Ask the experts: Question Time

Times of trouble

AT THE ACT ANNUAL CONFERENCE A PANEL OF EXPERTS ANSWERED QUESTIONS FROM AN AUDIENCE OF TREASURERS. **PETER WILLIAMS** LISTENED IN ON A FASCINATING DISCUSSION.

After its debut at last year's ACT Annual Conference, the question time session, which was sponsored by Lloyds TSB Corporate Markets, made a welcome return. This time it was led by Radio 4's rottweiler, the broadcaster and presenter John Humphrys. On the panel were keynote speakers Barbara Cassani and Alastair Clark, joined by Trevor Williams, chief economist at Lloyds TSB Corporate Markets, and Paul Boyle, CEO at the Financial Reporting Council (FRC).

Collapsed confidence The panel started off with a discussion of the Budget, which had been delivered by the chancellor, Alistair Darling, the day before. Cassani said she was both depressed and encouraged by the Budget: encouraged because there seemed to be an understanding that this was going to be a negative year; depressed by the growth predictions.

She added that business looked for two things from government: to create confidence and to get off its back. But the Budget had achieved neither of those. Delegates seemed equally convinced that the Budget had been a business flop: a vote of those present revealed that just one among the several hundred in the hall was feeling more confident after the chancellor's speech. The Budget had underlined the parlous state of the public finances but the chancellor's predictions for growth were seen as wildly optimistic, further undermining confidence.

Williams said the Budget laid out how costs were rising inexorably for the government. Predictions of when the recession will end are hard to make but most global slumps end within three years, while in Europe the timeframe is usually two years. So the most realistic prediction is that the downturn will end in the next year or so.

Boyle said the inconvenient truth was that as a result of the financial crisis everybody was facing lower standards of living, lower levels of public services and higher taxes. He condemned the 50% tax rate as a mistake, arguing that it was demotivating, especially for people like Cassani, whom he described as "inspiring".

DELEGATES SEEMED EQUALLY CONVINCED THAT THE BUDGET HAD BEEN A BUSINESS FLOP: A VOTE OF THOSE PRESENT REVEALED THAT JUST ONE AMONG THE SEVERAL HUNDRED IN THE HALL WAS FEELING MORE CONFIDENT AFTER THE CHANCELLOR'S SPEECH.

The key problem, according to Clark, is that the chancellor has to deal with the accumulating debt position but not with such ferocity that it results in the collapse of demand in the economy. The seriousness of the UK's situation should not be underestimated. Even at the most optimistic levels, a level of government debt that amounts to 80% of GDP has serious implications; in the 1990s, Latin American countries came close to total collapse when their public sector debt rose to 100% of GDP.

Implications for corporates So what does it all mean for the corporate sector? With a lack of access to capital, Cassani suggested that companies would have no choice but to grow more slowly and predicted that the money they spent would be subject to different criteria. For her, this very different environment would not be as much fun.

Clark agreed that the credit environment would remain much tougher, with the balance of power tipping back towards lenders and away from borrowers. He pointed to the erosion of covenants over recent years as well as other conditions that lenders might have wished to impose but hadn't felt able to. How far the pendulum will swing back remains to be seen.

Williams agreed, saying we were likely to see a return to conditions prior to the boom in liquidity and that the conditions in the years leading up to the credit crunch were abnormal. Changes in the world economy had made access to global capital cheap and the enormous provision of liquidity had led to erosion in credit and lending standards. A period of deleveraging seems inevitable.

Williams said that the best equilibrium would be one where both borrowers and lenders were happy with the amount and terms of credit and believed that debt would be repaid. But he warned that banks would need strong balance sheets before they could start profitably lending again in any quantity, and the renewal of the balance was still ongoing. The focus in the near term was likely to be domestic lending at the expense of cross-border lending. He added: "This is an unprecedented crisis and it is still in the process of being resolved."

Corporates are bound to have a different attitude to risk and risk management, according to Boyle. He said that one of the lessons we have learnt is that while unlikely events are still unlikely, they are not as unlikely as we may have thought. This change in corporate thinking is going to give treasurers a great opportunity because of their risk management skills.

Boyle also supported the new trend for business to "go back to basics" because of the belief that too many golden rules had been broken. But, he warned, at the same time it was important not to stifle innovation, and regulators, including the FRC, needed to take care not to impose too much extra regulation, although he conceded that more regulation in the banking and insurance sectors looked inevitable.

Cassani also suggested that a change in corporate governance culture was required. In the run-up to this crisis too many people had been silently

Left to right: John Humphreys, Barbara Cassani, Trevor Williams, Paul Boyle and Alistair Clark

complicit, she said. In particular, she suggested that many institutional investors had not held boards of directors to account. She said: "The big guys don't do it and there are few CEOs who invite the non-executive directors to disagree with them."

According to Clark, the seemingly intractable problem remains that the market tends to punish companies that fall short of the profit levels that brokers have indicated. He added: "We have had this debate on short-termism on and off over the last 40 years and it seems that we are back there again."

Directors need to be able to resist moving into business areas which they perceive as unacceptably risky but where their competitors are making large profits. The argument, said Clark, was that they had to join in because everyone else was in there, and if you didn't you risked being left behind.

The FRC is actively investigating the role of corporate governance in this financial crisis. Boyle said that the picture was a complex one and that the FRC was trying to find out what had really happened. The panel disagreed on whether enough of the directors of the banks that had got into trouble had left their posts.

Boyle said it was not clear that any model of corporate governance could have prevented the crisis in the banks. He also suggested that the FRC was hearing two different stories on the role of institutional investors. Overall, the FRC is determined to revisit the corporate governance code and see how it can work better in practice.

Where next? One of the possible consequences of this crisis is that the state in various guises may play a greater part in deciding the allocation of risk capital. Clark was adamant that, despite this latest inglorious episode in financial market history, junking the market approach in favour of an authoritarian approach would not work. He suggested that the restoration of a more even balance of power between lenders and borrowers would lead to better decisions than appears to have been the case recently.

Boyle also rejected heavy state intervention. A regulator for the last 10 years, Boyle said he was deeply sceptical about what regulators could and couldn't do. The best regulator, he said, was a well-informed market. He added: "We are all learning lessons and I am being candid about the limits of regulation. But I would ask you to accept that being a regulator isn't easy. You have to make tricky judgements on imperfect information."

Rejecting Moulton's argument for the need for greater simplicity (see page 15 of this issue) and warning against what he called a Luddite tendency, Boyle added: "It is about reflecting the underlying transaction. It is no use pretending the complex is simple."

As a director of both private and public companies, Cassani said that despite the huge amount of data contained in corporate accounts it was still debatable whether the key issues faced by business were captured in the accounts. Maybe, she suggested, mega corporations were simply too big.

The ticking timebomb While a great deal of attention has been paid to the financial crisis and the recession, the issue of pensions remains, in the words of a question to the panel, a "ticking timebomb". Cassani said the only good news was that many companies had moved away from defined benefit schemes: without the move to defined contributions the problems would be even greater.

The panel talked about the need to allocate risk between employees and shareholders. Williams said whatever the impact on individual companies, the problem was that we have an ageing population that is living longer and so we need to spend more on pensions. The simple truth is that we do not have enough savings set aside and that is going to require some tough decisions. For Williams, Western economies spend too much on consumption, don't invest enough and don't save enough, and the pension problem crystallises that fundamental issue.

Peter Williams is editor of The Treasurer.
editor@treasurers.org

For more on the ACT Annual Conference, see page 14.