Facing the fallout

BY 2050, THE SHAPE OF FINANCIAL SERVICES MAY HAVE ALTERED BEYOND RECOGNITION. **GILL RINGLAND**, AUTHOR OF THE IN SAFE HANDS? REPORT, OUTLINES HOW GEOPOLITICAL CHANGES WILL HAVE HUGE IMPLICATIONS FOR CORPORATE FUNDING, WHILE **GRAHAM BUCK** OUTLINES THE FOUR SCENARIOS CONSIDERED BY THE REPORT FOR THE INDUSTRY.

A report by the Long Finance Forum of Futurists (L3F) plots a series of possible future scenarios for the global financial services market, and considers the future of financial services over the next 40 years. On the basis of scenario planning conducted by futurists and key figures from the global financial services industry, it raises big questions about the size, location and role of financial services, the future of insurance, and the very nature of assets.

Underlying the scenarios was a set of macro global assumptions that will be operating by 2050:

- The global population will grow, principally in Africa and Asia, to nine billion and get older. This will cause major shifts of economic power, causing turbulence as political shifts follow. While financial services manage risk, the new centres of power may not share the value systems of the West, or the Washington consensus (see box on page 16). This raises questions over the future of the international governance of finance.

- Technology (info, cogno, bio, nano) will continue to introduce changes in personal capacity and lifestyles, while ICT will underpin much of society as well as commerce. The effect will be to decrease the headcount in financial services. The basis of life insurance – the sharing of risk – will be threatened by advances in genomics and by augmentation, and the basis of property insurance by advances in weather modelling and forecasting.

- Ecological, energy and environmental limits will be tested or breached as the population increases. The world's urban population will approach 70%, while the new middle class will eat meat, use cars, refrigerators and electronic goods, and travel for pleasure. By 2050, a primary role of the financial services industry could therefore be to manage ecological, environmental and energy resources. One consequence of the population growth could be that the assets most valued by people may be a permit to live in a city state or to reproduce.

Within this world, the L3F team developed four possible futures for the global financial services industry (outlined in Graham Buck's article starting on page 15).

IMPLICATIONS FOR TREASURERS At an event to publicise the publication of the report, a panel including ACT policy and technical director John Grout discussed the implications for corporate treasurers.

Grout distinguished the need for companies to have a strategic intent as well as a planning process and short-term decision-making. In setting both the strategic intent and making short-term decisions, they have tended to assume that finance will be available. Because that is changing, companies will need to start thinking more about capital efficiency.

He added that Western companies would increasingly need to explore alternative sources of finance to traditional banks, as is the case elsewhere in the world. China, for example, is a cash-oriented society that is investing directly in Western infrastructure without the involvement of banks.

Paul Moxey, head of corporate governance and risk finance at accounting body ACCA, said the report set a global context for financial services and then drew conclusions on their rationale and shape: were financial services "the stomach of the donkey rather than the tail"? In other words, do financial services have a key role in shaping the global context? Moxey suggested that the answer to this might be different in the US, Europe and different parts of Asia.

Michael Mainelli, a professor at Gresham College, said that the scenarios challenged conceptual frameworks, to ask the question – posed by Alan Greenspan – whether the framework that has been used for the past 40 years still reflects the world faithfully. He also emphasised that each scenario had positive and negative aspects and should be taken in that light.

The panel thought that the boundaries of financial services and other industries were blurring with the amalgamation of supply chains. The process is already well advanced in areas such as defence and infrastructure, and sales of furniture to consumers.

There was a wide-ranging discussion about the next decade. Bankers were thought to be shooting themselves in the foot over bonuses, with signs that governments were starting to stand up to financial services organisations. What form would the extreme discontent of many

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professionals in Europe take? Would banks be replaced by co-operatives?

Is the financial services industry able to pick up the pieces after the corrosive debt piles and possible crashes in Europe? While automation in many industries does far better than humans in managing complex systems, in financial services it seems to be heading towards more volatility. With so many examples of financial services failure, was it safe to ask those same systems to manage natural resources?

The report refers to US research – Gary Hamel and CK Prahalad's 1996 study, Competing for the Future – suggesting that just 2–3% of the time of senior managers is spent thinking strategically. So which industries are best at thinking strategically and use this time best? The answer is that it varies, but within sectors there are differences between those organisations that believe in being fast to adapt and those that believe they get an advantage by using future thinking; Shell, for example, reckons it can make decisions three to six months faster than its rivals by using scenario planning.

Gill Ringland is CEO of SAMI Consulting and chairman of L3F.
www.samiconsulting.co.uk

Future imperfect

GRAHAM BUCK LOOKS AT WHAT THE "IN SAFE HANDS" REPORT BELIEVES THE FINANCIAL SERVICES INDUSTRY MIGHT LOOK LIKE BY THE MIDDLE OF THE CENTURY.

The report "In Safe Hands? The Future of Financial Services" offers a sobering projection of how the sector might look like by the year 2050. Commissioned by Long Finance, set up by think-tank Z/yen and Gresham College, the study is part of the project's basic goal of improving society's understanding and use of finance over the long term.

As Mark Yeandle, a senior consultant at Z/yen, noted, the strongly market-based approach of the Washington consensus (see the box on page 16) is looking outmoded two decades after the term was first coined. Its imminent demise will have huge implications on how both financial services and the world in which they operate develop over the years ahead.

The In Safe Hands report proposes four potential scenarios for 2050. Two are based on the world still retaining many of the characteristics of today's society, while the other two are premised on a dramatic event, such as a major food or financial crisis, resulting in the destruction of consensus and triggering radical changes.

