

Investing for the future

B. P. MARSH & PARTNERS PLC

NEWS: BRIDGING THE GAP

MANY OF THE STATISTICS show that the UK is suffering a funding gap between £250,000 and £2m.

There are plenty of reasons for this, not least the diseconomy of scale in doing smaller deals for the funders (angels aside). The costs and time involved really do not make sense for a great deal of the financial world. This is coupled with the fact that by definition the lower end of the scale historically shows a highly volatile risk reward profile and can thus be an uncomfortable spot for a generalist.

Venture capital tends to want a fairly rapid exit which may not suit a start up – that is if you are lucky enough to be part of the 3% that actually manage to attract funding in the first place.

Advisors need to be paid a reasonable fee for their time so again tend to prefer larger deals where these fees can be charged without upsetting the finances of a start up or near start up company.

The Government has recognized the problem with its Business Link initiatives and now the Enterprise Funds but it remains a difficult area of funding.

Banks, again, tend to need reasonable and sustainable profit cover on their amortising interest payments and are thus fairly well out of any immature business sector to any material degree.

For these and other reasons most financial sector new starts or immature companies find it next to impossible to raise funds in the area.

The financial services sector is based largely on intellectual capital. This has the interesting dynamic that can deliver great leverage from small capital. Of course people have legs and can and do want to set up their own businesses which means a constant flow of opportunities if you know who to talk to and where to look (and no we are not telling!). Deal flow for the specialist is thus not a problem but as with all other financial ventures it all boils down to people.

WHERE DO THINGS COME UNSTUCK?

Of course nobody in the world of finance gets it right all the time, particularly not with smaller end businesses who simply do not have the EBIT depth to carry them over an unexpected, deep or prolonged cashflow crisis.

People change, and in particular change under pressure, which can produce some interesting (but never really that surprising) results. We try our best here to be supportive as, through experience, we do appreciate the intense pressures that a small businessman has to cope with. Even if our advice or action is sometimes not appreciated at the time it often is in retrospect; after all we are fellow travelers, and on the same train as our partners. All sides need to try and remain level-headed and calm in a crisis and weather the storms of fortune which come – and go.

Persistence (but not to the point of obsessive folly) and courage

are qualities that anyone starting out needs. It is part of our job here to try and gauge those and other qualities in making an assessment. The other need is for someone who is prepared to take advice and act accordingly. We are not always right but are more often right than wrong and if we have a partner who refuses to listen and continues to charge off in a prideful way it often ends in a fall.

As ever, the cardinal virtues and sins and their consequences are as true today as they have been stretching back through to the Greeks in Ancient times.

WHY DO THINGS WORK?

Moving on from the rather gloomy lowlands of difficulty it is also interesting to see why the sunny uplands of success are attained by some.

What is it that makes the difference? Perhaps a useful analogy might be one given by the great and wise Marcus Aurelius in his Meditations when he focused on the importance of 'Justice'. He did not mean legal justice but natural justice in the true sense.

How is this relevant? Well, I think the reason it is relevant is that people who are going against their natural talents (justice), or who have not yet acquired the knowledge or experience required, sooner or later cannot cope with the business demands and sooner or later may crack up in their personal and business lives (often simultaneously). So, being sure of who you are and what you are good at, bad at or simply do not yet know enough about, is a great start. In retrospect, some of our best investments have adhered to these personal characteristics and some of our worst have departed from them.

Apart from that there are of course many other matters that impinge on success such as the strength of any niche, the likely annuity nature of revenues, the gearing possible on any process involved, the exposure to markets outside their control, the amount

ISSUE 3 2006 - INSIDE THIS ISSUE

The Competitive Position of London as a Global Financial Centre	p2
Founders and Management Shares - Minimising Tax on Gains	p4
Compensation and Incentives in the VC sector	p6
The Future Distribution of Financial Services Products in the UK	p7

The Competitive Position of London as a Global Financial Centre

(continued from page 1)

- of competition, the depth of any team, their experience and so on.

