Contributions to Political Economy (2008) **27**, 125-137

REPORT FROM THE FEBRUARY 2008 CIBAM GLOBAL BUSINESS SYMPOSIUM "GLOBAL FINANCE", 21–22 FEBRUARY 2008, EMMANUEL COLLEGE AND JUDGE BUSINESS SCHOOL

I. INTRODUCTION

This report is a summary of the proceedings of the February 2008 Global Business Symposium, on Global Finance, organized by the Centre for International Business and Management (CIBAM) at the University of Cambridge. A number of leading authorities from business, rating agencies, private equity firms and financial organizations, analysts, policy makers and academics exchanged ideas and provided their views on critical issues pertaining to the current financial crisis. These complement and add flesh to the academic papers published in this special issue.

II. FIRST DAY—THURSDAY 21 FEBRUARY

Welcome Address

Professor Arnoud De Meyer, Director of the Judge Business School, gave the welcome address. He started by mentioning the School's recent success—Judge Business School (JBS) was ranked tenth in the world *Financial Times* business school ratings. Professor De Meyer specifically highlighted a significant improvement in research in the same ranking, an important aspect of the School's work. Commitment to continually improving the quality and quantity of research is the main strategy of JBS, closely linked to its place at the heart of Cambridge University. Professor De Meyer named CIBAM as a great signal that that strategy goes beyond the frameworks of the ordinary business school. He stressed the importance of the Symposium, since finance is the most notable area where academic research has direct implications in the real business world, making the interaction between financial research and financial industry unique. Finally, Professor De Meyer briefly touched on current conditions in the financial sector, and pointed to the importance of ethics, social responsibility and proper corporate governance.

Introduction

Dr Christos Pitelis, CIBAM Director, welcomed the audience and introduced CIBAM. He highlighted that CIBAM explores the conditions for sustainable wealth creation in the global environment and does this by identifying links between practice, theory and policy, by exploiting dispersed knowledge and deriving good practice. He added that proper dialogue between academics and business-professionals is important in order to exchange ideas accurately. The current Global Finance Symposium was proposed by Jonathan Garner almost two years ago, when the financial sector was booming. Dr Pitelis pointed out that now, however, the sector has become a big issue for everyone, and this topic is of particular relevance and importance at the moment. Then Dr Pitelis introduced the main topics of the financial symposium and left the floor to Dr Noreena Hertz, CIBAM Associate Director.

Opening Panel: Global Finance: The Issues

The Opening Panel was chaired by **Dr Noreena Hertz**, CIBAM Associate Director, who invited the panelists to introduce the crucial issues affecting global finance.

"The Credit Crisis and the Long Term Prospect of Global Financial Markets", Mr Chen Zhao (Managing Editor, Bank Credit Analyst)

Mr Zhao suggested that, to analyse the present sub-prime debt problem, analysts need to look at the big picture and at historical parallels to draw some comparisons with past crises. The current sub-prime debt meltdown is comparable to the US savings and loan crisis in 1980s. In Mr Zhao's opinion, the current sub-prime crisis is unlikely to turn out worse than the similar "meltdown" that affected US savings-and-loan (S&L) institutions in the 1980s. Both crises involved problem debts equivalent to around 3% of American national income. Although defaults on sub-prime residential debt are potentially more dangerous than the S&Ls' commercial property loans—because they undermine consumer spending—the current economic conditions are more benign than those in the 1980s. Mr Zhao also noted that capital adequacy ratios are currently higher than in the 1980s and price–earnings ratios, bank loans-to-reserves ratios and OECD core CPI inflation are all substantially lower, making it safer for the authorities to combat recession with monetary and fiscal expansion, and more likely that private industry can turn around quickly. Mr Zhao recalled that in the 1980s the S&L crises triggered a collapse in the global real estate market (the Japan, Asia and Europe real estate markets collapsed). He pointed out that this is not evident in the current sub-prime crisis.

