Primary internal and external influences to which the banking sector in the unite...

Finance, Banking

Primary internal and external influences to which the Banking sector in the United Kingdom is subject to

The banking sector is one of the very important sectors in the country and its the main participants in the sector are include the the central bank, the commercial banks and also other financial institutions that include the mortgage companies. The central bank is the government's bank that transacts on the interest of the government and has a soleresponsibilityof controlling the banking sector in the country by instituting the regulations that are expected to create confidence of public to the country's banking sector. It also has the role of issuing currency (Casu, Girardone and Molyneux 2006) The banks and other financial institutions are financial intermediaries who acts as mediators between the borrowers who needmoneyto invest and the savers of money who have excess money (McDonald and Burton 2002). The banks and other financial institutions operate in this business in the aim of making profits based on the difference between the interests in which they pay to the savers and the interest in which they paid by the borrowers. Profits are expected to arise only if the interest paid by the borrowers is greater than the interest paid to the savers.

The United Kingdom banking sector is the third largest banking sector in the world after the US and Japan, and it has the largest commercial banking industries. The United Kingdom banking sector is the main international center for investment and private banking and this is evident from the strong international orientation that is portrayed by the significant foreign presence and sizeable assets of foreign banks in London, The number of authorized banks in the United Kingdom totaled to 690 in 2004, however this number has been declining over the decade but still experiencing a substantial increase in their size and also financial strength (http://www. myoffshoreaccounts. com/english/offshore_uk-banking-uk-bank-account).

The increase in the number of banks in the United Kingdom is associated with the presence of the European Economic Area Banks, where many of these banks do not need to have a physical presence in the United Kingdom but accept deposits on a cross border basis. The assets of the United Kingdom banking sector clocked 4, 165 billion sterling pounds at the end of 2003 which was three time of 1993 total banking sector assets value. The foreign banks in the United Kingdom hold more than half of the United Kingdom banking sector (http://www. myoffshoreaccounts. com/english/offshore_uk-banking-uk-bank-account).

The authorization and the supervision of the financial sector was initially done by the Bank of England until June 1998 when the responsibility was passed to the Financial Service Authority (FSA) that marked the first reform of the banking sector in the United Kingdom. The second reform in the sector arose in December 2001 when the Financial Service Authority assumed the full responsibility following the Financial Service and Market Act 2000 (http://www. myoffshoreaccounts. com/english/offshore_uk-banking-uk-bank-account), which overridden the banking Act 1987. The Financial Service Authority is a limited company that is financed by the levies from the financial sector and is expected to report annually about its achievement, where this report is represented in parliament for evaluation. The Financial

Service Authority is entrusted to the responsibilities of maintaining confidence in the United Kingdom financial sector, to promote the public understanding about the financial system, protecting the consumers ' interest and also reducing the number of financial crimes in the financial system (Capie and Webber 2005). The Financial Service Authority achieves its roles through the admission of firms into the regulatory system, setting standards that should be observed by firms, take action on firms whose actions are against the set standards, and also resolving complaints against firms and paying compensations when the firms collapse.

The Bank of England only has the responsibility of ensuring the financial stability of the economy given that the responsibility of controlling individual banks was transferred to Financial Service Authority. The Bank of England participates in monitoring the financial infrastructure and more especially the payment systems and it also monitors the economic and financial market developments which are used as tool for the overview of the whole financial system. The Bank of England is the one that is responsible of the monetary policy control through the monetary policy committee.

The discussion on the primary external and internal influences of the banking sector in the United Kingdom is quite large and for this case the paper has taken a look in primary external and internal influences within the banks and mainly on how they influence the banks performance within the United Kingdom. They are discussed as follows:

a)International Trade.

International trade is an important factor in any country's economy and it normally has an impact in quite a number of sectors in the economy that include the ones which are competing within the international market. During the process of international trade there is normally the transfer of cash from one country to the other that follows after the transfer of good and services. This situations call for a financial intermediary, for this matter the banks, to help in the transfer of the cash because at times the sellers and the buyers do not need to be their physically (Penn 1989). The banks normally provide this service at a commission and therefore the more the number of international trade transactions is made, the income is generated by the banks. On the other hand the international trade also provides an incentive for the establishment of foreign banks in the United Kingdom following the reason that international traders normally have accounts with these banks. Moreover they need services from their respective banks whenever they go, thus a factor that accelerates both the increase in size of the banking sector and also its performance. The rules for international trade can also be attributed to the performance of the banking sector in the United Kingdom, because when the rules are flexible and accommodating to the foreign investors in the banking sector, is certain to improve its efficiency and also its capacity. The foreign banks provide the local banks a competition that is likely to increase efficiency in the banking sector following the various adjustments that each bank in the United Kingdom has to make in the process of maintaining its relevance and competence in the banking sector.

b) TechnologicalEnvironment.

