

Focus on: Financial services

International Business Report 2010 – Sector focus series

The Grant Thornton International Business Report (IBR) 2010 reveals that privately held businesses (PHBs) in the financial services sector are the most confident about their economic prospects for the year; a balance¹ of +42 per cent are optimistic this year. Businesses, on average across all sectors, are more optimistic this year (+24 per cent) than they were in 2009 (-16 per cent).

Of the ten sectors considered in the 2010 sector focus series, financial services is the most buoyant at +42 per cent; ahead of technology (+40 per cent), cleantech (+34 per cent), hospitality (+32 per cent), retail (+31 per cent), manufacturing (+25 per cent), construction & real estate (+13 per cent), food & beverage (+7 per cent), transport (+5 per cent) and healthcare (-18 per cent).

The financial services sector

The financial services sector found itself at the centre of the economic storm, sparked by the collapse of Lehman Brothers in September 2008. Whilst the ensuing government bailouts saved some of the major players in the sector, the regulatory measures introduced have been severe, not only on those institutions most heavily implicated in the crisis, such as banks, but across the entire sector. The International Monetary Fund (IMF) reported in June 2010 that risks to the global economy had risen, revealing that investors' appetite for risk is fragile and that equity and capital markets are not recovering as well as expected.

In Europe, soaring unemployment rates, sluggish economic activity and the sovereign debt crisis – which has reignited fears of a double-dip recession and sent stock markets tumbling – are all increasing the likelihood of a fresh round of bad debts. Meanwhile, the reduced exposure of banks in emerging markets to toxic debts – in comparison with their large counterparts in mature economies – means they have strengthened their position to profit from growing local wealth and development.



¹ the balance is the proportion of companies reporting they are optimistic less those reporting they are pessimistic

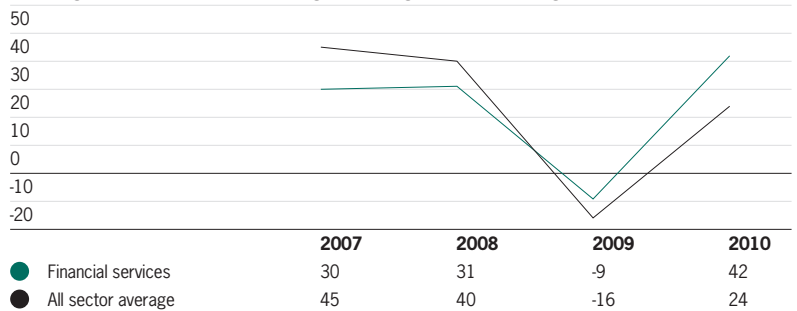
The state of the sector

Optimism/pessimism

- a balance of two-fifths of businesses in the financial services sector are optimistic about their respective countries' economic outlook this year (+42 per cent)
- this represents an increase of 51 percentage points from 2009 (-9 per cent)
- the balance, on average across all sectors, indicating optimism for the year ahead has risen by 40 per cent this year, from -16 per cent in 2009 to +24 per cent.

Figure 1: Outlook for the economy over the next 12 months

Percentage balance of businesses indicating optimism against those indicating pessimism



Source: Grant Thornton IBR 2010



Hervé Grondin
Grant Thornton, France

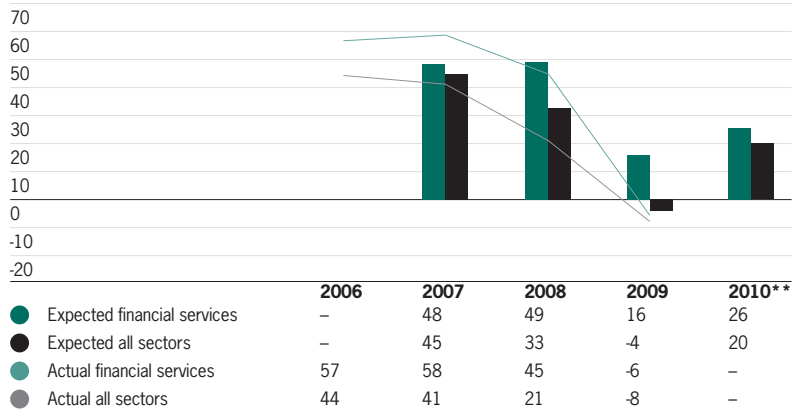
“The economic crisis was a big lesson for the sector. It showed that we need more ethics and more rules as well as more regulations regarding compliance and internal controls to ensure that we have risks monitored and accounted for.”