Mr Zhao reminded the audience that the US$ rose 20% in the Trade Weighted Index (TWI) from 1987 to 1989. By comparison, today we have a consistent decline in US$ and it is creating a massive export boom. Mr Zhao stressed that the dollar decline could also bring long-run salvation for the United States, generating an export boom that revives the economy and corrects the trade imbalance that forced it to borrow abroad during its previous phase of fast growth. Mr Zhao noted that, while the corporate sector 18 years ago was massively over-leveraged, now the

US private-sector debt ratio is low. He also pointed out that in every decade there is a crisis and these financial crises have to be credible for central banks to reduce interest rates and inject liquidity. If this sub-prime "mini" crisis is credible and if central banks respond by injecting liquidity, there is a reasonable chance that the next mania will be triggered by emerging markets or oil. Mr Zhao also highlighted that this is the first time the emerging markets have decoupled (emerging markets out-performed the S&P 500 for the first time). In future, as we approach 2010, we may see the development of a major crisis.

"The Evolution of the Global Credit Cycle with Special Reference to OECD Housing Markets", Dr Peter Warburton (Director, Economic Perspectives Ltd, Member of the Shadow Monetary Policy Committee)

Dr Warburton began by stating how important it is to fully understand the initial conditions which cause crises. Globalization of financial markets in the last 20 years argues strongly for a global understanding of the global credit cycle. The events unfolding over the last year should be regarded as the culmination of a "protracted" global credit cycle—with the expectation of a depressed credit market condition over the next 3 years, leading to inevitable spill-overs into the economy and the attendant loss of output. He pointed out that the world is at the end of an unusually long phase of credit expansion, whose unwinding will necessitate two to three years of zero or negative growth for Organization for Economic Cooperation and Development (OECD) economies—including Europe—despite central banks' efforts to avert it through big reductions in borrowing costs.

Dr Warburton commented that, over the last 15 years, credit cycles have become more dominant, whilst we have been focusing on business cycle and recommended business cycle remedies. Bank credit does not tell the whole story about credit—we have to look at globalized credit, national credit, private and public sector borrowing, as well as financial and non-financial motives for borrowing. Key developments in last 15–20 years are:

- the last credit meta-cycle ended at the end of the 1980s, which focussed on bank lending;
- there were severe bond market falls in 1994 and 1998–1999 (including Russia's bond default and LTCM), but the US banking system was resilient;
- the biggest threat to the credit cycle was in 2002, and needed radical policy to avert a credit crunch.

Dr Warburton also highlighted that the credit cycle was synchronous to the business cycle until 1990s, but now the credit cycle is more moderate and has different characteristics from the business cycle. This current crisis marks the birth of globalized credit markets, highlights a period of difficulty for fiscal and monetary policy. Notably, the yield curve which was previously predominantly controlled by the short end until the early 1990s is now driven by the long end of the bond market, which has more influence now than the policy-driven short-term rates.

Dr Warburton noted that the US Federal Reserve ceased to respond to conditions of buoyant private sector demand (expressed as a financial deficit share of GDP) and failed to respond with tightening monetary policy in the way that they had consistently done since the 1970s. He commented that the Fed shied away from tough action needed to discipline those excesses and thus created a moral hazard situation. Warburton argued that the Federal Reserve and other OECD central banks averted a global slowdown in 2002, when widespread defaults—including Argentina's—threatened to stall world bond markets, but they did so only by "driving deeper into moral hazard territory", sparking the reckless search for higher yield which has now blown back in the form of excessive debt.

Typically, emerging markets have very different characteristics from OECD, primarily because of the crisis which emerged in 1997–8. It has had a sobering effect on the balance sheet development in the financial system. In addition, emerging markets countries have low debt to GDP because they do not have developed bond markets. It is possible that the current correction in the credit cycle need not undermine the emerging markets. However, the Asian bloc remains more exposed to losses of investment, rather than to losses from the banking system. Unlike Chen Zhao, Warburton claimed that the housing credit cycle is synchronous with the OECD business cycle and tends to be coordinated across all countries. Given this global characteristic in the housing market, a globalized downturn in housing market may be very likely in the future.