We are also fairly skeptical of 'hockey stick' business profiles that predict large losses followed by large gains. Inevitably these profiles lose more than they think and the backer is then forced into double, quits or hefty dilution. So a sensible plan with reasonable cost/benefit sharing for all and some cash commitment from the founders is a preferred (but not the only) option.

Getting rich quick often takes up to 7 years, with honorable exceptions either side, but there is no doubt that slow cooking on the Aga is usually better than the microwave approach in building real value for all sides.

LOOKING FORWARD

This is the first Newsletter following our successful floatation on AIM in which we have raised in excess of £10m to invest in the sector. We believe that we continue to be one of the leading houses to focus exclusively on this area.

We intend to continue minority investing for the medium term in the financial intermediary space and in supporting the successful investments we have made thus far in their various expansion plans.

We welcome new opportunities at all stages in the business cycle from pure start up to more mature equity leakage and will always try to give a swift response one way or another.

We would remind our intermediaries that we do offer an introductory rate in circumstances where a normal fee has not been a practical solution and that we are not restricted to the UK in our investment scope. We currently, directly or indirectly, have interests that include the UK, USA, Canada, Spain, Italy, India, Israel and Scandinavia.

We wish you all a prosperous and healthy 2006.

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Martyn Baker, Director of Economic Development at the City of London Corporation, outlines the conclusions of a major research project assessing London's competitive position in relation to rival financial centres.

IN NOVEMBER 2005 the City of London Corporation published *The Competitive Position of London as a Global Financial Centre*. The research, undertaken by City-based consultancy Z/Yen, was based on a survey of opinion of professionals in the financial services industry in over 20 countries. Almost 400 senior decision makers were asked about the key components of competitive advantage, and how the world's major financial centres ranked against these criteria. The new report updated and expanded upon our landmark *Sizing Up the City* report, published in June 2003.

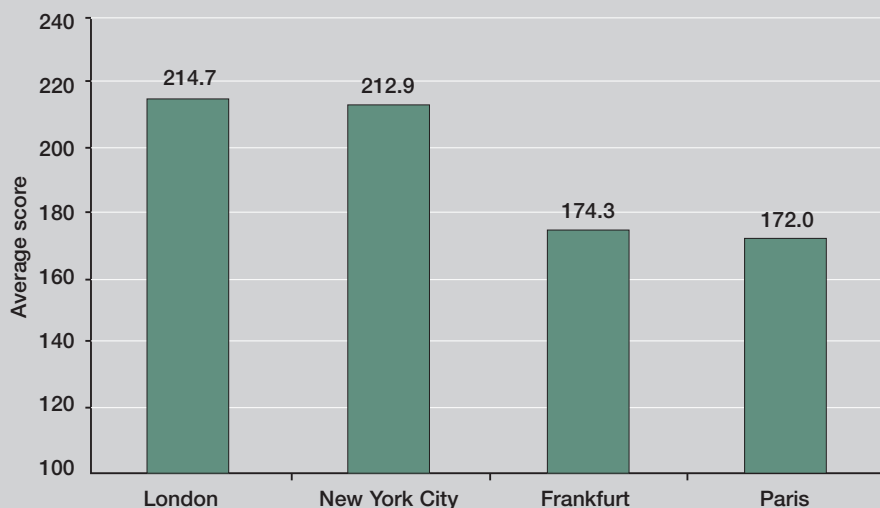
LONDON & NEW YORK PULL AHEAD

The report shows that London and New York have moved further ahead of Frankfurt and Paris. Indeed, those interviewed during the course of the research believe that there are only two genuinely global financial centres - London and New York. Although Paris and Frankfurt are extremely important regional financial centres, and a number of other cities have been very successful in individual sub-sectors of the industry, the pre-eminence of the City and Wall Street is if anything even more pronounced than before.

