Vector
from SAMI Consulting
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Financial Wild West or a Global Ivy League?

During the course of 2006 and 2007, I was invited to join the Project Team of the World Economic Forum (WEF) to develop scenarios for the Future of Financial Services. This project originated as a result of the world leaders conference in Davos in 2006. The view was that the industry is so critical to national economies and is changing so fast owing to a variety of regulatory and technological drivers, that any instability in the financial world could destabilise everything.

How right they were. 2008, the year the credit markets are losing liquidity faster than an emptying bath, shows us just how frightening financial markets instability can be.

So what were the scenarios we came up with and who was on the team? The team was led by the WEF's core financial project management group and supported by McKinsey Consulting. Those invited to join the financial scenarios project, other than myself, included Accenture, Barclays Capital, Gartner, ICICI Bank, Infosys, INSEAD, Visa and many others.

Over a period of a year we developed a variety of scenario discussions, with the two critical drivers – regulation and technology – as the main axis of focus. The scenarios were therefore based on the ideas of more or less regulation and more or less innovation, where innovation incorporates technology change but has a wider meaning and spread.

Chris Skinner

The resulting four scenarios were:

- A Global Ivy League
- The Next Frontier (a Financial Wild West)
- Innovation Islands
- Back to the Past

To explain each one briefly, the first scenario is based upon more globally harmonised regulation causing less innovation, and creating a few major global banks: a Global Ivy League. The fact that regulation can act as a barrier to entry to financial markets, due to the complexity of reporting and maintaining accounts, as well as gaining banking licences and creating compliant operational practices, means that the only people who really get to grips with this are the major financial players such as HSBC, JPMorgan Chase, Barclays Bank, Bank of Tokyo-Mitsubishi and so on. Effectively the large global players therefore become larger and create a Global Ivy League that is hard to compete with or surpass. This is in fact the course that has been emerging and that, with the latest credit crunch catalysing more globally harmonised regulation, is the one likely to be enacted in the long term.

The second scenario, The Next Frontier, believes in more harmonised global regulation but also massive technology change creating many new entrants. PayPal becomes just one example of financial disruption, and Zopa, Wesabe, Obopay and others start to get increasing slices of financial markets action. Soon, you have new start-ups in banking and insurance almost every day, thanks to the opportunities technology can create. The Next Frontier represents almost a financial Wild West, with changes every day.

This scenario has also been bubbling away quietly and, yes, there have been significant innovations in the last two years, particularly around mobile payments, mobile banking, and the gradual integration of chip technologies to allow more intelligence in cards and other devices for payments. However, it is not a Wild West, even with the credit crisis, caused by over-extensive bank lending due to complex capital market derivatives. That crisis has been fuelled through leveraged balance sheets and by the banks – the banks who are heavily regulated, or so world leaders believed. The fact is that we will be moving further and further every day away from a financial Wild West of innovative new start-ups, to more and more regulated markets that squeeze out innovation.

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Financial Wild West or a Global Ivy League? (contnued)

The third scenario focuses upon regulatory matters being more locally based, rather than globally harmonised. In addition, innovation is high, but at a very local level. This scenario plays into the illustrations of Asia where South Korea, China and Japan are all showing significant levels of innovation in retail payments and banking. China is particularly innovative as their financial markets were pretty much closed to any investment until the turn of this century when they joined the World Trade Organisation. To join, China had to open its financial markets to foreign investors and, ever since, the level of renewal of its front-to-back-office financial operations and technologies has been astounding.

The same could be said of developing Central and Eastern European, Middle Eastern, Latin American and African countries that need sound financial markets to enable a sound economy. These markets also tend to be protective, with local regulations in place to ensure that the economy is not eaten alive by foreign players before they even get off the ground. But the idea of these islands of innovation staying for the long term is also inherently unsound, as financial markets operate globally. Therefore, yet again, we come back to global markets, globally managed and globally regulated.

Finally, the fourth scenario entertains the idea the people reject technological advances, dump their PCs and mobiles and return to branches and open outcry. Regulation is local, and there are fewer innovations. No-one on the team believed this could happen… although one individual (yes, you guessed, it was I!) did say that technology is becoming less and less reliable and more and more frustrating for many citizens, so the idea of returning to human relationships over a desk may not be mere fantasy after all.

But no. The idea of less change was rejected by all.

These ideas were presented at Davos 2007, and the white paper can be downloaded at:

http://www.weforum.org/en/initiatives/Scenarios/TechnologyandInnovationinFinancialServicesScenarios/index.htm.

In fact, all of these scenarios have some relevance to today's world of finance. However, the International Monetary Fund has claimed that the credit crisis is set to cost almost a trillion dollars in losses and, with most developed economies finding their banks, banking systems and regulators stretched to the hilt, is it any wonder that the G7 meeting in Washington in April 2008 called for globally harmonised regulation? The G7 meeting also summoned the leaders of the top banks of the world, including JPMorgan Chase and Barclays. Oh my word… the Global Ivy League.