Dr Warburton closed by commenting that by focusing on inflation targets, OECD governments ignored the improbably large rise in asset prices, especially for houses; and by setting ceilings only on public sector debt, they allowed a growth of private borrowing that has lifted the average total debt-to-GDP ratio to around 250% across the OECD, rising above 400% in Ireland, the Netherlands and Spain. As such, the whole ethos of inflation targeting in central banks may close as a result of these corrections. In Dr Warburton's opinion, public institutions need to suspend inflation control.

"Can Emerging Markets Save the Day? Evidence for Decoupling", Mr Jonathan Garner (Managing Director and Head of Global Emerging Market Strategy, Morgan Stanley)

Mr Garner began his presentation by describing the massive supply chain development in emerging countries. He raised the question of how investment banks generate huge amounts of fixed income revenues when on yield curves we observe very low spreads. Mr Garner maintained that nowadays, as we observe massive credit bubble and balance sheet expenditures, emerging markets can save the world. He highlighted that there is a fundamentally strong growth of working age population, rise in urbanization and increase in labour force that plays a positive role in driving household income in emerging markets (EM). Extensive technology adoption in EM countries further enhances the process. The market now allocates vast resources in China and other large EM countries, and gradually the emerging world is becoming dominant. Therefore it is logical that trade is booming there and this year's equity winner was EMs.

Mr Garner then compared decoupling in two decades, the 1990s (United States vs Japan) and the 2000s (EM vs United States). He explained that the major drivers in both decades have been initial valuations, divergent domestic demand and the interplay of leverage/property market trend. Trade linkages were a second-order impact in both decades. In Mr Garner's opinion, if anything, the most notable effect was to mitigate the underperformance in the laggard market (Toyota in 1990s vs GE today). Mr Garner also talked about fast increase in EM economies, highlighting trends using a range of statistical data. The three largest EM auto makers (China, India and Brazil) are now 77% of the size of the US market, growing 21% annually; in PC shipment, Asia Pacific (excluding Japan) is now a market of approximately the same size as the United States, while only in 1998 it was one-third of the US market; in addition, the infrastructure spending in EM from 2008 to 2017 is forecast to be 22 trillion US$. Based on these and others statistics, Mr Garner concluded that EMs are making gigantic steps to transition the world to EM-led global economy.

III. SECOND DAY—FRIDAY 22 FEBRUARY

Mr Jonathan Garner, Managing Director and Head of Global Emerging Market Strategy at Morgan Stanley, was the Chair for the second day of the Symposium and introduced the speakers.

"Recession or Deflation?", Mr Roger Nightingale (Global Economist, Pointon York Sipp Solutions)

Mr Nightingale discussed the cyclical behaviour of economies, and of the US economy in particular. His central theme was the idea that, while the periodicity of the cycles was easier to forecast, the amplitude of each cycle was almost impossible to predict. However, it is possible for central bankers to manage the amplitude of the cycles, by tightening and loosening the availability of credit through the use of interest rates. Mr Nightingale argued that the current financial problems were at least partially caused by the bankers' response to the realization that they have let credit grow too fast for too long. Just at the moment when the economy is slowing, central banks are trying to limit credit, and they may cause the economy to stall. He also highlighted parallels with the situation in Japan in the late 1980s, and in the United States in the 1920s: both saw excess credit for long periods, which led to misbehaviour among the financial community.