Employment

- a balance of +26 per cent of businesses in the financial services sector expect to expand the size of their workforce in 2010, just above the all sector average of +20 per cent
- actual employment growth in the sector (-6 per cent) was worse than expected 12 months previously (+16 per cent)
- the same trend was observed on average across all sectors (-8 per cent actual vs -4 per cent expected).

Figure 2: Employment history

Percentage balance of businesses indicating an increase against those indicating a decrease



*actual 2010 data will be documented in IBR 2011

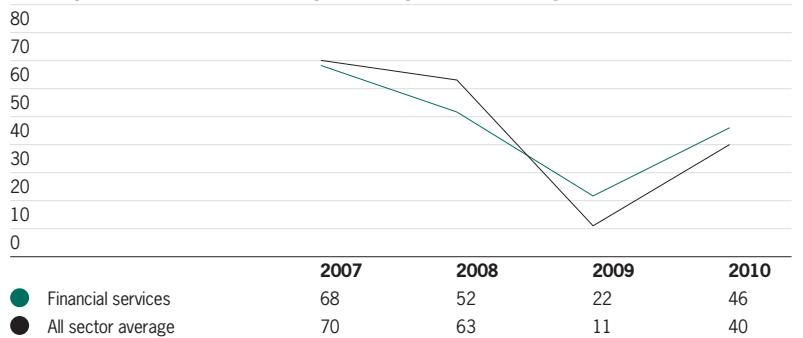
Source: Grant Thornton IBR 2010

Revenue expectations

- a balance of +46 per cent of businesses in the financial services sector expect their revenue to increase across 2010
- businesses in the healthcare (+61 per cent), cleantech (+54 per cent) and technology (+52 per cent) sectors are more optimistic about increasing revenue in 2010
- on average across all sectors, revenue expectations have rebounded to +40 per cent this year, up from just +11 per cent in 2009.

Figure 3: Revenue expectations over the next 12 months

Percentage balance of businesses indicating optimism against those indicating pessimism



Source: Grant Thornton IBR 2010



Yiannis Leos
Grant Thornton, Greece

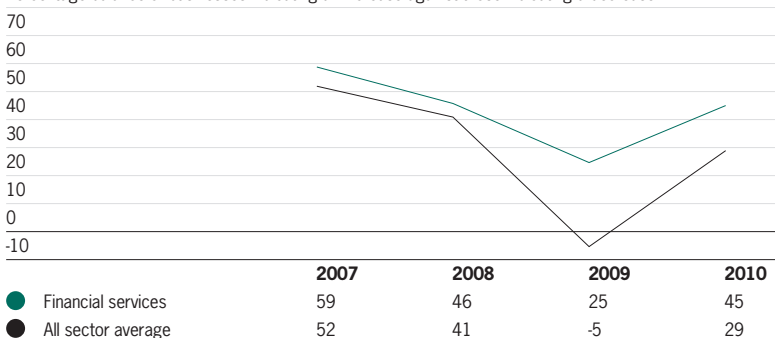
“The most important issue for the sector in Greece is how regulations imposed with government bailouts, along with the current liquidity shortages, will affect the wider economy. Arguably, a decrease in government expenditure and soaring unemployment are likely to cause severe credit losses.”

Profitability expectations

- the balance of businesses in the financial services sector expecting to increase profits in 2010 is +45 per cent, the most optimistic sector on profitability expectations
- this is considerably higher than the all sectors average of +29 per cent
- the all sectors average has increased by 34 per cent, from -5 per cent in 2009 to +29 per cent this year.

Figure 4: Profitability expectations over the next 12 months

Percentage balance of businesses indicating an increase against those indicating a decrease



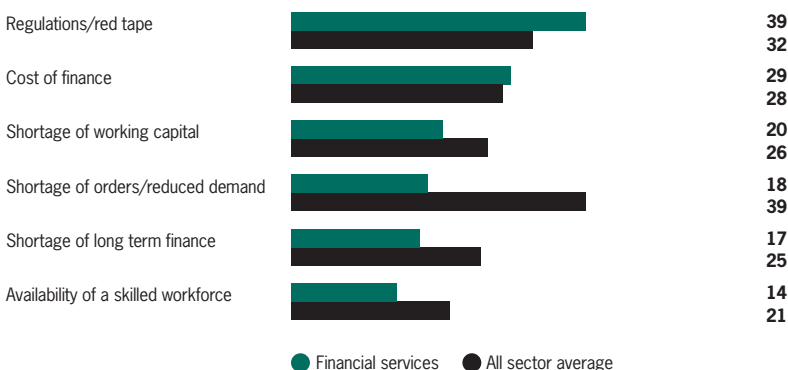
Source: Grant Thornton IBR 2010

Constraints

- regulations/red tape is the most pressing concern for businesses in the financial services sector, 39 per cent compared to 32 per cent on average across all sectors
- the cost of finance is also of greater concern in the financial services sector (29 per cent) compared to the all sector average (28 per cent)
- whilst the remaining constraints (a shortage of working capital, orders and long term finance and the availability of a skilled workforce) are all of lesser concern in financial services, compared to the all sectors average.