SECOND HAND The Second Hand scenario posits a world in which democracy is still valued, Western values and institutions are still part of the global business environment and capitalism remains the dominant paradigm, as part of the Washington consensus. Rather than thriving, international institutions have merely managed to stagger on but have been in decay as they fail to reflect the relative wealth of the four BRIC economies (Brazil, Russia, India and China) and other fast industrialising nations such as Turkey.

Early indicators of this scenario in the short term include the US and Europe losing economic strength and struggling to maintain military power, with Western states steadily shifting the onus for pensions and healthcare provision onto individuals and (decreasingly) employers. Western economies are constrained by debt and financial crises, but the global economy receives support from China and sovereign wealth funds.

The report regards this scenario as unlikely and considers it more probable that the Washington consensus will break down sometime over the next 40 years, ushering in a more fragmented world.

VISIBLE HAND In the Visible Hand scenario, the current political, social and economic regimes are still recognisable in 2050 within the Washington consensus. The world has evolved after financial and fiscal crises, developed responses to population and resource pressures, and taken advantage of the benefits of new technology.

THE LONG HAND SCENARIO SUGGESTS THAT THE FINANCIAL CRISES OF RECENT YEARS ARE MERELY THE PRELUDE TO A COMPLETE MELTDOWN IN MANY WESTERN COUNTRIES BY 2050.

The result is a better-educated and well-fed world, but one achieved at the expense of "rugged individualism". A pervasive global culture leads, in turn, to extreme volatility and ultimately the breakdown of international institutions by the middle of the century.

This scenario is also based on the assumption that Western economies recover strongly from financial crisis and avoid further crises. Nevertheless, the report suggests that, in any event, the large numbers of people whose living standards decline and the increasing dominance of very large corporations will see the consensus break down by 2050.

LONG HAND The Long Hand scenario suggests that the financial crises of recent years are merely the prelude to a complete meltdown in many Western countries by 2050. State budgets will have become overloaded, triggering retrenchment in state expenditure, consumer spending power and overall consumption.

Long Hand is a bleaker scenario than Second Hand or Visible Hand. Crises spell the demise of the Washington consensus, society breaks down and subsequently reforms around ethnic and religious affinity groups, and democracy is not unanimously regarded as a universal good.

This scenario could develop following a major collapse in world order, such as a serious global food shortage or as a result of the ongoing effect of financial crises such as the breakup of the euro. What might prevent Long Hand developing is if – contrary to expectation – the Washington consensus survives but undergoes a steady evolution by 2050 to permit greater diversity and to decrease volatility.

MANY HANDS Possibly the most alarming scenario of all is Many Hands, which envisages a world where globalisation is deemed to have failed, democracy is seen as too unwieldy and Western value systems regarded as inadequate. The concept of the nation state as provider will have disappeared, with society reforming around city-states. Its causes would be similar to those of the Long Hand scenario and again it is assumed that the Washington consensus has been abandoned. The city-state will not assume all of the nation state's former responsibilities, particularly for welfare and financial protection, and individuals will aggressively defend their personal identity and credit ratings in a world where traditional monetary and cash systems have collapsed.

INDIVIDUALS WILL AGGRESSIVELY DEFEND THEIR PERSONAL IDENTITY AND CREDIT RATINGS IN A WORLD WHERE TRADITIONAL MONETARY AND CASH SYSTEMS HAVE COLLAPSED.

While the Long Hand and Many Hands scenarios share many characteristics, the prominence of cybercrime attacks could favour the latter, which has a greater emphasis on physical presence. A Long Hand scenario would be distinguished by military and civil insecurity, and trust within a community would play an important role.

FINANCIAL SERVICES CENTRES The report examines in some detail how the differing scenarios might affect the financial services sector of 2050 – and even whether parts of the industry, such as insurance, would still exist.

The strengths of respective financial services centres is considered under each scenario. Second Hand anticipates the emergence of Singapore as the world's pre-eminent financial hub, although both London and New York continue to enjoy eminence under Second Hand and Visible Hand too. Both cities are also considered likely to prosper under a Long Hand scenario, in which multiple virtual communities inhabit the same space – much as today's London and New York are home to many different nationalities.

The city-state scenario outlined under Many Hands would benefit centres such as Hong Kong. Many Hands envisages the emergence of a loose federation of around 50 city-states, each setting its own currency, regulatory framework and mobility rules given that trust between each of them would be weak and international regulation would have decayed. Around five of these 50 will dominate financial services; one of the five will be Istanbul by virtue of its lead in Sharia-compliant services.

Graham Buck is a reporter on The Treasurer.
editor@treasurers.org

The In Safe Hands report can be downloaded free from:

- *www.longfinance.net*
- *www.samiconsulting.co.uk*

The Washington consensus

The term "Washington consensus", originally coined by economist John Williamson in 1989, describes a set of 10 relatively specific economic policy prescriptions. These, he considered, constituted the standard reform package for crisis-wracked developing countries promoted by institutions such as the International Monetary Fund (IMF), the World Bank and the US Treasury Department.

1. Fiscal policy discipline avoids large fiscal deficits relative to GDP.
2. Public spending redirected from subsidies toward broad-based provision of key pro-growth, pro-poor services such as primary education, primary healthcare and infrastructure investment.
3. Tax reform broadens the tax base and adopts moderate, marginal tax rates.
4. Interest rates are market-determined and positive (but moderate) in real terms.
5. Exchange rates are competitive.
6. Trade liberalisation is pursued, with particular emphasis on eliminating quantitative import restrictions and trade protection achieved by low and relatively uniform tariffs.
7. Inward foreign direct investment is liberalised.
8. State enterprises are privatised.
9. Deregulation is undertaken, with regulations impeding market entry or restricting competition abolished (except when justified on safety, environmental and consumer protection grounds) and financial institutions subject to prudential oversight.
10. Legal security is given to property rights.