Banks tried to deal with the moral hazard by penalizing with interest rates, and, while they were successful in removing the "bad boys", the wider economic and social costs were significant. Mr Nightingale highlighted his fear that history would repeat itself. Banks will refuse to cut interest rates in the way they should, citing the moral hazard argument, and this may push the United States into depression (a more severe, longer lasting, economic downturn than a recession). During the ensuing discussion, Mr Nightingale highlighted his point that periods of excess supply of credit were more serious than periods of excess demand. During excess demand, interest rates can be used to curb inflation. However, during periods of excess supply, it is important to cut interest rates, as the prospect of a depression is worse than that of inflation. In Mr Nightingale's opinion, this is not always the bankers' response, and this should make us concerned.

"Private Equity or Public Equity: Substitutes or Complements?", Mr Charles Sherwood (Partner, Permira)

Mr Sherwood, Partner at Permira, began with an introduction to Permira and an overview of the Private Equity (PE) sector. The sector has become a global phenomenon and has grown exponentially over the last seven years. However, Mr Sherwood pointed out that, even at the peak in early 2007, the profile of the industry was out of all proportion to the role it actually played in the market. He pointed out that, of the 20 largest M&A deals in H1 2007, only one involved a PE firm, and the same was true in 2006 (one of the largest 15). Since mid-2007, larger deals have almost disappeared, but there is a steady flow of smaller deals. However, while there was initially a liquidity issue, shortly followed by a small recovery, very recently, the debt market has imploded with the threat of default undermining consumer confidence. This has also been highlighted by the dramatic falls in the Global CEO Confidence Index (published by Goldman Sachs), which plunged over the last two to three quarters.

Mr Sherwood then moved on to the question of how PE companies create value and debunked a number of common arguments:

- "The secrecy argument"—Mr Sherwood highlighted that most PE companies and their portfolio companies are too large and too high profile to be secret, and they do not make money simply by doing things.
- "The money argument"—this argument is also inconclusive, as PE companies have a very similar profile of investors in their funds compared with investors in public companies.
- "The myth of gearing"—taking a blend of senior, second-lien and mezzanine debt rates, the after-tax return is very similar to the stock market (6.5% against 6–7%), confirming that the gearing does not create value, it simply magnifies value created by other means.
- "The ruthlessness argument"—if the value creation came from asset stripping, inflation of cash flow, cutting R&D spend etc., others would not be stupid enough to buy those companies.
- "The short-termism argument—the quick flip"—Permira's average holding is *circa* 5 years, and the World Economic Forum's recent report confirmed that only 12% of deals are exited in less than 2 years, and 58% are exited after 5 years.

Mr Sherwood argued that value creation comes from exploiting governance arbitrage, i.e. the reasons for and the way in which decisions are made. In Public Equity, long decision-making chains make rapid decisions difficult. Private Equity has a much closer relationship with the Board, and has closer financial alignment. It is therefore effective when the premium on rapid, aligned decision-making is high, i.e. for companies going through radical change. PE is a cost-effective form of ownership for these companies, but will never replace Public Equity. It is much longer term and fees are considerably higher, making it suitable only in certain circumstances. During the discussion it was also highlighted that, while PE firms do not know how to manage firms better than those already in the industry (i.e. they are not the new conglomerates), they do know which management teams are best, and can bring them in when needed.

"Credit Ratings: A Simple Tool in a Complex World", Mr Richard Hunter (Chief Credit Officer, Europe, Fitch Ratings)

Richard Hunter, Chief Credit Officer, Europe for Fitch Ratings, began with an introduction to credit ratings, highlighting their value as a simple tool. However, he also noted their limitations in that they are just an opinion; they are one-dimensional (only looking at default risk); they are ordinal (not cardinal); they are bottom-up not top-down; and, by their very nature, a huge amount of information is hidden in a few letters. He also noted that the ratings reflect the median risk, and do not reflect the spread of opinion, and discussed the limitations on the comparability of ratings across asset classes. Mr Hunter introduced some of the new ratings scales used to counteract these criticisms, such as loss severity, volatility and liquidity, but pointed out that these were difficult to parameterize, faster changing than default risk, and that there was very limited demand from investors—many are content, at the moment at least, to use just one rating.

