Pick on someone your own size!

Mathew Beale: 'The big versus small imbalance exists in all industry sectors'

Mathew Beale, managing director of Comsure Compliance Limited, wonders whether regulations harm small businesses while protecting the larger firms

RECEIVED wisdom suggests that the JFSC do not like small businesses. The idea is so pervasive that the Director General of the JFSC, John Harris, has been moved to vigorously defend how they regulate smaller firms stating at a recent Institute of Directors' lunch: 'The JFSC do not pick on any particular firm because of their size.'

But what about the JFSC policy that only allows the top 500 banks to be registered in Jersey? This glass ceiling is a regulatory one; a rule that I am sure some in government would like to see relaxed to boost our economy.

Many claim that regulatory intervention in business promotes better and more ethical business. However, such actions have consequences that provoke an opposite negative reaction which can diminish any positive effect. The laws of unintended consequences are quite clear; the complexities involved in regulating outcomes often result in undesirable effects such as stunting innovation and business growth, resulting in fewer jobs and the exodus of business to other jurisdictions.

For example, the top 500 policy has caused the recent loss of 30 jobs when Kleinwort Benson was forced to relocate to Guernsey as a result of dropping out of the top 500. Further, the Jersey consumer is consistently offered non-competitive banking products, such as mortgages, due to the lack of provider choice in the local market.

So is it right that big is always better? Recent evidence would suggest not. For example, the UK Financial Services Authority has recently reported that several banks mis-sold specialist insurance, known as interest rate swaps, to thousands of small businesses. The FSA said it had found 'serious failings' in the sale of the products, designed to protect firms taking out loans against rising interest rates.

The mis-selling is the third case of serious malpractice with the UK's banks; it comes after the manipulation of lending rates (Libor) and PPI insurance mis-selling. Some of these same banks have been welcomed in Jersey. Furthermore, and alongside these disappointing stories, we now also have the money laundering investigations in HSBC (30 July 2012) and at the time of writing our very own Jersey bank HBME is now implicated.

Against these examples we should not lose sight of the fact that reckless mis-selling of financial products and money laundering are criminal offences. And as Paul Moore (ex-head of risk at HBOS 2002 to 2004) recently commented when considering this bizarre state of affairs: 'We put people in prison for stealing a water bottle when they get carried away in a riot but we let top directors of banks, [who are] paid millions, get away with putting compensation provisions on their balance sheets and monetising their morality and illegality.'

In these enlightened times should we not look back at the biggest financial failures over the last few years and who has caused them and consider reassessing our entrance criteria? Maybe big is not always better. Perhaps an evaluation of an individual company's potential contribution to Jersey alongside their ethics, integrity and corporate responsibility would be a better measure.

When it comes to size, the anecdotes that have been doing the rounds in Jersey for the last few years suggest that the JFSC long ago embarked upon a campaign to rid Jersey of smaller trust companies. The perception being that the JFSC believe the same is true of trust that is 'true' in banking: Big is good, small is bad.

I do not actually agree that there is such an overt plan, I would instead argue that the regulatory process is inherently imbalanced, which inevitably and inexorably leads to the oppression of smaller companies. Simply put, the lack or proportional regulation means the odds are always stacked against the smaller firm whether it be a bank, trust company or other.

By way of example, a five-man investment business in Jersey has to follow the same rules as a 100-man company. Further, consider the process of a regulatory visit; the regulatory process will generally be the same in terms of information being requested to be seen, time on the ground (three to four days) and the number of supervisors (three or four) reviewing the firms practices. It therefore stands to reason that a small company will be subject to far more intensive and invasive scrutiny.

It is clear that for smaller firms, getting compliance wrong is far more damaging than for large firms. By way of example, look at HSBC. At the time of writing, HSBC are in the news and have reportedly set aside £1.3bn for potential fines. This is indeed a lot of money but when put in the context of a rise in profits to $12.7bn (£8bn) it does not really seem too much to bear for such a shocking activity that may even be criminal.

What small firm would survive if they had engaged in such activity? The fines, criminal charges and howls of anger from the regulator (and most likely the public) would bring down most. Some may say 'and rightly so' but, as outlined above, unlike the small the big inevitably survive to fight another day (and don't always learn their lesson) and this goes to show once again that there is a lack of a level playing field.

The big versus small imbalance exists in all industry sectors (I know, Comsure is an SME). However, small firms survive and succeed and in doing so they all seem to follow the following golden rules;

- **Create economies of scale:** You cannot possibly hire an expert in every field like the bigger players. There are many 'turnkey solutions' that can assist and provide economies of scale to the expertise you need; for example human resources, marketing, and compliance – use them.
- **Have good in-house financial management:** Firms should create realistic annual budgets that serve as a financial road map for the future and test the assumptions to allow for the spikes in costs (including the Regulator and their fines).
- **Employee training:** Employees must not be put on the 'floor' until they are thoroughly familiar with the business, its clients, its product and the risks.
- **Create a niche:** Set your business apart from the larger competitors and focus on what you are good at without diversifying too much.

It is hard enough trying to combat the competition without having to beat the judges as well, but such is a small businessman's lot. But remember, being a small business can also be a virtue if it allows you to be agile, innovative and change direction when required; you can use your size to your advantage. Innovation and inspiration are often the best course for those bold enough to run a small business.