Figure 5: Constraints on expansion

Percentage of businesses rating constraint 4 or 5 on a scale of 1 to 5 where 1 is not a constraint and 5 is a major constraint



Source: Grant Thornton IBR 2010



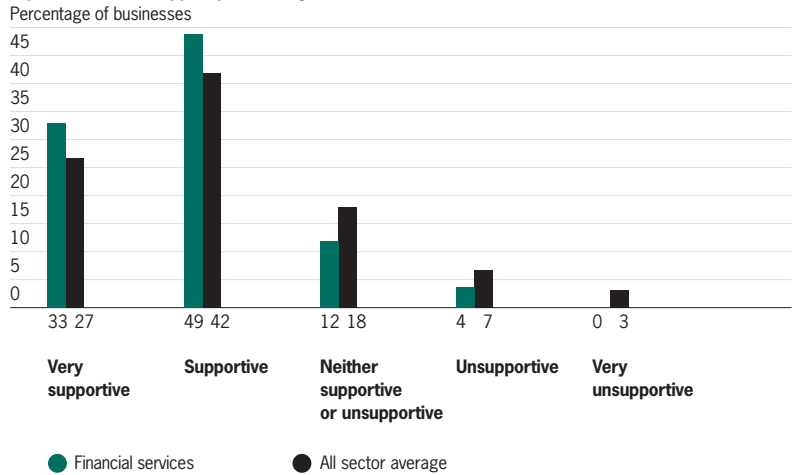
Peter D. Allen
Grant Thornton, United Kingdom

“The regulatory environment in the UK has become much tougher. The regulator is taking a more aggressive approach – not only to those institutions most heavily implicated in the financial crisis, such as banks – but also to those businesses and institutions which were not so responsible, such as insurance and asset management companies.”

Support of lender

- 82 per cent of businesses in the financial services sector are happy with the level of support provided by lenders, compared with 69 per cent on average across all sectors
- just four per cent of businesses in the sector believe that lenders are unsupportive or very unsupportive of their business, compared to ten per cent on average across all sectors.

Figure 6: Level of support provided by lenders

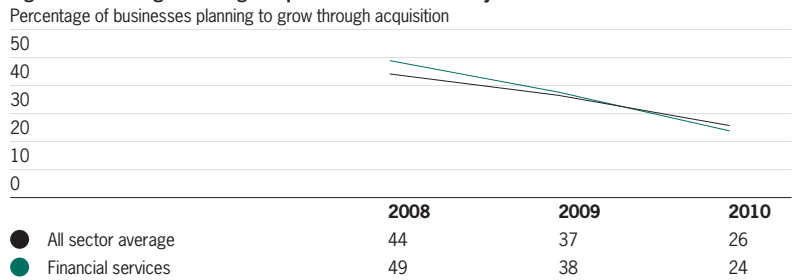


Source: Grant Thornton IBR 2010

Mergers & acquisitions

- the proportion of businesses in the financial services sector planning to grow through acquisition is 24 per cent; ahead only of healthcare (11 per cent), food & beverage (16 per cent) and technology (23 per cent)
- the all sector average has fallen steadily over the past three years from 44 per cent in 2007 to 26 per cent this year.

Figure 7: Plans to grow through acquisition in the next three years

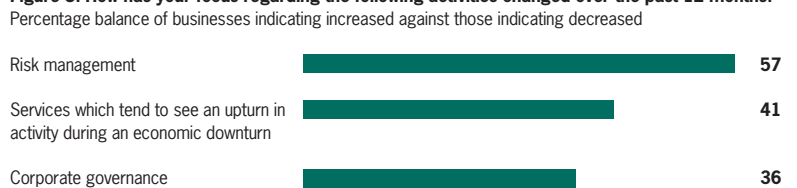


Source: Grant Thornton IBR 2010

Focus

- a balance of 57 per cent of businesses in the financial services sector have increased their focus on risk management
- a smaller proportion have increased their focus on services which tend to see an upturn in activity during the economic downturn (41 per cent)
- whilst just one-third have increased their focus on corporate governance (36 per cent).

Figure 8: How has your focus regarding the following activities changed over the past 12 months?