Moving on to the current crisis, Mr Hunter discussed some of the surprises which the credit rating agencies (CRAs) had encountered, and which had led to errors in ratings and poor anticipation of emerging problems. These surprises included:

- US residential backed mortgage securities—the impact of weaker lending practices, the house price fall effect on loss frequency and the sensitivity of borrowers to refinancing options
- Global CDOs—the level of correlation between underlying assets, particularly structured finance assets
- Financial institutions—the scale of off-balance sheet exposures, and impact of market interruption on "disintermediaters".

Mr Hunter described the ratings agencies' reaction to these surprises, highlighting that the ratings downgrades were not that significant, but there was a significant increase in the percentage expected losses. The result has been the emergence of a world without ratings. Ratings are not seen to play "catch-up", by being confirmatory, and not anticipatory. Investors have lost faith in a broad range of ratings of solid but opaque structures, and there are question-marks over the use of ratings for systemic purposes. Mr Hunter questioned what will happen now—one option is to regulate the CRAs or stop using them—or both. He also noted the regulatory conflicts of interest, given that CRAs are paid by the people they are rating, and questioned whether companies speak the truth to the system guardian.

In future, Mr Hunter expects further negative ratings trends. He also considered what other things might go wrong and highlighted further weaknesses in the ratings system, e.g. EM banking system crunch, failures in insurance/reinsurance market, CDS counterparty risk, particularly unregulated protection writers. Finally, Mr Hunter discussed some potential changes in the ratings industry, e.g. tougher internal corporate governance, more conservative ratings, less reliance on models, more deterministic stress tests and potentially more ratings scales.

"Quantitative Fund Management", Professor Michael Dempster (Emeritus Professor of Management Studies, Judge Business School)

Professor Dempster discussed quantitative methods in systematic investments. Professor Dempster started with showing evidence that technical methods in investments are becoming more and more popular. Then he touched on the factors that delay wider use (two major factors are in-house culture and IT cost) and the factors that contribute to wider use (including desktop computers and positive results). The most popular quantitative methodology is regression analyses, the most widely spread risk measurements are variance and value at risk, and the most popular optimization method for portfolio construction is the mean-variance approach. Professor Dempster concluded that, due to the influence of hedge funds on the industry, employment of systematic investment strategies is moving from tactical allocation to trading and the next area to be emphasized by the industry will be dynamic stochastic optimization modelling of strategic problems in investment and asset liability management.

In the second part of his presentation, Professor Dempster discussed systematic Portfolio Construction. He began by briefly discussing classical mean variance portfolio optimization and then introduced some new approaches, where the estimate based on historical returns series on individual instruments/strategies is generally not positive definite and must be "corrected". Professor Dempster summarized extensive modern research on various classes of instruments that has shown that approximate normality depends upon the instrument class and the period over which returns (assumed independent) are defined. As a result, many alternative distributions for returns have been applied to portfolio construction for stocks, bonds, FX, futures, etc. Professor Dempster then explained all the technical details such as MVO sensitivity to input variations, correcting estimation error, dynamic optimization, portfolios with skewed return distributions and scenarios as randomization techniques.

Professor Dempster closed his presentation by introducing institutional and individual asset liability management covering scenario based dynamic models and strategic financial planning. He argued that multistage dynamic ALM models incorporate many future random scenarios, generate future decisions by optimizing all decisions simultaneously and provide results on future individual scenario evolution. One important lesson is that risk management should be integrated into the process of optimum portfolio construction. In addition, the proper modelling environment is needed in which any particular problem under uncertainty can be formulated and investigated to dramatically improve the efficiency and effectiveness of DSP for real-world problems. Professor Dempster concluded by stating that interactive use of financial planning tools leads to a new paradigm in investment management.

