



## **The inside view: No quick fix for broken investment cycle**

BY EDMOND WARNER

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There can be no doubt that the investment system is broke. How to fix it, that is the issue. The government and its authorities have heaped inquiry upon inquiry, with little evidence of consequential legislation. The financial industry has hunkered down in the hope that these squalls will blow themselves out. As yet, there are few signs of the necessary behavioural change.

This week heralded the launch of yet another inquiry. This one, I hope, has a chance of getting to the heart of the problem, and not just because I am privileged enough to be included in the inquiry team. This is an independent examination of the entire investment system, not government-sponsored sticking plaster, nor a narrow focus on a single cog in the machine.

The Centre for Tomorrow's Company, a think tank, has assembled a group of industrialists, investment practitioners and advisers who are concerned about the flaws in the system and are committed to a fresh examination of their causes and possible remedies. Under the leadership of Sir Richard Sykes, formerly chairman of GlaxoSmithKline and now rector of Imperial College, we will attempt to form a holistic view of the cycle of capital from savers to corporates and back again. All input gratefully received.

The inquiry is titled 21st Century Investment, recognising that three years of systemic failure need not condemn the economy to a further 97 years of a misfiring capital engine. There is little doubt, though, that the pell mell developments of the past couple of decades have long since outstripped the ability of the financial infrastructure to adapt to new ideas and processes, and to the sheer volume of agents operating within it.

As the bear market has dragged on, it has ground away at the weak spots in the system. While there have been high profile cracks - Enron, Equitable Life, etc - there are many, many more instances of wafer-thin infrastructure that is barely resisting the strain from greatly diminished asset prices. A few busts are fine. They can constitute healthy reminders of the nature of risk. Systemic weaknesses are altogether more worrying.

### Gripes

Many of the problems ingrained in the investment system are well known and understood. Many have been the source of gripes for years. Some have formed the specific focus of previous narrow inquiries. Only this week the financial services authority published new guidelines for the conduct of brokers' analysts, intended to prevent the recurrence of their apparent abuses in the bull market.

The gripes are unlikely to cease, however. And not just because the government has been slow to implement recommendations, or because guidelines still allow too much latitude. They will continue because dissatisfaction runs too deep to be assuaged by kicking the odd scapegoat, and because proscriptio and prescription usually just encourage the exploration of novel ways for business to continue as usual.

The investment chain can be likened to a game of Chinese whispers. What the saver tells his adviser, who hires his investment manager, who seeks advice from his broker, whose analyst talks to companies, who make the investments that pay the dividends that provide a return to the saver, might be very different by the time the company gets to hear it. Small wonder that the saver feels aggrieved that he has not got what he wants and has paid through the nose not to achieve it.

The system can only work if all parties have sufficient trust in each other. There are many agents and few principals in the system, and hence many potentially conflicting agendas. If interests can be aligned so that the actions of all parties reflect the original interests of the providers of risk capital, then the chances

## MEDIA

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that these interests will eventually be met will be greatly improved.

### Dangers

Unfortunately, these interests are often poorly understood by the capital providers. They know they want a comfortable retirement, or to provide for their children, but they are incapable of calculating the financial implications of these aspirations. The Myners report highlighted the need for better education of pension fund trustees. It is likely that this requirement extends to a far greater population.

Recent events have demonstrated the dangers consequent upon a breakdown in trust in the financial system. Savers have spurned paper investments in favour of bricks and mortar. They may prove to have made wise decisions, but the sharp divergence in the valuation of equities and houses suggests that the risk they have embraced is far greater than they perceive. The economy can ill afford a repeat of the house price slump of the early 1990s, particularly coming on top of the pensions and savings crisis.

The 21st Century Investment inquiry team is not embarking with prejudged conclusions - the problems are too knotty. At the outset we are gathering evidence and opinions. My hope is that recommendations emerge that constitute a practical agenda for enduring change to the system of wealth creation within our economy.

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