

## risk management GLOBALISATION

# The global reality

Since the fall of the Berlin wall, the global economy has undergone as immense and probably irrevocable a change as that seen in the political world following the collapse of communism as a mainstream ideology. It has left businesses and treasurers needing to understand how global issues and events will affect them, if they are to continue to grow and be successful.

During the last 15 years, the UK economy has enjoyed major growth and the global economy has doubled in size. While manufacturing in this country has remained the same in terms of value, its share of total UK GDP has decreased as the UK has shifted decisively to a service economy – although the differences between the manufacturing sector and the services sector are blurring.

The service sector has put on a great show of strength for the UK economy and it's partly thanks to a large proportion of the services being provided by overseas companies. In fact, a great deal of UK services are provided by foreign-owned firms – in particular, oil, automotive and technology. The resulting cross-border activity has benefited the UK's economy and such activity should still be encouraged in all organisations whatever their size. Smaller businesses need to be aware of macro-economic issues, even if they don't seem directly relevant to them, as well as their own micro issues.

**FINANCIAL SERVICES SECTOR** While manufacturing has been in relative decline in the UK in terms of its share of GDP, the service sector has performed strongly – none more so than the financial services industry. It is only in recent years that the UK's export of financial services has grown strongly, but since the financial markets have opened up and cross-border business become more feasible, the UK financial services industry has moved swiftly to take advantage of this liberalisation.

For instance, the UK share of the world's total of exported financial services is 24%, compared with Germany's 4.2%. Perhaps this is one reason for the recent strength of the UK economy compared with other countries. With regard to insurance services, the UK's record is much the same: its share of the world total of insurance exports is in excess of 20%, compared with the 10% share of the US and Germany's 6.3%. So why has the UK economy been generating such formidable economic growth recently, and are the boom and bust years a thing of the past?

**BYE-BYE TO BOOM AND BUST** According to Pryce, economists believe the UK is now able to avoid booms and busts through design, rather than luck. By constantly bearing down on inflation in a period during which enormous and sustained growth has taken place, we are able to take advantage of lower costs. Given the international environment, small firms have to take advantage of the international links and be open to changes in strategy.

Changing ownership of assets has been coupled with a remarkable movement in foreign direct investment, especially in services. Foreign

AT THE TREASURERS' CONFERENCE, VICKY PRYCE, CHIEF ECONOMIC ADVISER AND DIRECTOR GENERAL FOR ECONOMICS AT THE DEPARTMENT OF TRADE & INDUSTRY, ASSESSED THE IMPACT OF



GLOBALISATION AND THE CHALLENGES FACING TREASURERS. JENNIFER CARRUTH LISTENED.

### Executive summary

- Globalisation seems an inevitable fact of life for national governments, large companies and even smaller businesses. Over the last 14 years the global economy has doubled in size. It has been predicted that China's economy will have eclipsed Japan's by 2012 and will possibly overtake that of the US as well. How should countries and companies react to these economic forces?

direct investment is often mentioned as a lead driver for economic growth and is thought to benefit national economies.

It can, for example, contribute to GDP and the balance of payments, and the creation and maintenance of fixed assets. The UK government believes that investment flows benefit both developed and developing countries, creating opportunities for investors and helping developing countries to achieve sustainable development. The impact of foreign ownership of companies and assets can be seen at every level of the UK economy, including in the largest companies. The regulatory framework of the UK economy is constantly under scrutiny and allows the impact of foreign direct investment to be closely administered and reviewed.

**THE NEED FOR ACTION** Government action is designed to ensure that the UK economy remains competitive in a global marketplace and to address particular concerns. For example, the Leitch Review set out a compelling argument for the UK to raise achievements at all levels of skills, and recommended that the country commit to becoming a world leader in skills by 2020, benchmarked against the upper quartile of the OECD. Doing this means doubling attainment at most levels of skill, and Leitch said responsibility for that had to be shared between government, employers and individuals.

**SERIOUS GLOBALISATION** Although the first traces of globalisation began in the 1870s, significant changes occurred during the 1990s. New market growth resulted in momentous change in China and India, and we are now moving to a stage where issues are of global importance, rather than national or local. The changes that will need to be made will have political consequences.

Globalisation is leading to a period of rapid and large growth in the GDP of countries in the developing world, resulting in increases in world GDP. In 2006 alone, global GDP grew by 5.4% and there was a growth in trade of 9.7%. Predictions that growth will slow down have



been proven wrong, and economic forecasters now argue that these heightened levels of growth are set to continue.

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Globalisation affects issues that treasurers deal with on a daily basis, such as pensions and interest rates. Pryce argued that it was important for organisations and treasurers to look at the implications of government policy and to reach an understanding of the extent to which these would affect them and how they could prepare for the future. When considering macro-economic uncertainties, treasurers are faced daily with terrorism and conflict – events such as 9/11 have had huge implications on the economy. It is important to try to assess the economic impact of climate change and cope with it. Treasurers also have to adapt to the decreasing availability of natural resources such as oil and coal, which is currently stoking inflation.

There are other long-term challenges that will affect the economy which should be considered when analysing risks for the future: the demographics of the country, socio-economic factors and the old-age dependency ratio and pressure on public services.

An investment in knowledge is essential for corporations, both big and small, to maintain and increase their skills base in order to operate efficiently and to have a well-informed workforce. This applies particularly to the smaller organisations, since, essentially, all businesses can now be global players in the world economy. Thanks to IT, there is broad connectivity between many countries, and smaller firms can take advantage of this. The markets in Asia and India are able to combine niche players with the larger ones in a way which allows smaller firms to participate in the global economy and grow. We're all global now.

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