"Opportunities in the Global Carbon Markets", Ms Karen McClellan (former Head of Asset Management, Carbon Capital Markets)

Ms Karen McClellan discussed current opportunities in the Carbon Markets. She noted that the world today faces global climate change and briefly talked about climatology, introducing several global and regional scenarios. She noted that, although carbon markets started earlier, they really started developing in 2005, with active involvement of EBRD. Now Carbon Markets are emerging investment opportunities; global pools of capital are being mobilized and US$10 billion have been invested in over 50 carbon funds for the purchase of carbon instruments and investment in emission reduction projects. Under a base-case scenario, the "social" price of carbon will rise progressively, from perhaps $20 per tonne today to over $80 by 2050. Some estimates are significantly higher. Some of the big players, such as Morgan Stanley, Goldman Sachs and Bill Gates, have entered this market, making significant investments.

Ms McClellan discussed one of the most important documents in the area, the Kyoto Protocol—the International agreement adopted in 1997 under the United Nations Framework Convention on Climate Change. The Protocol entered into force on 16 February 2005, after having been ratified by 164 countries, representing over 55% of global emissions. The Protocol establishes strict mandatory reductions targets for 35 industrialized countries:

- target reduction of 5.2% from 1990 levels in 2008–2012;
- 35 industrialized countries are legally bound to achieve individual target reductions;
- further mandatory targets expected post-2012.

The Protocol also provides a framework and tools to help achieve these reductions, i.e. trading mechanisms. Ms McClellan discussed the price setting market. The US SO_x–NO_x market is a successful cap and trade system that sets a market price and meets environmental targets. It became the model for the first carbon trading market. The European Emissions Trading System (EU ETS) is a legally binding cap and trade market which allocates greenhouse gas emission allowances to 12,000 European carbon emitters. These allowances trade on several exchanges, mainly the European Climate Exchange. Ms McClellan noted that investors and traders have focused their attention on the Kyoto Protocol and the EU ETS, and these schemes create the majority of demand for emissions reductions to 2012. Post-2012, the world may look very different from a carbon market perspective, with North America playing a significant role, either through a series of regional initiatives, or federal level schemes. In Ms McClellan's opinion, there is considerable upside from developments in the United States—a new presidency is likely to enact domestic climate policy, which may then be linked to global trading.

Ms McClellan concluded her presentation by introducing the major source of supply in the carbon market, i.e. the Clean Development Mechanism (CDM), established under the Kyoto Protocol. The CDM allows industrialized countries to invest in emission reducing projects in developing countries in order to meet their Kyoto targets at lower cost, and promote sustainable development in host countries that are not yet subject to emission caps.

Panel: "Global Finance and the Future of Private Equity"

The panel was chaired by **Mr Michael Calvey,** Managing Partner at Baring Vostok Capital Partners, who introduced the speakers: **Professor Hans Schenk** (Professor of Organizational Economics, Utrecht School of Economics); **Mr Charles Sherwood** (Partner, Permira); and **Mr Jeff Summers** (Director and Head of Research, Klesch and Company Ltd).

Professor Schenk started off the discussion by introducing some initial findings from his research into the long-term sustainability of the private equity industry. His view is that the jury is still out on whether the "financialization" of the economy, led by PE, is for the benefit of everyone or just of the financiers. Professor Schenk highlighted two key arguments:

- PE Leveraged Buyouts (LBOs) are necessary to repair the damage done by mergers—and therefore the long-term existence of the industry depends on the continuation of waves of M&A activity. He also questioned whether PE firms were the right instruments to undo this damage.
- Target companies are submitted to strict financial discipline, but are forced to over-economise on long-term capital and R&D investments. He highlighted evidence which suggested R&D intensity after buyouts was substantially lower than in competitors (8.64 against 42.35%) and said that LBO companies end up in default 3.5× as often as other companies.

