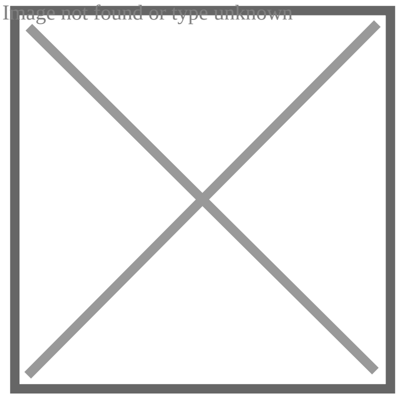

Financial Challenges in a VUCA world

Description

Given the economic challenges of today, it is obvious that our businesses need to be more agile. This is not something that can happen overnight and in many cases will demand a cultural shift. I believe we now live in precarious times and we can't rule out another crash. This will be marked by acute Volatility, Uncertainty, Complexity, and Ambiguity within the financial markets.

This demands greater technical and behavioral insight. A report by Deloitte, Global Human Capital Trends 2016 found that of 7000 executives surveyed, 92 percent believed that leadership was a critical priority[1]. Furthermore, 56 percent stated that their companies were not ready to meet the leadership challenges presented by today's market economy[2].

What to do?

We need to build adaptive leaders and teams that will bend and not break. To me, VUCA is the new norm. Outlined below are the key points from my webinar Stick or Shift. For each point, there are huge leadership implications.

Volatility

Volatility across financial markets and between economies has been heightened since the early 1990s. The IMF recently examined the correlation between various market indices and identified two distinct periods of correlation of returns: prior to 2008, 0.45 and post 2008, 0.7[3]. As a consequence, the increasing ease of trading across various jurisdictions and the heightened correlations has created the conditions for shock across financial markets. This interdependence, in part, lies behind the higher volatility facing financial markets.

This effect is mirrored by the performance of the real economy. Trade linkages have mushroomed with the rapid growth in emerging market economies. China is a classic example: the EU now accounts for almost 20% of China's exports and over 40% of the UK's. A sluggish recovery in the Eurozone will impact the export performance of both China and the UK. Volatile external forces in a company's target markets will negatively impact a business and affect its earnings stream. These forces are not directly controllable.

Uncertainty

Predicting market behavior is becoming increasingly difficult. What odds would I have been given in 2006 on Lehman's going bust or Merrill Lynch being taken over? Equally, who would have contemplated that a software company focused on video streaming and only founded in 2005 would be bought for $1.6billion in 2006? These events were not really forecastable and demonstrate how easily we can be overtaken by a course of events. This uncertainty is prevalent in the economy today. There is no concrete idea as to when interest rates will rise or fall. This is macroeconomic uncertainty.

Complexity

Financial markets are not only increasingly fragmented but compared to 20 years ago there has been a significant increase in the range of financial instruments available. To put this in perspective, a paper by the Bank of England states that for an investor to be fully informed about a structured bond called a Collateralised Debt Obligation or CDO2 , the investor would have needed to have read over a billion pages[4]! 2 This is an extreme example but consider the number of trading relationships the UK has with other countries across numerous product and service sectors. The daily global turnover in the foreign exchange market is in excess of $5 trillion per day and London's share of this is over 40%[5]. From this consider the ramifications of the UK leaving the EU.

Ambiguity

This is writ large at the moment in terms of negative interest rates. It doesn't mean retail or commercial banks are going to be charging their customers to keep cash at the bank. It means the commercial bank will be charged for keeping cash at their respective Central Bank. The impact of this policy is ambiguous. There is the potential for pressure to be placed on a commercial bank's margins and as a consequence increase the rate charged on loans; an action which in turn would reduce borrowing by consumers and businesses. It may also increase borrowing and boost aggregate demand thus achieving its primary objective – but that increased borrowing may also make the balance sheet of households and firms more susceptible to an external shock.

1. David Brown et al, Global Human Capital Trends, Deloitte University Press, 2016.
2. Ibid
3. IMF Global Financial Stability Report, Oct 2015, fig.1.17 p. 37.
4. Andrew Haldane, Bank of England Rethinking the Financial Network, April 2009, Table 2, p. 37.
5. Bank for International Settlements, Triennial Central Bank Survey of Foreign Exchange and OTC Derivatives Markets, 30 March 2016.

Date Created
September 2018
Author
brian-kikkert