COMPETITIVE FACTORS

As was the case with the 2003 report, today's respondents believe that the availability of skilled personnel and the nature of the regulatory environment are the two most important competitive factors affecting international financial centres. Over 90% of respondents judged the quality and availability of skilled personnel to be either 'Very Important' or 'Critically Important', with London ranked first amongst its competitors. London also scored highest in terms of regulatory environment, although there is no room for complacency. It is clear that UK policy makers must continue to monitor the regulatory balance carefully and respond where necessary with proportionate action if London's relative competitiveness is to be maintained.

DIAGRAM 1 - Average Scores of the Financial Centres





LONDON: COMPETITIVE FACTORS RANKED

FACTOR OF COMPETITIVENESS	RANK	AVERAGE SCORE
Availability of Skilled Personnel	1	5.37
Regulatory Environment	2	5.16
Access to International Financial Markets	3	5.08
Availability of Business Infrastructure	4	5.01
Access to Customers	5	4.90
A Fair and Just Business Environment	6	4.67
Government Responsiveness	7	4.61
Corporate Tax Regime	8	4.47
Operational Costs	9	4.38
Access to Suppliers of Professional Services	10	4.33
Quality of Life	11	4.30
Cultural & Language	12	4.28
Quality / Availability of Commercial Property	13	4.04
Personal Tax Regime	14	3.89

“Research indicates that financial centres may lose certain types of commoditised activities to low cost cities although important parts of the industry, companies’ headquarters and their most skilled employees, will continue to cluster in financial centres”

LONDON'S APPEAL

None of the respondents believes that London or New York will lose their positions as global financial centres within the next ten years. Part of the continuing appeal of London to foreign companies is its cosmopolitan status. Frankfurt and Tokyo, for example, are primarily market places for domestic participants to which foreign players are granted access. London, and to a lesser extent, New York are characterised by international players trading with each other.

An argument has been made that financial centres will be weakened by technology, outsourcing and off-shoring. This research indicates that financial centres may lose certain types of commoditised activities to low cost cities although important parts of the industry, companies’ headquarters and their most skilled employees, will continue to cluster in financial centres. ‘Value-added’ activities will remain in the business clusters that financial centres offer. These value-added activities include senior ‘strategic’ management and front office, product innovation, client facing and deal-making activities.

LOOKING AHEAD

Looking ahead, respondents were divided as to whether there was scope for the emergence of a third global financial services centre. They were, however, strongly of the view that if such a centre did emerge it would be in China and probably in Shanghai. The City of London Corporation is acutely aware that China’s role as an economic power has grown dramatically, and a vast market is being created for financial products and services. In November 2005 we established City of London Representation in Beijing and Shanghai to engage more closely with the People’s Republic and to respond to these challenges and opportunities.

Copies of this report can be obtained, free of charge, by contacting Karen Burr, Marketing and Communications Officer, City of London Corporation on 020 7332 3614. Alternatively, the report can be downloaded in pdf format via the internet: www.cityoflondon.gov.uk/economicresearch.

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Founders and Management Shares – Minimising Tax on Gains

Mike Cunningham discusses the range of mechanisms for tax efficient employee share schemes.

SHAREHOLDERS IN PRIVATE COMPANIES can potentially enjoy an effective tax rate as low as 10% on gains made on disposal of their shares. However, arrangements made between shareholders can expose some or all of such gains to tax at an effective rate of almost 50%. This article comments on some of the more common issues that can inadvertently give rise to exposure to higher rates of tax and prompts preventative action.

HOW DO THE DIFFERENT TAX RATES ARISE?

Normally a profit realised by shareholders in a private company when they dispose of their shares will be taxed under the Capital Gains Tax rules. Provided certain qualifying conditions are met, such gains can be subjected to tax at a rate of no more than 10% for a higher rate taxpayer.

The 10% tax rate is potentially available when shareholders exit the company. However, annual income paid out by the company prior to exit will be in the form of dividends or directors/employees emoluments, which will generally be liable to rates of Income Tax higher than those applicable to Capital Gains. The marginal rate of Income Tax on emoluments is 40%, together with uncapped employees NIC of 1% and employers NIC at 12.8%. The employers NIC is tax deductible in the company's hands (or the employees hands in those circumstances where liability can lawfully be transferred to the employee) resulting in an overall effective rate of tax of slightly less than 50%.