Source: Grant Thornton IBR 2010



Andrew Lam
Grant Thornton, Hong Kong

“Over the next 12 months there will be an increasing focus on wealth management, something which is pretty new in Asia. There is a growing sector of wealthy middle class, especially in mainland China, and wealth management is something that they are really looking into at the moment.”

Outlook for the sector

The regulatory upheaval in the financial services sector looks likely to shape the future of the industry for many years to come. Fundamental changes to global financial regulations are being designed, which will look to increase banks' capital requirements to above pre-crisis levels and build up buffers in good time to secure against future shocks.

In more mature markets, these reforms will mean a continued shift of focus away from pure profitability in the short term, towards greater monitoring of asset quality and better management of existing portfolios. Meanwhile, the burgeoning middle classes in emerging markets such as Brazil, Russia, India and China are quickly becoming key sources of growth, in areas such as wealth management, for businesses in the sector across the globe.



Eduard Gellida
Grant Thornton, Spain

“Sovereign debt issues are the major concern that is currently impacting on markets. It’s proving very hard for the Spanish government, and even Spanish banks, to go to the market and raise high amounts of debt because the spreads are increasing.”

Sector's perspective

Erik Penser

BANKAKTIEBOLAG

Erik Penser Bankaktiebolag is an independent, privately owned bank in Sweden which employs around 150 people.

Lessons learned from the downturn

“Cash is king! The importance of cash flow for the overall fiscal health of a business has once again been clearly demonstrated. Also for investors it has been relatively rewarding to have cash available, first in order to avoid falling asset prices and then to seize the emerging investment opportunities.

Furthermore, for us as a bank and for our peers in the financial sector, the importance of an adequate risk control and serious compliance has become evident, to say the least. These functions are no longer just a necessary part of the regulatory framework; they have indeed proved to be of significant importance for the development of the business. For us, the reinforcement of risk control and compliance was the natural starting point of our expansion during the crisis.”

Major risks for the year ahead

“A major risk is that the necessary financing of increasing sovereign debts will reduce corporate financing. This, in addition to central banks closing some of the extraordinary and

temporary liquidity arrangements put in place during the midst of the credit crisis, is likely to increase risk aversion among investors and thus effectively hold back economic growth.

As for the banking industry, the Basel Committee's proposition of increased capital requirements and improved liquidity for the banks could also create serious turbulence on the financial markets which, in turn, could easily spill over to the real economy.”

Planning for the future

“In recent years we have expanded our organisation and broadened our customer offering within our three business areas – private banking, investment banking and asset management. Our main focus going forward will be the expansion of our customer base. We will thus put increased emphasis on the marketing of our services and customer value added within these business areas.

Personalised and independent services form the back bone of our offering.”

“A major risk is that the necessary financing of increasing sovereign debts will reduce corporate financing.”

“We have to make sure that we are careful and make the right decisions as we do not want to repeat the recent economic situation.”

A deposit taking subsidiary of a banking and financial services group, situated in Hong Kong which employs around 300 people.

Lessons learned from the downturn

“Over the last 12 months we have learnt to be more prudent. We are getting the compliance department to do more checking on the day to day operations to ensure that any irregularities can be spotted. This is more of an external demand as we have to account to the regulatory office. But also it is beneficial for us to enforce compliance internally.”

Major risks for the year ahead

“From the recent situation it is clear that financial institutions, in particular, do not have much transparency. The outcome in the US highlights this and this is a major risk to us. We will have to be more careful with external parties because of this lack of transparency. And I think especially overseas as there is more risk involved and less transparency. We have to make sure that we are careful and make the right decisions as we do not want to repeat the recent economic situation.”

Planning for the future

“We are trying to explore the potential of partnerships in China. We are stationed in Hong Kong and there are business development opportunities for us in China. We are currently exploring this option with the aid of a steering committee that has been set up by management. The committee works on development and has highlighted that China is a major opportunity, so we are seeking relevant relationships in the country.”



View from Grant Thornton

Lessons learned from the downturn

- **changing regulatory environment:** regulators are taking a much more aggressive approach to all institutions as regards risk management, not just those heavily implicated in the financial crisis
- **monitoring of asset quality:** profitability cannot be the only concern, monitoring asset quality to ensure asset liquidity levels is vital
- **cushioning against economic shocks:** businesses have become much more pro-active as regards building in flexibility to their operating decisions
- **product simplification:** there is a need for the so-called sophisticated products to be simplified so that their risk can be more accurately assessed.