The Global Ivy League is our scenario of truth: more regulation, globally harmonised and creating less innovation but more security amongst the major league players whom we feel we can trust. Or rather, our politicians feel we should trust.

I personally have moved on to other initiatives, but look forward to going back to Davos in future years to find out if our insights of 2006 and 2007 made any difference at all.

Chris Skinner

Chris Skinner is the author of a series of books published by Wiley & Co, including The Future of Banking, The Future of Finance and The Future of Investing. He is Chairman of the London-based Financial Services Club and Chief Executive of Balatro.

Scenar

SAMI Fellow John Ormerod reviews these scenarios in the light of recent global events.

The aim of this briefing is to test whether some of the global events since the publication of these scenarios in October 2006 have either challenged the assumptions underlying them or given us reason to believe that movement in the direction of a particular scenario is taking place. The general conclusion is that the scenarios remain sound.

Specific events and trends considered are:

Oil is currently around $120 per barrel. Growth in Russian oil production has peaked and, without massive investment, will start to decline. Outside the Middle East, new sources will be expensive but in real terms global spending on oil as a percentage of GDP is well below its 1980 peak.

The loss of confidence in derivatives and a more cautious approach to risk will increase the cost of capital for investment.

There is continued growth in sovereign wealth funds and private equity, but hedge fund activity is less exuberant.

The US dollar has proved enduringly weak, and the Chinese and Indian economies have performed robustly in the face of recession in US and Europe.

The impact of increasing food prices falls mainly on the very poor, exacerbated by the diversion of resources to biofuel production,

Governments fear to be too outspoken on human rights but people protests ensure that issues are not closed down.

Neither China nor India has suffered to any great extent from the collapse of the derivatives markets (China's investments in hedge funds and private equity are tiny in relation to its reserves). Both have seen increasing food consumption with prosperity but both are near self-sufficient in basic agricultural products, so although India will have to support its poor, neither are threatened to a significant degree. Similarly in oil, both have been chasing long-term supply contracts, China initially

rios for India and China 2015: UPDATE

winning more due to its deeper pockets but India recently catching up by securing agreements in Venezuela, Turkmenistan and Kazakhstan. Furthermore India will shortly have the world's largest oil refinery, a private sector facility at Jamnagar which will be largely export-oriented. In the future the two powers may find that cooperation rather than rivalry serves their interests better, a process which has started in Sudan.

India's savvy traders are pitched against China's government-sponsored investors and colonists; both countries are capable at adapting and finding new uses for existing technology, and it is this flexibility which will underpin their growth.

China

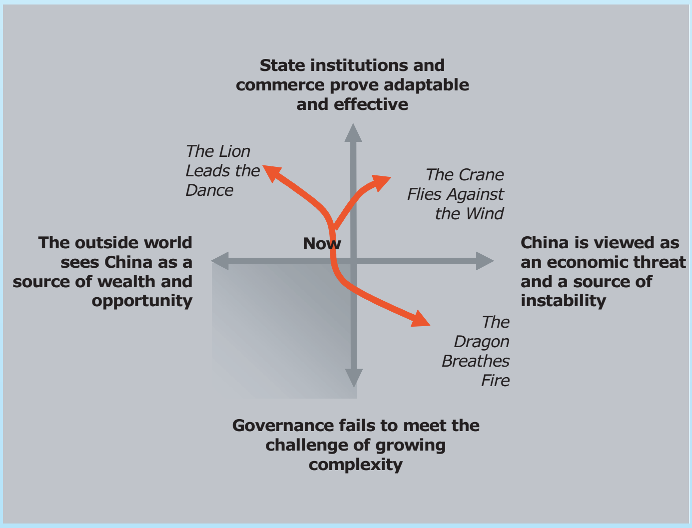
China's rapid industrialisation continues essentially unchanged in the year of the Olympics. Cheap capital and a government determined to modernise, often at the expense of individual and community concerns, have created a domestic boom to match that in exports. The need for raw materials and now food has driven China to secure resources wherever it can find them, adapting its foreign policy as appropriate: in the west using its financial resources to buy into producer companies, and in the developing world securing favours through more 'neo-colonial' methods such as financial and military dependency together with a blind eye to human rights issues. A recent survey showed that Europeans now view China as a greater threat to world stability than the United States. However, the economic partnership between the West and China remains beneficial and, as relations with Taiwan start to thaw, releasing more entrepreneurial energy, the business of development will remain the priority for Chinese leaders.

The scenario, 'The lion leads the dance' remains dominant, and although public concern over issues such as human rights abuses in Tibet, Chinese support for repressive regimes such as Sudan and Myanmar, and neo-colonialism in parts of Africa will boil over from time to time, it remains uncertain whether global pressure will be sufficient to mobilise an internal movement for democratic change. The position of the 'Now' on the China scenario diagram looks about right, close to the fork but the momentum is up not down.