The tax avoidance industry has historically endeavoured to devise schemes that essentially satisfy in kind (in the form of shares) the payment of income so that the payment benefits from the lower rates of tax available to shareholders rather than being exposed to Income Tax. In response to the perceived tax avoidance the Government has introduced a raft of anti-avoidance legislation requiring the profit made in relation to certain share schemes to be brought back within the charge to Income Tax and NIC. Inevitably, anti-avoidance rules tend to have a much wider application in practice than the perceived abuse against which they are specifically directed, and can easily bring within the charge to income tax at rates of nearly 50% shareholder's profits that one would normally expect to be eligible for the 10% rate. When dealing with anti-avoidance rules it is necessary to take care to avoid these penal rates of tax.

START-UPS AND SHARES ACQUIRED AT UNDERVALUE

Traditionally it has been accepted that anti-avoidance rules bringing profits on shares within the charge to Income Tax do not apply to the individuals who originally established the company, the founders. This recognised distinction between founders and other management shareholders broadly ceased to be relevant when the rules were changed in 2003. Since then any individual who acquires shares in a company of which he is (or was or will

be) a director or employee are deemed to be employment-related securities. This, of itself, does not expose profits on the shares to the higher rates of Income Tax, but it means that the anti-avoidance rules can potentially apply and care therefore needs to be exercised whenever a director/employee acquires shares. The anti-avoidance rules can potentially apply however the shares are acquired e.g. a bonus issue, consideration shares given in satisfaction of an earn-out on a takeover, etc. and also extend to securities other than shares, e.g. loan notes, as well as options to acquire shares.

The two most likely areas that can give rise to problems in relation to a start-up are the acquisition of shares by directors/employees at an undervalue and the acquisition of restricted shares.

UNDERVALUE

Where founders establish a company and then at a later date introduce new shareholders, e.g. by obtaining private equity funding, the simple acquisition of shares in the company by the new shareholders at a price higher than that paid for the original shares by the founders should not, of itself, give rise to any particular problems for the founders. However, sometimes on these occasions the opportunity is taken to allow management to take up some shares or for there to be a change in the proportion of shares held by each founder, which can entail directors/employees acquiring shares at a value substantially less than that being paid by the new shareholders and the undervalue will potentially be liable to Income Tax and NIC. The same problem can arise if private equity funds are made available at the time of the start-up so that the founder's original subscription price for shares could also be deemed to be at undervalue compared to the price paid by funders at about the same time. This can happen at the time of an MBO for instance.

In these circumstances it is important to ensure that, as far as possible, the order of events enables founders/management to acquire their shares before the external investor subscribes for shares or any other action is taken that can attribute value to the shares. Where it is not possible to avoid founder/management acquiring the shares at undervalue, a more tax efficient route might be EMI options (see below) or to require founder/management to be liable to pay the full market value of the shares, thereby avoiding any undervalue, but on deferred terms. The intention being that the deferred element of the share price will only become due at the same time that individuals are able to realise the value in their shares.

Company loans to directors are generally prohibited under company law and any loan to shareholders made by a "close" company (this covers most private companies) gives rise to other undesirable adverse tax consequences. However, partly paid shares will often afford an acceptable mechanism for deferring payment.

“The author, and a number of other tax professionals, do not believe the Revenue’s stated view is correct and that if the share rights are appropriately structured all of the profits should be eligible for the favourable Capital Gains Tax rates”

RESTRICTED SECURITIES

It is perhaps relatively straightforward to understand how shares could be acquired at an undervalue compared to the price paid by funders, but the impact of the income tax anti-avoidance rules in relation to what are called restricted securities is often far less obvious and can have longer term adverse consequences.

