# When it comes to banking, politicians mustn't throw the baby out with the bathwater

When someone breaks a leg it is normally put in a cast to mend; you don't cut it off. There is a worrying possibility that politicians will attempt to chop off the legs of the banking sector rather than mend them. Yes, changes are essential, but reducing the size of our banks by any means is not realistic.

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Banks are in a position to dictate the pace and type of innovation that continues to unfold
Photo: PA

We live in an age where dollars and pounds are more powerful than bullets and aircraft carriers, and for this reason the future of the banking industry is not a trivial concern. The modern-day world around us was conceived from an idea in the head of an entrepreneur; an idea whose success was only made possible through funding originating in our banks' investment operations.

Every entrepreneur believes their idea to be the most brilliant ever conceived; clearly most are not. Who decides what projects get the funding to make them a reality? Financial services professionals. Banks are therefore in a position to dictate the pace and type of innovation that continues to unfold. Consequently, banks have to take leaps of faith. That is far easier and preferable to control within their own local culture.

Surely the internet is the quintessential example of innovation. This amazing service and associated products were heavily funded from banks operating on the west coast of the US and received virtually no support from Chinese banks. Why? The internet is about inclusion, transparency, distribution and fundamental Western values – an anathema to China. Consequently, Chinese investment professionals had no interest in supporting technology, as they didn't believe that was important within China. US and European banks backed the venture and therefore they developed technology that supported these basic values, which permeated into all corners of the globe. The same can be said for mobile phone, media companies, and thousands of other products and services we rely upon today.

Without doubt banks with huge cash resources are more likely to take the necessary risk to support innovative ideas. It's all about percentages. Basic investment principles dictate that only a small portion of portfolios are allocated to risky ventures. The rest put in more secure longer-term assets. Therefore, by reducing the size of the banks' capital, you reduce the size of the funds available to entrepreneurs. If a bank has enough money to invest in a total of 10 projects a year, then it's reasonable to take the risk on one or two highly speculative projects because if those investments fail, the bank more than makes up for it on the other eight or nine projects. If a bank only has enough to invest in three or four projects a year then it simply can't invest in any risky ventures. Conservative projects remain funded, but innovation dies.

If we are to support our own values and our long-term economic strength we need to assure our ability to take risk and that means assuring our banks have the funds that encourage them to do just that.

The vast majority of entrepreneurs set up their businesses close to where their funds emanate from. It is only natural. The Middle East, for example, has massive innovation funds, But to get access to those funds, entrepreneurs have to sign agreements that insist a certain portion of the jobs are created in the region. However, Humphrey Percy, chief executive of Bank of London & the Middle East, said: "London was the financial centre of choice for us in 2006 when we established this bank, given its market size, its supportive tax and regulatory regimes."

Should this be a government function? Governments are reasonably adept at grand-scale innovation, but they are completely lost when it comes to smaller "bread and butter" innovation. The reason is that the government doesn't have the people. Assessing the viability of innovative ideas is very difficult because, by definition, innovative ideas don't have data that can be analysed. Innovation attracts risk and that explains the excessive remuneration packages which come with the territory of making difficult but successful decision-making processes. In that department, governments simply can't afford to compete with the private sector.

The banks' importance to our way of life is not an excuse for leaving them to revert to pre-crisis practices. However, new rules cannot deter from their ability to serve us and our way of life. The government is hell-bent on shrinking the size of the banks to such an extent that their ability to take risk is completely curtailed, but we do this at the cost of our future place on this planet.

Increase the transparency of banks, increase the amount of reserves the banks hold, make managers more accountable for their actions, and build a central reserve to deal with the next crisis, thus erasing unnecessary uncertainty. But keep our British banks large. Keep them world leaders. Keep them promoting British values to all corners of the world and give our children security and a country where they can enjoy a standard of living that is the envy of the world.