Small (and computerised) is beautiful

Capital Market Revolution — The Future of Markets in an Online World
By Patrick Young and Thomas Thes
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“There is nowhere to hide from capital markets. Nobody is safe from the capital markets revolution."

With this stern warning, author Patrick Young begins his insightful and thoroughly entertaining examination of the world’s financial markets.

In an iconoclastic look at the trends in global capital markets, Young argues that a major sea-change in market practices and products is currently taking place. Further, the change is so profound that it is set to change forever the way these markets operate.

Using the mantra of “liquidity, accessibility and transparency”, Young argues that the advent of the Internet and electronic trading technologies is changing the landscape of global capital markets by driving down costs and improving access for private investors.

According to Young, recent developments such as on-line securities trading represent the first stage in a global trend towards the empowerment of private investors that will ultimately see this group become a significant force in global capital markets. The result will be that they will demand (and will receive) access to a range of products and services hitherto unknown.

While the outlook is bright for consumers of financial products, the providers of such products face an uncertain and challenging future. Profit margins will be slashed and competition among providers will intensify as technology breaks down the geographic boundaries that once separated (and therefore protected) markets. Businesses that are slow or fail to acknowledge the new reality (the aptly named “luddites”) face extinction while the winners will be the small and nimble firms who are able to respond to the changing needs of their customers.

To demonstrate the reality of the capital market revolution, Young devotes the first half of the book to the study of the futures industry and the current debate surrounding electronic versus floor trading. In doing so, Young points to the dramatic fall from grace suffered by the London International Financial Futures and Options Exchange (Liffe).

Liffe was once the world’s second largest futures exchange and one of the most important financial institutions in the city of London. In 1997 however, Liffe’s fortunes took a turn for the worse when its main rival, Germany’s Deutsche Terminbörse (DTB), began to take the lion’s share of trading in the German bund futures contract, then Liffe’s largest product.

The migration of business away from Liffe to DTB was a combination of many factors, not least of which was the fact that DTB offered its member firms access to the market via the exchange’s efficient and low-cost electronic trading system. This system contrasted sharply with the expensive and anachronistic method of floor trading then favoured by Liffe which, while reliable, was significantly less cost-efficient.

In later chapters, Young turns his focus away from futures to other sectors of the financial markets. In what is perhaps the most illuminating chapter, “Living with the Revolution”, Young provides an insight into the market segments that he believes will benefit most from the revolution. He also suggests some survival skills for those wishing to ensure they are not left behind in what is an ever-changing landscape.

Among the skills regarded as pre-requisites are computer literacy (no surprise there), language skills, geographic flexibility and market knowledge. Global thinking is also listed as a key attribute, with Young warning that in the new virtual world, providers need to think in macro terms. Among the markets Young sees as having the greatest potential for growth are electricity, credit, emissions, insurance, Islamic finance and securitisation. Telecommunications is another sector forecast to experience growth, particularly in the area of bandwidth trading.

While the outlook for these segments is bright, the future for more traditional market sectors such as fund management is mixed. Once again the winners will be small and nimble companies which are able to offer niche products that, while exotic in nature, offer true portfolio diversification. Art and vintage cars are just two of the products listed under this category.

The losers meanwhile will be the firms that do not have the capacity to add value or large firms whose bloated cost structures and outdated management techniques render them too inflexible to benefit from the opportunities the revolution has too offer. The simple message once again: small is beautiful.

Overall, Capital Market Revolution is a provocative and courageous attempt to forecast the path of global capital markets. While some of its predictions are open to dispute, readers will no doubt appreciate the forthright and passionate manner in which Young presents his ideas.

In this age of e-commerce and where terms such as dot.com and browser have become part of the mainstream vernacular, Capital Market Revolution offers both a timely reflection of where global markets have been and a bold prediction of where they are headed in this new millennium. Let the revolution begin.