Marketplace perspective
Shifting economics

In the past 12 months, we have seen a marked shift in fortunes in the UK economy. An era of cheap debt and strong growth has come to an end. Credit has become scarce, house prices are falling and the consumer sector is under real pressure. The pace of growth is likely to slow markedly in the coming quarters. Against a backdrop of weakening growth, demand has increased for our specialist debt and restructuring advice. The high-profile collapse of a number of Structured Investment Vehicles (SIVs) is one such example. Structured investments had become increasingly aggressive in the high growth environment, with growing concern over off-balance sheet liabilities. Following the collapse of the US sub-prime market and the resulting impact on SIVs, a real need for experts who could unpick the complexity and work out the best approach for the restructuring process grew.

Our quarterly CFO Survey has shown that, despite reductions in Bank of England base rates, even our largest corporates are finding credit pricier and harder to obtain. CFOs say they are likely to respond by squeezing discretionary spending, jobs and capital expenditure. Our experts are working with a whole range of businesses to find the best way of managing both cost and cash in a less benign market. A particularly important area for corporates is working capital. Our specialist team is working with businesses to ensure they work their capital as effectively as possible in these difficult times. There are a variety of techniques that can counter the impact of slower growth.

Sustainable working capital improvement

A combination of an increase in the cost of capital and a heightened competitive landscape led a leading global healthcare company to engage our working capital team. Our client faced the dual challenges of operating in over 50 countries with management objectives historically focused on revenue and margin growth. As is typical in these cases, any working capital improvement needed to be sustainable, achieved without adversely impacting the underlying business and in an environment where client resource was limited and with multiple other initiatives under way. Our experts, working in small, senior teams alongside client personnel, are driving a programme to convert 20% of our client's working capital into cash required to fund the future of the business.

"Deloitte is snapping up most of the receivership mandates for Structured Investment Vehicles (SIVs), sidelining competitors."

Reuters, 15 April 2008.

For some companies, however, the dark economic clouds may hold a silver lining. For companies with healthy capital reserves, the combination of lower valuations and less competition from private equity houses will make transactions more accessible than they were a year ago. The financial services industry is one sector that looks ripe for a spate of M&A activity, with some companies keen to shed non-core portfolio companies while others look to make the most of cheaper pricing.

Sterling's decline has also made UK assets more attractive to international investors. Chinese and Indian investors are increasingly looking to the UK for business opportunities. While the pound has made pricing more favourable for international investors, there are strong underlying factors which make the UK an exciting business destination.

In spite of the downturn, London is still the leading global financial centre and businesses from around the world are keen to benefit from this. Branding, technological innovation and business services, such as marketing, are also of great interest to international trade.

Shifting economics

Economic power is moving eastward, as economies in Asia and the Middle East continue to grow. Many organisations, including Deloitte, are looking at how to respond to the opportunity this presents. At the start of this year, John Connolly was part of a trade delegation led by the Prime Minister to China and India.

Asia

The past 12 months have seen record levels of trade between China and the UK. We have seen phenomenal growth in Deloitte China, which has a current workforce of 7,500 compared to 4,000 two-and-a-half years ago. The UK firm has been supporting this growth, with one example being the relocation of a team of private equity experts from the UK to the Chinese firm to work alongside the existing M&A group. This team is working with European private equity clients looking to source deal opportunities in China as well as serving the growing number of Chinese investors who want to access deals in the UK. Earlier this year, for example, we acted as reporting accountants on the initial public offering (IPO) of China Central Properties Limited, a China-based property developer which raised £150m on AIM. We also helped Chinese pharmaceutical company China Medical System Holdings (CMS) with a successful AIM listing. CMS was valued at £65.2m on its IPO and raised £10m to fund further expansion.

Middle East

In a survey of the region's private equity market, Deloitte found that confidence levels are high for long-term growth prospects, largely due to the plentiful availability of capital for investment and a buoyant economic climate. In response, we are creating a corporate finance joint venture with the Middle East firm and relocating a team of partners and managers to the region.

Islamic finance currently accounts for around 1–2% of the global financial services industry. Yet with Muslims accounting for approximately 20% of the world's population and growing, the market is likely to see continuing double digit growth. London's existing eminence as a world financial centre and the affinity the UK has with the Middle East as a place to do business, makes the Government's vision of London becoming a key global centre for the Islamic finance industry very achievable.

In anticipation of this, Deloitte has launched an Islamic Finance proposition which offers clients our core expertise in Audit, Tax, Consulting and Corporate Finance within a Shariah (Islamic law) compliant framework.

India

With an economy growing consistently at over 8% per annum, India has emerged as an increasingly significant player in the global economy. For British companies, India represents an opportunity to tap new markets and access world class talent. As a consequence of this, developing an India strategy is becoming an important element in the thinking of many of our existing and potential clients. Deloitte India has bolstered the talent in each of its service lines to meet the growing interest from international companies in India, with the recruitment of new partners and transferring teams from the UK firm.

In May Vodafone announced the acquisition of Hutchison Essar, the India-based mobile operator. Deloitte UK advised on the accounting for the acquisition and was subsequently appointed as auditors.

India-based Tata Steel demonstrated its global ambitions by its acquisition of Corus plc in April 2007, thereby becoming the sixth largest steel manufacturer in the world. Through the close cooperation of partners from Deloitte India and Deloitte UK, we were appointed auditors for the worldwide operations of Corus for the year ending 31 March 2009.

Russia and the Commonwealth of Independent States (CIS)

The rapid growth of the CIS is making it an attractive place for foreign investors. For both British and multinational companies, developing a strong 'CIS strategy' is seen as key to ensuring future growth.

Deloitte has hosted a series of Russian Executive Master Classes for companies considering an IPO which cover all aspects of listing on the London Stock Exchange, including corporate governance issues, the differences in listing requirements on the main market and AIM, the search for alternative sources of financing, and the role of NOMADs and brokers.

> "The information given in the classes was directly relevant to our bank's IPO plans – the speakers had direct experience in the areas covered and they seemed professional in their work. It's rare to meet so many high-quality speakers in one place."
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> **Yuriy Mitrofanov, Deputy Head of Legal, Gazprombank.**

Africa

In recent years, there has been a strong appetite for companies across Africa to grow their global footprints. For many that has meant moving their primary listings to London and raising capital in the London markets through AIM and the full board.

One example is Naspers, South Africa's leading Pay TV and ISP provider, which acquired the major European online auction site, QXL Ricardo, earlier this year. Deloitte UK, working with Deloitte South Africa, provided financial due diligence, tax and employee benefits services work, which involved coordinating Deloitte teams in multiple territories across the UK, Poland, Switzerland, Denmark and South Africa.

In June, Deloitte UK was offered the opportunity to become a training office for the South African Institute of Chartered Accountants. Once completed, this admission will make Deloitte UK the first firm outside of Africa allowed to train chartered accountants for the Institute. This initiative supports the UK's International Markets programme as well as our firm's commitment to innovation, talent and global deployment.

> "The Deloitte Master Classes have provided the London Stock Exchange with a much needed forum for in-depth discussions with pre-IPO companies looking at both our Main Market and AIM. By including the broadest possible group of IPO advisers the Master Classes have given CIS companies a comprehensive view of the challenges ahead of them."

Jon Edwards, senior manager (CIS), London Stock Exchange.