

Boring Banking

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“If we want things to stay as they are, everything will have to change”. The most famous line in “The Leopard” by Giuseppe di Lampedusa illuminates the paradox at the heart of investment.

Of all the moving parts that comprise a modern economy, finance is the most conservative activity least amenable to innovation. Indeed, when the words “financial” and “innovative” appear in the same sentence, experienced investors reach for their handbook of “Security Analysis” and move quietly on.

The business of corralling aggregate savings and distributing them in the form of letters of credit, loans and securities to finance investment hasn’t changed since Cosimo Medici paced the Palazzo della Signoria, the Fuggers financed the Holy Roman Empire and the Scottish economist, financier and grand larcenist John Law introduced paper money to the Banque Generale of France.

Robert Shiller, of Shiller CAPE indices fame, sees “money” as a technology. Yet the history of money strongly suggests that financial “technological” innovation is found simply in degrees of leverage. As Adair Turner noted, much of the activity of investment banks is simply “slicing, dicing and selling” different forms of debt.

But, fundamentally, the role of finance; moving funds from savers who need a return, to enterprises that need funds to grow, has not changed nor has the basic national accounting identity that $S=I$, “savings equals investment.”

What, of course, has changed and changes all the time, are the uses to which that finance is put.

The function of public markets is not only to allow investors to put their savings where they may be used most productively but also to allow investors to withdraw funds from where their capital is failing to generate adequate returns.

This process is far more dynamic – creatively destructive – than we commonly realise.

The FTSE 100 Index is much younger than you might think. It was founded as recently as 1984 as a record of the performance of the top UK companies. Yet, the current membership list comprises only about ¼ of the original members. Slightly older readers might remember BICC, Boots, ICI, British and Commonwealth, Grand Met, Hanson Trust, MFI, Pilkington, Rank, Thorn EMI and United Biscuits, none of which remain in the index.

All these companies have come and gone through acquisitions, mergers, takeovers or bankruptcy. Capital has been employed and then redeployed as part of the healthy dynamism of a capitalist economy.

As Lampedusa noted, everything changes, except the role of finance. When Mark Carney says, “banks should be boring,” this is what he means. When the economy is the story financial markets are doing their job. When finance is the story you can be sure the real economy is headed for trouble.

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