Mr Sherwood responded by raising several points. Firstly, he referenced McKinsey research, which showed that financial buyers can create value in the way that corporate buyers may not. He also referenced the recent World Economic Forum report on PE, which reviewed 21,000 transactions over a 37 year period and concluded that R&D levels were reasonably sustained. Mr Sherwood accepted that five-year ownership might encourage some PE investors to restrain from investment in long-term R&D, but questioned what alternative ownership structure was more likely to. He then returned to the question of why PE-owned firms fail. The normal argument states that this is because they become over-leveraged, and the company goes bankrupt because of its capital structure. Mr Sherwood argued that this does not actually matter—if debt is the only problem, investors will lose their money but the company will survive and will reform with a new capital structure once it is sold. In contrast, if a company fails due to operational reasons, this is fine as well, because that company is no longer providing a useful purpose and it is better for its assets to be redistributed.

Mr Summers moved on to discuss the role of PE in the global market, again highlighting that it is not as important as its profile might suggest. He noted that while there are *circa* $3 trillion invested in PE fund globally, this is dwarfed by the $5.5 trillion in Sovereign Wealth Funds. He also put this in the context that PE is coming under increasing pressure from regulators, and now has a slightly dirty name, putting the current PE model under threat.

Mr Calvey returned to the question of who is the better owner, and argued that it is not a case of good vs bad. Actually, a combination of the two works well, as pressure from PE has improved productivity and increased efficiency in public markets, and the ultimate beneficiaries of the success of PE is a similar set of owners as those of public equity (pension funds, holders of mutual funds, etc.).

The discussion then returned to the length of holding, and whether there was more of a short-term motive in the public markets. Mr Summers commented that this was applicable to the Anglo-Saxon model of returns, while Professor Schenk commented that actually everything was now becoming more short-term, as institutions and technology move ever faster. Mr Calvey compared quarterly reporting as required by the public markets with the flexibility offered by PE, and Mr Sherwood added that CEOs might prefer different models at different times, depending on what the company is trying to do.

Finally, the discussion moved onto the future of PE. Mr Summers argued that it was an industry full of clever people, who will adapt to changing circumstances. He was confident that the industry will exist in future and will expand, but perhaps become known as something else, given the current associations with PE. Mr Sherwood commented that, if markets do not find a way to enact change, something like PE will continue to exist. He envisaged a continued role for transitional owners, but thought that there would be a polarization between large global firms and very clear specialists, and the middle of the PE market will disappear. Professor Schenk predicted that regulation will try to remove perverse incentives, and the fiscal treatment of PE will change. However, he argued that failed mergers will continue, so there will still be opportunities for smart investors to improve companies. Mr Calvey stated his belief that PE will continue to grow, the boundaries between PE and Hedge Funds will blur, and that the jury is still out on publicly listed PE firms. Either way, the dynamics of the industry will change, and the leading firms in future will be those strongly involved in, or even grown within, the emerging markets.

Panel: "Global Finance: Beyond the Credit Crunch"

Ms Vicky Pryce, Chief Economic Adviser and Director General of Economics at BERR and Joint Head of Government Economic Service, chaired the concluding panel and introduced the last speaker, Mr Richard Segal.

"Africa: Life after the Credit Crunch", Mr Richard Segal (Fixed Income Strategist, Renaissance Capital)

Mr Segal began by saying that Sub-Saharan economies have benefited from debt relief, stronger monetary/fiscal policy frameworks, booming commodity markets and continued Foreign Direct Investment (FDI) from China and Russia. As a result of these factors, Mr Segal expressed confidence that there will be an African growth phase on the back of China's growth. The economic growth is high and stable and consumers' access to goods and services is accelerating (particularly in banking and telephony). For example, Nigeria has been growing rapidly and contributing the largest share to African economic growth. The second point he highlighted was that financial markets are developing rapidly (i.e. micro-finance), but market supervision and corporate governance has been lagging. Along those lines, as commercial banks reduce their capital—shrinking balance sheets—the opportunity to capture gains from financial markets may be fleeting. The Sub-Saharan economic growth is largely driven by strong growth in Nigeria and its success over the next few years will drive African growth.

