

Four: Why Does the External Environment Matter?

For the times they are a-changin'.

Bob Dylan

Prophetic words. Times have changed. But some things have not.

Shocked faces—anxious and worried—were the most memorable images. The lines of people ran for miles. Up and down the country, there were queues outside every bank. It could have been 1926. But it was not. It was 17 September, 2007. The bank was Northern Rock, a bank based in Newcastle, in the north of England.

This was no small backwater entity. It had 1 million savers, 800,000 mortgage holders (including our family), 180,000 shareholders, and 6,000 staff. By the middle of 2007, Northern Rock held 19 per cent of the UK mortgage market, up from 11 per cent in 2006. It was the country's fifth-largest lender. And the bank's high-risk business model—dependent on funding from wholesale credit markets—kept it afloat as long as funding remained available.

Northern Rock had steady and progressive growth, with assets growing by a fifth annually. In January 2007, the bank announced record pre-tax profits for 2006 of £627 million, up 27 per cent from 2005. And then the credit crunch hit, fallout from the US subprime crisis. Looking to cover its likely exposure, Northern Rock was forced to request emergency funds from the Bank of England. The crisis led to the queues—and an overall loss of confidence in the banking system.¹

After six months of rescue efforts, with Northern Rock's loan having grown to £26 billion, the government moved to nationalise the bank, absorbing costs of some £90 billion. The subprime crisis may have begun with low-income US homeowners, but it had a very real impact on a solid-seeming financial institution—and on UK taxpayers.

The Northern Rock story shows how a series of apparently, unrelated events in one market can end up freezing the rear end of another. Our environment catches us in unexpected ways.

Leaders of organizations now operate in a rapidly changing environment. Gordon Brown, the British prime minister, would have turned pale green if he ever thought that a bank would be nationalised on his watch as PM. The irony was that he previously

served as chancellor. Such is the speed of change. The story shows how easy it is to be caught unawares.

All Change

Dominant assumptions are no longer valid. New markets, channels, and business models win over the tried and tested. Business as usual is not enough.

1 Northern Rock, Lessons of the fall, The Economist, Oct 18th 2007 -
How a financial darling fell from grace, and why regulators didn't
catch it