Broadly restricted securities on any shares that have some limitations on the individual shareholder’s right to deal with the shares as he sees fit or to enjoy the full value of the shares. This will often include pre-emption rights, good leaver/bad leaver provisions, and other similar restrictions that will often be included in a shareholder’s agreement or the company’s articles when a company enters into arrangements with a private equity funder. Such restrictions will normally reduce the value of the shares compared to unrestricted shares and this can adversely affect the rate of tax on future gains. For instance, an unrestricted share ordinarily worth, say, £1 might be worth only 60p because of the restrictions. The income tax anti-avoidance rules determine whether the shares are acquired at an undervalue in the first place by reference to the restricted value of 60p. Thereafter, the proportion of the value of the shares equivalent to the original discount of 40% created by the restrictions remains within the charge to Income Tax and potentially NIC, unless the individual can demonstrate that upon the original acquisition date he paid the full unrestricted value of £1 per share.

It is notoriously difficult to value private company shares in the early stages of a company’s development and there is therefore a risk that valuation subsequently agreed with the benefit of hindsight might indicate a significant initial discount due to restrictions, thus exposing a significant proportion of an individual’s profits to the higher rates of Income Tax and NIC.

This problem can be avoided by the individual and the company entering into a joint election to assess any undervalue at the time the shares are acquired by reference to the full unrestricted market value of £1 per share. In most situations individuals will not be acquiring shares at less than their unrestricted value, or the shares will be of a low value in any event. Accordingly, there will normally be little risk of such an election giving rise to any significant tax liabilities on an undervalue at the time the shares are required and it avoids a significant proportion of what will hopefully be substantial profits in the future being exposed to the higher rates of Income Tax and NIC.

Importantly, this election has to be made within 14 days of when the individual acquires the initial interest in the shares.

Private equity funds will usually be alive to the merits of this election as it avoids the company in which they have invested from potentially being liable for substantial employer’s NIC liabilities, and they will often invite founders/management to enter into the election as part of the normal documentation dealing with the private equity funds participation.

RATCHETS

Another area that is a relatively common feature as between a private equity fund and the founders/management is that management will have an entitlement to an increasing proportion of the equity in the company depending upon the company’s performance. For instance, management might have an initial 20% stake in the equity of the company, which, depending upon how well the company performs could be increased to, say, a 30% interest at a future date. Such shares are sometimes called flowering shares or blossoming shares or exploding shares.

Prior to the change in the anti-avoidance rules in 2003 the 10% increased interest in the equity of the company, per the example, would have been able to have been organised so as to benefit from the more favourable Capital Gains Tax rates. However, since the change in the rules the Revenue is suggesting that all such increased rights in the equity will be liable to the higher rates of Income Tax unless at the outset the individual pays for the shares a price which reflects the full maximum potential. That is to say, in the example the shares at the outset might be worth only 20% of the equity, say, £20,000. Yet the Revenue view is that unless individuals pay £30,000 for the shares at that time (reflecting their maximum potential entitlement to 30% of the equity), the ratchet element of the future value of the shares will remain liable to Income Tax.

The author, and a number of other tax professionals, do not believe the Revenue’s stated view is correct and that if the share rights are appropriately structured all of the profits should be eligible for the favourable Capital Gains Tax rates. However, management will wish to be aware of this issue when entering into arrangements with a private equity house. For instance, if the shares are of relatively low value at the outset management might want to consider paying the maximum value at the outset to avoid possible problems with the Revenue at a later date.

A possible exemption from this particular anti-avoidance rule is available for certain employee-controlled companies. Private equity funds will often invest in companies that will continue to be controlled by founders/management and this exemption can be useful in a number of situations.

EMI OPTIONS

Unapproved share options are generally tax inefficient. The traditional larger approved share option schemes are simply not suitable for the size of company that will usually be seeking private equity funds. However, there is one type of approved share option that is very flexible and lends itself to the type of private company that often seeks private equity funding, and that is an Enterprise Management Incentive (“EMI”) option.

There need be no formal approved scheme as such. Each option between the company and the director/employee can be tailored and can be performance related, so the company has a free hand when it comes to deciding a participant’s rights.