Mr Segal noted that Sub-Saharan Africa currently faces financial market challenges. In general, African countries need to upgrade their infrastructure (IT, telecoms, travel); improve market access for institutional investors (primary and secondary market); and improve investor relations, research and trading skills. At the same time, Africa needs to make sure that the banking system balance sheet is flexible and transparent, so that it will be easy for micro-credit investors to have access to information. The lack of transparency can also lead to international banks withdrawing capital and resources. Mr Segal also highlighted the need to rectify political risks (Kenya) and governance risks (Tanzania). It is also important to ensure reduction in transaction costs, so that foreign investors will be enticed to African stock markets. In addition, policy makers need to streamline capital account regulations to encourage FDI and portfolio capital inflows.

In the ensuing discussion, Mr Garner added that China's involvement in Africa is similar to a neo-colonialist approach, where China taps Africa's natural resources, provides some infrastructure and cheap manufactured goods. This may not work in Africa's favour. A similar approach was applied by the UK and other European colonial powers and was not successful. He also expressed the concern that growth in Africa may be relatively short-lived, given that the underlying problems with human capital enhancements, such as health, education and institutions, are not being addressed. Mr Garner argued that the recent strength in African economic growth may be largely driven by the high commodity prices. In addition, the lack of intra-regional trade between African countries has remained low and will continue to hamper long-term trade development between African countries, which could lead to long-term economic growth. Mr Garner further remarked that Africa is politically very volatile, e.g. Ivory Coast and Zimbabwe used to be thriving economies in the 1990s. Although there have been positive stories of endogenous growth coming out of large countries in Latin America, Asia, Russia and possibly Nigeria, a general application to the whole of African continent seems too optimistic.

Ms Pryce then asked if a future population boom could exacerbate problems in Africa. For instance, average GDP growth per capita could fall and healthcare costs may rise. Mr Garner replied that improvement in governance is more important in Africa than population growth for short-term GDP growth.

Summing up

Mr Jeff Summers, Director and Head of Research at Klesch and Company Ltd, provided a short closing summary and highlighted several important issues that were presented during the Symposium. He also praised the Symposium organizers and the quality of the discussion. Mr Summers highlighted the interesting presentation that Mr Zhao made which summarized the main drivers of the past few decades. These were oil in the 1960s, gold in the 1970s, Japan in the 1980s, hi-tech products in the 1990s and China in the 2000s. Mr Summers noted that this was a nice way to sum up the past few decades. He also noted that, based on this information, there is a likelihood that a perfect storm is developing. Indeed, three drivers in the list have been rising in importance lately. Given that gold and oil are at an all-time high, China is growing rapidly and coupled with commodity shortages and political uncertainty in the BRIC countries, there is a likelihood that a negative scenario may develop.

However, Mr Summers also pointed out that the impact of the credit crunch currently faced in the United States and UK is somewhat less severe in the BRIC countries. He is convinced that the decoupling story is valid and that the global economy will still grow despite the credit crunch. Mr Summers then re-iterated the importance of Jonathan Garner's presentation and particularly highlighted the fact that emerging markets' share of global GDP is already 30% and that it has been growing at a rate of 61% GDP growth year on year. Given this backdrop, he is convinced that, if an economic slowdown develops in the west, the rest of the world will still be able to support the global economy. On the issue of carbon trading, Mr Summers believes that it is a topic which should be looked at very closely and is an area which is misunderstood. He suggested that the legal framework and the development of the market will need to be closely monitored, particularly the processes needed to enforce the carbon trading limits. Overall, he found the Symposium well organized and the discussions lively and enlightening.

(Reportage by Sarah Langslow, Giorgi Megrelishvili and Saktiandi Supaat, MBA students 2007–8, Judge Business School)

doi:10.1093/cpe/bzn009
Advance Access Publication April 9, 2008