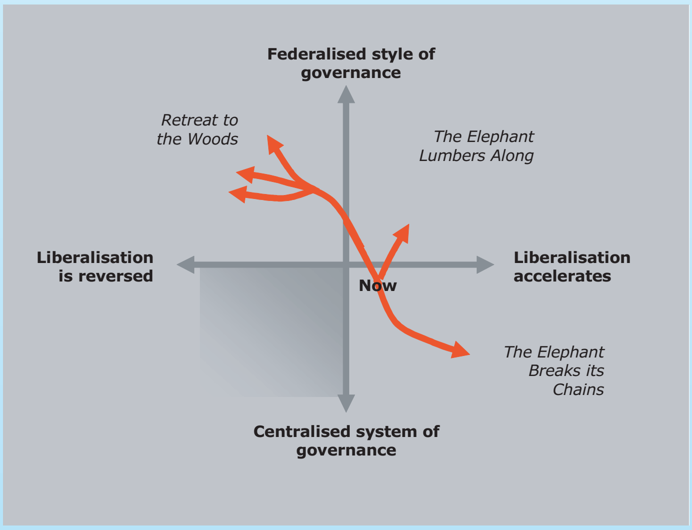
India

India's economy continues to bubble along and its private sector companies are starting to acquire significant overseas assets. Although India is rapidly becoming an open economy and trade is flourishing, the country faces a huge problem in building a 21st century infrastructure. Unlike China, whose government can literally railroad through major projects, India's has neither the financing nor the power to push through the development of roads, railways, ports and other much-needed facilities. India's budget remains tied to providing relief to the poor, subsidies to farmers and support for multiple layers of government administration and enterprise.

The very robustness of India's democracy means that it is difficult to change and, with so many fingers in the pie, there is little incentive for significant reform in the direction of greater centralisation. The lumbering elephant remains the dominant scenario theme until such time as the private sector can take on a greater role in infrastructure development. It is this, perhaps more than political change, which will open up the country to wide-scale modernisation.



Three scenarios for China



Three scenarios for India

From the CEO

Gill Ringland, CEO

The SAMI Fellows are all people who have ‘been there, done it’ in big organisations and have joined SAMI because they have concluded that making decisions looking forward is a lot better than making decisions with a firm eye on the rear view mirror.

We have designed our Executive Mentoring Service to apply our experience for the benefit of senior people who are perhaps new in role or convinced that the competitive environment is changing. Mentoring is a confidential, one-to-one developmental process. Its purpose is to develop confidence and improve performance of an individual. Its success depends on a close relationship of trust between the two people involved.

Executive mentoring is for senior managers and is even more sensitive to trust and mutual understanding than ordinary mentoring. The relationship is less that of teacher and pupil than of leader and trusted adviser. The role of executive mentors can range from ‘sounding boards’ for confident leaders, to acting as ‘water-wings’ for those who are out of their depth. Executive mentors are not mandated to be decision-makers; their task is to develop the ability of leaders to make decisions.

If you would like to discuss Executive Mentoring, contact us by phone on 0207 630 1104 or by email to *ExecMentor@samiconsulting.co.uk.*

Workforce Planning: Construction Focus

In the SAMI Consulting report on the Future of Services to the Public, published last summer by the Chartered Institute of Public Finance and Accounting, workforce planning arose as a key issue. Most employers think about their employees in a tactical way – worrying about the here and now, and possibly looking a year ahead. A very few look five years ahead and almost none look fifteen years ahead. Yet the changes anticipated in levels of skill requirements and workforce demographics mean that both public and private sector organisations cannot count on being able to recruit the right quality of people in the right place and at the right time – certainly without careful forward thinking and contingency planning.

Over the past few months, SAMI Consulting has received a growing number of enquiries from organisations interested in taking a strategic look at their long-term workforce needs, utilising SAMI’s scenario and other tools as a basis for exploring key issues, uncertainties and potential options. Working in this area in conjunction with the Organisation Consulting Partnership (OCP), SAMI Consulting now also offers its clients associated human resources and organisational change support to assist them in translating workforce strategy into action.

A workforce planning project currently being undertaken by SAMI Consulting in a joint venture with Experian Business Strategies is examining construction industry skills. Given the length of time required to train new entrants to the industry, particularly in the professions and a number of other high-skill disciplines, the team decided to look beyond its existing five-year skill and training requirement forecasting horizon and use a scenario-based approach to explore the changes which could occur up to 2020 in the overall environment in which the UK construction industry operates, and in the materials, methods and skill-base which it utilises. In this project, SAMI Consulting is providing scenario building expertise while Experian is providing modelling capability. Both organisations complement this technical expertise with considerable construction sector knowledge. The report is due to be published during this coming May and will be featured in more detail in a future issue of Vector.

For more information contact *colin.fletcher@samiconsulting.co.uk.*