

1984 Creating the FTSE 100

Back in 1983, Elroy Dimson and Paul Marsh were approached to advise on how to construct the first ever real time index for London's stock market. This led to the creation of the FTSE 100, now a household name.

The impetus came from the London International Financial Futures Exchange (LIFFE). They wanted to introduce futures and options trading so that investors could hedge and manage their UK equity exposure more effectively. This required a real time index, a rarity at the time. The new index also needed to be representative, which required around 100 stocks.

At the time, the existing bellwether for the UK market was the FT 30. Although this index dated back to 1935, it was too narrowly focused. And its calculation methods were so flawed that investors could beat the index simply by holding it. Clearly, a new index was needed.

A small team was put together to design the FTSE 100, including representatives from LIFFE, the Stock Exchange, the Institute of Actuaries, the *Financial Times*, plus London Business School finance professors Dimson and Marsh. The team also included Mark Makepeace, who is today the CEO of FTSE Group, now wholly owned by the London Stock Exchange.

The power of real-time indices

Dimson and Marsh had a background of researching stock market performance and index construction. Their role was to create a back history for the new index, to establish how well it would track the market, and to advise on other issues such as how and when it should be rebalanced.

"In those days it wasn't routine to set up a new index," says Dimson. "Now it's commonplace. At the time, there were only a few hundred indices worldwide. Now FTSE Group alone calculates over 200,000 indices every day. It's an indication of the vast changes in the finance industry over the past 30 years and the opportunities that have opened up."

"The FTSE 100 has been enormously successful in allowing people to monitor market movements in real time, hedge their positions and improve risk management," says Marsh. "It also encouraged the growth of index funds which are a cheap way of investing in the stock market. Instead of paying charges of 1-2 per cent, you can today buy a FTSE 100 tracker with annual charges of just 0.1 per cent."

The birth of a household name

The FTSE 100 Index is today the most widely followed UK stock market index. It has become known fondly as the Footsie, but Dimson and Marsh say its name was in doubt until the last minute. The Stock Exchange had decided it wanted its name on the new index, but the *Financial Times* was reluctant to support an alternative to the venerable FT 30 index. So SE 100 was the working name until the day before launch, when the *Financial Times* finally decided to join in and the FT prefix was inserted.

For Pearson Group, the owner of the *Financial Times*, owning half of the FTSE business was to prove an astute decision. When the London Stock Exchange acquired the remaining half of the index firm in 2011, FTSE Group was valued at £1 billion.

Dimson is now Chair of FTSE's academic advisory board and of the FTSE Group

Policy Committee, the most senior position within the FTSE governance committees. And Marsh serves on FTSE's jury of appeal.

Paul Marsh and Elroy Dimson are both Emeritus Professors of Finance at London Business School.