

Recession shows capitalism works

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'Our homes are for living in; is it right that they are used as a mechanism to finance a lifestyle beyond our means?'

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IT'S April 2012. The growth in the economy signifies the gloom that filled the past three years has now passed.

What did we learn during the credit crunch and the following recession? The collapse of trust in traditional institutions in 2009 was startling.

Banking had always been a relatively 'closed' industry to the public; the crunch put the bankers in the spotlight. The Scottish banks have good businesses and a good story to tell; the problem is no one trusted them after the 'toxic loans' scandal.

In order to rebuild trust they had to become more open and permit greater understanding of how they work and manage their customers' wealth.

Disaggregation (the break-up of complex banking structures) and the emergence of simpler 'old style' utility banks are helping to slowly rebuild trust.

During the early 1980s, a survey found 82 per cent of the population trusted the media to inform us about that recession and to provide helpful advice. In 2009, it was only 32 per cent. We witnessed a diffusion of media sources in the intervening years but, for many, the trust in traditional media has yet to recover.

My profession was complicit in producing overly complex financial statements and reporting mechanisms. Many investors were perplexed, unable to interpret the financial health of many listed companies.

Since 2009 regulation has made some significant changes to financial reporting, governance and directors' behaviour. The accountancy profession, working in tandem with business, has improved corporate reporting and financial disclosures.

The recession not only taught us new lessons; it made us re-learn some universal truths. Capitalism is not dead; it didn't even catch a cold. What we've witnessed over the past three years is capitalism hard at work.

Yes, there have been corrections to asset values and income levels. Many are familiar with the phrase "the value of your investment can go down as well as up"; why did more people not believe it?

Not only have market forces worked. Capitalism is the only economic model that can work in the long term.

Businesses which went into the downturn in poor health didn't live to see the upturn. The strong survived. The ones who understood their customers' needs increased their market share and are now reaping the benefits.

A fool and his money are soon parted. Cost

and value are not synonyms. Most people who referred to adding value could not define the term and were really adding cost.

Creating wealth usually involves getting up early in the morning and working hard to provide something people need. For every lender there's a borrower. Rising markets and cheap money made prudence history.

Investors approached life with an attitude of "the more you borrow, the more you make".

Banks became lazy, some with an attitude of "if the asset value isn't there, it will be soon." Let's be clear; we've been through a period of irresponsible lending and irresponsible borrowing; a toxic combination for all.

We are not all property experts. Our homes are for living in; is it right that they are used as a mechanism to finance a lifestyle beyond our means? We were all too obsessed with the value of our houses. It is easy to make money in a rising market.

Loans of more than 100 per cent of value are a bad idea. The attitudes of individuals and financial institutions to debt and risk have changed, although, I suspect, temporarily.

We had an 'emergency stop' in 2008 when 100 per cent plus loan-to-value funding ratios came to a standstill; 80 per cent became the norm. We're now edging back towards more conventional ratios. Lily Allen summed up the excesses of the boom years with "But it doesn't matter 'cause I'm packing plastic and that's what makes my life so ***** fantastic".

Debts have to be paid for; sometimes by the debtor, sometimes by the lender and sometimes by the lender's other customers; somebody has to pay.

'Get rich quick' schemes don't work. This has been observed from biblical times; "Wealth obtained by fraud dwindles, but the one who gathers by labour increases it."

If it seems too good to be true, it probably is. Generation Y, many of whom lived their adult lives in a period of economic growth with an "I want it all but I don't want to work for it" attitude, have had to reassess their priorities. They now know they can't have it all.

Finally, there is nothing new under the sun. The long arc of post-war consumption did not stop in 2009, 2010 or 2011. It continued, albeit with a couple of minor blips.

However, our attitude to debt has changed. I can't sum this up better than Charles Dickens who wrote in 1849: "Annual income twenty pounds, annual expenditure nineteen and six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery."

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