Compensation and Incentives in the VC sector

(continued from page 5)

- The tax advantages of an EMI option for the individual is that, if the exercise price is no less than the market value of the shares at the date of grant, all future growth in value enjoyed by the individual will be liable to the favourable Capital Gains Tax rules and outside the scope of Income Tax and NIC. This is also favourable for the company, which then has no exposure to employer's NIC and in certain circumstances will be entitled to a corporation tax deduction for an amount equivalent to the profit realised by the individual.

As would be expected, such favourable options can only be granted in certain circumstances. The issuing company must be carrying on an acceptable qualifying trade and its gross assets must not exceed £30m. The individual must work more or less full time for the company and is only entitled to EMI options over shares worth no more than £100,000. The company in total cannot issue qualifying EMI options over shares worth more than £3m.

The Revenue will agree to value the company's shares for the purposes of EMI options in advance and, to date, have tended not to dispute valuations at the lower end of the reasonable scale.

EMI options are not available in every situation, but should always be considered.

SUMMARY

The comments above are intended to highlight a few of the more common areas where problems can arise in relation to founder's and management's shares in companies in which external investors participate. The tax rules involved are unfortunately somewhat complex, but it will usually always be worth obtaining advice at the time shares are being acquired by founders or management in any circumstance as relatively inexpensive and straightforward preventative measures can be taken at the relevant time which can easily avoid exposure to significant additional tax liabilities at a later date.

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Adrian Graves looks at motivational and retention mechanisms in the VC sector.

ATTRACTION AND RETENTION OF top talent is becoming increasingly critical to small and/or fast-growing companies' success. However, it is also about making sure that senior manager and key employee motivation and objectives are properly aligned with the organisation over the medium to long term.

Any company seeking additional investment to accelerate its growth potential will come under close scrutiny regarding the capability, breadth and security of the existing senior management team:

- Is the team sufficiently well incentivised?
- Are these incentives redeemable only against delivery of activities adding value to the business?
- What additional skills and capabilities are required and how will these be incentivised?
- Are there employees outside of the senior team critical to the success of the organisation and, if so, are they incentivised to stay with the company and continue delivering?

Attraction and retention of senior and key employees is not purely a broadly based remuneration strategy but it certainly represents a major part of that equation. Of course communication, leadership and management, recognition and opportunity all play a part in the success of the company concerned. However, they merit a separate discussion altogether.

What steps should the VC or other major investor take in ensuring that management and key employees are properly incentivised?:

- Basic Salary – is it competitive across similar companies in the sector?
- Short term performance related bonus – is it competitive, linked to corporate, team or individual objectives?
- Equity – is it valued by the individual, linked to tenure and/or performance and is full advantage taken of schemes available in the market, both Inland Revenue approved and otherwise?
- Enterprise Management Initiative (Revenue approved scheme enabling tax-efficient distribution of substantial tranches of equity up to a company limit of £3m).
- Company Share Option schemes (Revenue approved tax-efficient scheme enabling distribution of options to a grant value of £30,000).
- Long Term Incentives (flexible but less tax efficient mechanisms for distributing equity to senior managers, linked to tenure, company performance or individual performance).
- Restrictive schemes (an umbrella term covering equity schemes enabling discounted equity distribution through downgrading the status of the shares such that they have no voting rights).

Whilst it is understandable that companies will focus on senior and key employees when constructing incentive schemes, there is considerable benefit to be derived from ensuring highly valued and hard-working junior and administrative staff are incentivised to remain with the firm and continue to work hard. There is a range of tax-efficient equity vehicles aimed specifically at more broadly based low-level equity distribution:

- SAYE (Save As You Earn) – staff can save up to £250 per month, typically over a 3 year period, to purchase shares at the end of the saving period at a price up to 20% below the market price extant at the outset of the scheme. Where the share price is anticipated to rise sharply this is an excellent retention tool for junior staff.
- SIP (Share Incentive Plan) – a scheme offering a range of low level employee share purchase, employer matching and share granting mechanisms which can be driven by a combination of service and performance. As with SAYE it represents a great way of incentivising junior staff.
- COSOP (Company Share Options) – up to £30,000 worth of shares can be allocated to staff as options.

