2027 or 2037. Because, as is often said, the more things change the more they stay the same.

The companies mentioned above are named to further the discussion. This should not be construed to be personalised advice nor a recommendation to invest in these companies. Please contact Kinnell & Co. regarding how best to take advantage of the trends discussed above.

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