Given the nature of the banking sector, technologyis an important factor that determines the level of efficiency of the banking sector and more especially the information technology. Information technology has contributed much to the banking sector in the United Kingdom as the banks are performing their activities more efficiently compared to the early times when technology was at its crude stage (Watkins, 2003). For example the time taken to seal transactions has been shortened by the adaptation of the technology compared to the ancient times, when all activities were to be done almost manually. The technological advancement has also promoted accuracy, customer satisfaction and increased capacity in the handling of tasks within a specific period of time. All these have an impact of lowering the banks operating costs which in turn has an impact of increasing their profitability (Evans and Makepeace, 1976). Technology has also enhanced easier international approach of the banks as they can coordinate their operations from a centralized position than when technology was crude, and all this has been made possible by the utilization of the Internet and the equipments associated with the Internet. The United Kingdom's technology application in the baking sector is advanced in that it provides the sector an international competence, which in turn determines the sector' s performance in the international banking and the ability to attract foreign banks into the country.

c) Legal Environment.

The banks in the United Kingdom are monitored by the Financial Service Authority which determines on how they should operate in the process of ensuring that the public has confidence in the United Kingdom banking system. Different banks in the United Kingdom are certain to have varied interests in them trying to increase their profitability, assuming that they are all guided by a profit motive. It is possible that some of the interest are individual based which are certain to conflict with the overall interests of the financial system of the country. For that reason there arises a need for a body to be initiated that is expected to balance the interests in promoting the general good to the participants in the financial system, where in this case is the Financial Service Authority (Djarove 2004). The banks operations like the extension of credit and the interests charged on the cash borrowed or saved are controlled by the Financial Service Authority following its set code of rules that each and every bank should observe, while operating in the United Kingdom in ensuring financial stability. The regulations that are set by the Financial Service Authority affects the banks performance because they are restrained on the way in which they are supposed torespectin the process of them, while trying to maximize their profitability. Thus this is an influencing factor that determines the performance of the banks in the United Kingdom.

Regardless of the Bank of England transferring its responsibility of controlling the banks to the Financial Service Authority, it still influences the banks operations through its monetary policy interventions, which are directed towards ensuring financial stability of the United Kingdom economy. The monetary policy engage in the control of the money supply and demand in the aim of containing inflation. This is achieved through the direct and indirect interventions of the Bank of England through the banking sector. For example during high inflation rates that are not desirable, according to the monetary policy committee, the Bank of England is likely to increase the cash reserve requirement ratio which is meant to reduce the cash at the disposal of the banks that could have otherwise been used in extending credit to earn interest hence a restrain to achieving high profits (Sloman and Smith 2005). The bank of England can also advise the banks on how they should conduct their business which is certain to distort their strategic plans. The consequences could be an impact on their performance. Therefore, the Bank of England can be perceived as an influencing factor that determines the banks performance as it has the powers to alter the amount of cash that is at their reserve.

d) Competitive Environment.

There is a free entry and exit from the United Kingdom banking sector. Once a firm meets the requirements of operating as a financial institutions and following this situation, it is only the most competitive firms that are certain to survive from the competition. The banks in the United Kingdom are forced to provide the most innovated products and are relevant to the customers at the competitive market price. This means that all the banks are price taker other than price makers.

The competition provides the banks with an incentive of adapting the most appropriate methods of operation. These are meant to reduce their costs of operation, while selling their products at the competitive market price. The aim which is to increase their profit margin compared to their competitors in order to survive in the market and realize profits at the same time. During this adaption process process facilitates the emergences of new technologies within the banking sector. Those technological innovations are transferable at a fee while copyrighted to other banks which will increase the overall performance of the bank and the British banking sector in genera (Noguer 2004). Therefore, competition can be regarded as one of the factors that determines the performance of the banking sector in the United Kingdom, that is later reflected as a national comparative advantage of the sector in the world market. In situations where there is less competition, the opposite will occur as the tendency to monopoly will take place. Consequently, this will increase inefficiencies due thefailureof the market mechanism.

e) Financial Environment.