Major risks for the year ahead

- **sovereign debt:** fears of default in Europe is affecting confidence in the stock markets whilst a lack of control and transparency regarding sovereign debt is a concern
- **slowdown in economic activity:** highly-leveraged industries, such as construction, are struggling to meet repayments, and lending conditions are having to become far more strict
- **debt restructuring:** much debt is having to be restructured which is affecting the ability of banks to lend
- **another bubble:** financial institutions need to be watchful over their involvement in increasing levels of international acquisitions
- **unemployment:** high rates of unemployment, especially in Europe, could lead to severe credit losses for banks, and a fall in demand for other financial services.



Harish HV
Grant Thornton, India

“The speed of the economic growth in India over the last year has been good and the sector is confident. However, the major risk is that of over optimism by the markets and lenders. It is important for lenders to be cautious especially where businesses are focused on international markets as the recovery internationally is yet to take off.”

Planning for the future

- **focus on risk management:** because of the tough regulatory environment there is much internal and external pressure to increase business focus on risk management
- **repairing balance sheets:** for institutions which found themselves over extended, harsh regulatory environments dictate that they restrain growth to some degree
- **increasing consumer base:** in the emerging economies, the focus is on growing the consumer base for financial services, looking for opportunities both domestically and further afield
- **debt collection:** increasing focus is being placed on managing existing portfolios, including how to collect debts, rather than expansion
- **mitigation of risk:** financial institutions in more mature markets are increasingly looking for opportunities in emerging markets to spread risk
- **wealth management:** the burgeoning middle classes in the emerging markets (especially in China) offer an opportunity for institutions in this area.



Jack Katz
Grant Thornton, United States

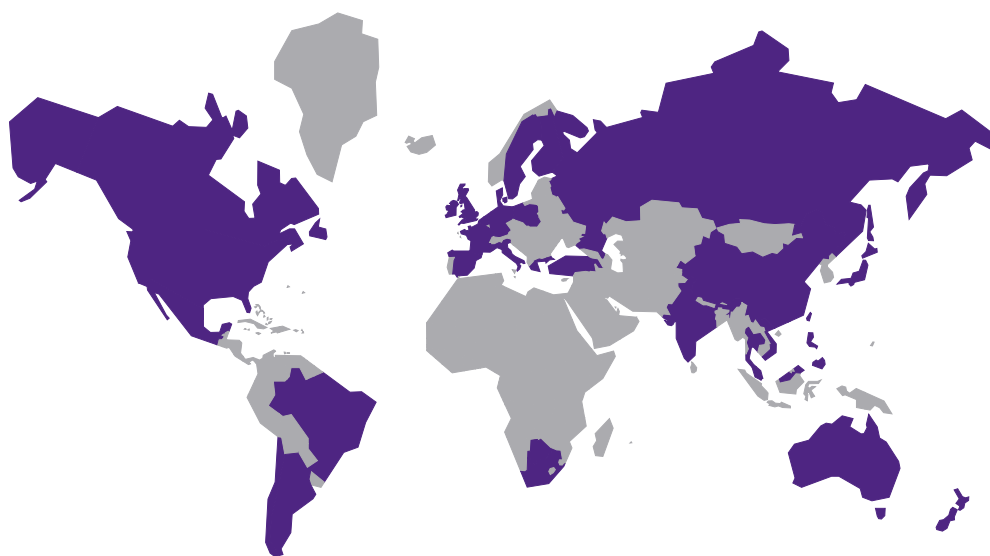
“The major lesson learnt from the downturn is the need to keep the products and the offerings that the financial services industry brings to market simple; the so-called sophistication of the products meant there was difficulty in understanding, valuing and assessing risk. It caused major havoc in the market.”

The Grant Thornton International Business Report (IBR) is an annual survey of the views of senior executives in privately held businesses (PHBs) all over the world. Launched in 1992 in nine European countries the report now surveys over 7,400 PHBs in 36 economies providing insights on the economic and commercial issues affecting a segment often described as the 'engine' of the world's economy. In the financial services sector, 227 businesses were interviewed, 42 per cent from financial service activities, 20 per cent from insurance, reinsurance and pension funding, ten per cent from activities auxiliary to financial service and insurance and 27 per cent from other financial services.

To find out more about IBR and to obtain copies of reports and summaries visit: www.internationalbusinessreport.com. The site also allows users to complete the survey and benchmark their results against all other respondents by territory, industry type and size of business.

Participating economies

Argentina	Japan
Armenia	Malaysia
Australia	Mexico
Belgium	Netherlands
Botswana	New Zealand
Brazil	Philippines
Canada	Poland
Chile	Russia
Mainland China	Singapore
Denmark	South Africa
Finland	Spain
France	Sweden
Germany	Taiwan
Greece	Thailand
Hong Kong	Turkey
India	United Kingdom
Ireland	United States
Italy	Vietnam



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