FLEXIBLE AND VOLUNTARY BENEFITS

Provision of non-salary benefits is a valuable addition to any organisation's remuneration strategy. These benefits will include pension, life and critical illness cover, private medical cover, income protection and other lifestyle related products and services. Such benefits are tax-efficient for both employer and employee and typically much more expensive for the employee to source privately.

However, such benefits are frequently taken for granted and very rarely valued by the employee according to their cost. A flexible benefits scheme introduces several mechanisms which enhance employee understanding, and appreciation of employer funded benefits, increase choice and broaden flexibility. The three constituent parts, available as discrete modules are:

- Total Reward Statements – each employee gets an annual statement outlining the value of their complete remuneration package divided into its constituent parts – salary, bonus, equity grants, pension, insured benefits and so on.
- Flexible Benefits – because the constituent parts of the benefit package are independently valued, employees can choose only the benefits matching their lifestyle with the balancing cash either taken as salary or re-allocated to other benefits. The flexible benefits mechanism includes a salary sacrifice facility whereby employees can sacrifice salary (with consequent tax and NI benefits to employer and employee) to buy approved services (childcare vouchers, computer purchase etc)
- Voluntary Benefits – the employer buys into a market facility bringing substantial scale discounts across a wide range of non-employer funded benefits such as dental cover, travel insurance and other lifestyle benefits.

Investment in a flexible benefits structure has proved to enhance employee appreciation of employer spend on benefits consequently impacting on recruitment and retention.

AGE DISCRIMINATION

2006 will see another category added to the body of anti-discrimination employment law – age.

Employers have until 1 October 2006 this year to review all policies, procedures and practices, and make any necessary changes, to ensure that they won't be vulnerable to a claim of age discrimination thenceforth. However, it is not just a question of documentation. Probably the harder job is to engender a workplace culture in which age discrimination and harassment are as unacceptable as that based on sex, race or disability.

It will mean reviewing recruitment practice. Indicators such as "young and energetic" or "would suit someone with a mature approach" will need to be consigned to the bin; along with the more obviously discriminatory "we seek candidates aged between 25 and 30".

Any age related benefits for existing staff will need to be examined carefully in case they fall foul of the new law, although length of service benefits such as salary or holiday increments in general can be maintained.

Perhaps the biggest impact of the new law will be on retirement ages. From 1 October 2006, employers will not normally be able to require any earlier retirement age for their employees than 65. This will apply even where there is a company pension scheme operating from an earlier age, e.g. 60. Employees will remain free to retire whenever they wish, but a forced retirement before 65 could be viewed as an unfair dismissal. Employers will be obliged to consider requests from individuals to work beyond the default retirement age of 65.

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FINANCIAL: DISTRIBUTION

The Future Distribution of Financial Services Products in the UK

Dr David Bland looks into his crystal ball for future financial services distribution models.

THE DRIVERS INTO THE future are consumerism, technology, globalisation, regulation and a dozen other massive and frequently conflicting forces that appear to diminish the individual (including the small businessman) and allow very large corporations to become even more obviously more powerful than small countries.

The pensions funding crisis that has erupted onto Britain, with the active assistance of the Labour government and the FSA, allows nobody to escape from awareness of their per-

sonal dependency on the Financial Services sector of the economy; while at the corporate level the clear recognition in London markets of the difference between wholesale and retail business has enabled the London corporate trades in banking, insurance, asset management and related trades to lead the world. The recent decision in Lloyd's to pull the plug on Kinnect, after seventy million went down the overflow, shows that technology is no more certain a friend for financial services operators than it is for Her Majesty's Government (as in

the case of the Child Support Agency).

The growing cohort of billionaires who have significant personal investment potential does not affect this picture: the idea of a 'corporation sole' has existed since the dark ages, in the shape of massive territorial landlordships and medieval bishops' extensive assets. Large personal investors fall in the corporate sector, as they always have; though the number of zillions of Yuan that will mark the threshold to corporate status in the year 2100 cannot yet be estimated. ➤

(continued from page 7)

- For lesser individuals, an integrated package of cash and investment management, pensions construction and access to borrowing – provided by a named contact person – will become increasingly attractive. Such a provider will be the individual's stock and insurance broker, mortgage negotiator and representative in the making of prenuptial and post separation contracts: and it will settle the estate after the client's death. Most of these jobs are done extremely badly when large organisations offer them: this is conspicuous, for example, when a bank undertakes the probate of even a simple estate. Thus there is a growing need for firms that will offer client-friendly access to best buys in all these specialist services, through a panel of providers.

The client-facing firms will unambiguously be the agents of the retail customers, and will have no improper or covert relationship with the product providers. Such a prediction will seem naïve to many financial services professionals, who are all too conscious of the reluctance of even risk-aware affluent clients to pay fees to financial advisers. This reluctance arises because the client sees the adviser as someone who only does what the client herself could do, if they had a bit more time to scan the web and a little more self-confidence. So long as consultants remain advisers, and focus on the hard challenge of self-denial (which all saving entails), the negative image will remain. Only when the personal financial services provider provides services rather than advice, unlocks access to 'affordable' medical insurance, or mortgage borrowing or pensions prospects, ensures that the client gets the best deal on bank charges and car hire, will these services be paid for relatively willingly. But as the world becomes a more scary and complex place, the availability of a good and personal service such as I have described – covering the whole of an individual's access to personal financial services, and providing many of these (such as annual tax returns, and small business accounts) in-house – will become a desired and highly valued service.

In the corporate financial markets, corporate treasurers with strong risk management support will increasingly manage their own financing and risk financing by advertising propositions on the web and looking for the best offers globally. Following the Marsh-AIG scandal, and the general nausea of non-financial companies at seeing the megafees that their banks charge them being dissipated in bonuses to jack-anapes who know only a limited range of moves in a zero-sum game of cyberspace trading, companies will increasingly seek to trade direct – preferably with niche providers – to secure exactly the financial products they require, at the least cost of intermediation. The zero-sum game in the next generation won't be derivatives trade: it will be disintermediation. As they did in the early twentieth century, CEOs of trading and manufacturing organisations, news and media companies, healthcare providers and the tourist industry, will look

askance at the steel and glass towers occupied by the banks and insurance brokers, and ask: 'why should I be paying for that?'

Smaller companies that do not have the treasury and risk management resources of their large competitors will constantly need more professional advice on their insurances, on their options for raising development finance, on the viability even of directors' pensions funds, on incentivising workers and protecting travelling representatives against pandemics and terrorists. Providers will format their clients' propositions for financial products that they would be willing to purchase, and launch them into the web with trailers for relevant search engines. At the other end of the open information exchange a new equivalent of the traditional Lloyd's broker will emerge, who recognises potentially viable propositions that may come from anywhere in the world and introduce them – with the format of a suggested solution – to potential providers of that solution. The probability that more and more products will be bespoke in this manner encourages my belief that their providers and introducers will increasingly be niche boutiques.

The intractability of liability cover means that the funds for employee compensation following incidents, experiences and accumulations of exposures by individuals at work, means that traditional insurance concepts will be abandoned, and employers liability settlements will be met on a pay-as-you go funded basis with a compulsory levy on employers, potentially weighted according to sector and type of risk. This will be met by an up-front annual payment for each worker employed (at the specified tariff); thus employers liability will be reduced from a pseudo-actuarial market to a merely administrative activity.

The more intelligent and ICT-literate the intermediary may be, the brighter is his future; and smaller intermediating businesses will be beautifully equipped to undergo metamorphosis into the flexible friendly firms of the future. The big will be broken up, and the once cocksure will become the cockshies of the 2010s.

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If you are seeking private equity capital to finance a financial services start up or expansion, contact:
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