The financial environment is also another factor that influences the banking sector in the United Kingdom and this includes the easy for the investors to access credit. The interest rates which are set by the Bank of England, affects the number of loans extended to the investors in the sense that when the interest rates are low, the investors tend to borrow more compared to when the interest rates are high. This scenario affect the banks performance in the matter that their credit scores not certain to be attained. Otherwise they will opt to offer sub prime loans which are risky when the interests are low. The sub prime loans are risky because most of the borrowers are certain to default paying back their loans because of their financial unsoundness or the loans may end up at foreclosure activities. For example the financial environment of 2000 in the United States encouraged sub prime lending, where at later times in 2006 the interest rates rose (http://www. economics.

harvard. edu/faculty/rogoff/files/Is_The_US_Subprime_Crisis_So_Different. pdf.). This made it difficult for the sub prime borrowers to service their loans which lead to massive defaults and foreclosures. Hence the emergence of the famous sub prime crisis of 2006 affected most economies of the world. This crisis in the United States spilled over to the United Kingdom that exposed banks to making losses. Therefore. the Bank of England took a step of cutting down the interests rates and giving a direct aid to defaulters. This situation affected the performance of the banks because they incurred a lot of losses that arose from the default of the sub prime borrowers to pay back their loans and also the involvement in the foreclosure activities.

Socio-cultural environment.

The social and cultural practices of an organisation normally affects the extend to which organisations' human resources are utilized and this is reflected in their respective performances. In the United Kingdom there is a lager number of foreign banks that comprise over half of the banks and this implies that the banks in the United Kingdom vary in terms of the social and cultural environments. Therefore, cultures vary from one bank to the other. Cultureof an organisation is an important factor because of promoted the sense of unit and acts as a motivational factor among the employees, which in turn determines their performance (Bucley and Pearce, 1991). The culture of the bank also determines the extend to which the bank utilizes its resources and the pattern that it adapts in doing its investments. Risk management also varies from one bank to the other, depending on its culture. On the hand, other banks like to take more risk in maximizing their returns on investments, while others are risk averse. The appropriate culture should be the one that motivates the employees of the banks and instills some traits promote teamwork andaccountability.

f) Political environment.

The political environment of the United Kingdom has an impact on the United Kingdom' s Banking sector and this is followed from the chain of command that follows on how the Bank of England and Financial Service Authority should operate. The actions of the Banks of England and that of the Financial Service Authority are first approved by the United Kingdom parliament before implemented, that is the whole financial system is accountable to the country 's political structure. The Financial Service Authority normally prepares annual reports, which are presented in parliament for evaluation and then follows the making the necessary changes according to the desires of the political structure in place (Mullineux 1987). The suggestions from the political structure are passed to Financial Service Authority and the Bank of England, who in turn implement the suggestions by changing the set code on how banks should operate, hence influencing the banking sector.

The other political factor that is likely to affect the banking sector is the government expenditure which is determined in a political system. The government expenditure has an impact of increasing the money supply in the economy, meaning that the interest rates are likely to fall which will encourage borrowing. This will affect the banks performance positively as they will be having more cash to lend and also given the low interest rates on borrowing money it will attract more borrowers hence the increased performance among the banks as financial intermediaries. When the government expenditure is small, the interest rates are certain to increase implying that the borrowers are likely not to afford the servicing of the loans which in turn discourages the borrowing , hence rendering the banks to extending less loans that limits their income. Therefore the nature of the political environment normally influences banking sector's performance.

Task Two.

i) Analysis on how Increasing Economic integration influences policies and decision making in the Banking Sectors

Economic integration implies that the countries that are in an integration perform their economic activities in joint, where they are expected to share the market freely across the boundaries of various industries. It will require counties to avail the necessary conditions that will enable the other countries to trade within the country with much easy, with an aim of expecting to be treated in the same manner on the country trading at the other countries too. This means that the various countries involved in an economic Integration have to put aside their individual interests and otherwise encourage economic activities which are aimed to benefit the member countries, mutually. For this reason, the increasing economic integration will cause the countries to change on how they are designing their policies and the making of decisions about various sectors in the country because they have to consider the interest of the other parties in the Integration.

The bank regulations and practises seem to vary from one country to the other, implying that a country has to change its policies on how its banking sector is operating in order to receive an international recognition that is to adapt policies, which are compatible with the other countries' banking policies. For example, the banking principles in the United States are not the same as the ones in the United Kingdom nor are they the same as the ones in Germany. The increasing international economic integration call for the unification of the policies that are applied in some sensitive sectors like banking which are likely to undermine the whole process if not well handled. The banking sector is the most important sector that will enable the success of the international economic integration compared to any other sector as it is likely to support the transaction procedures across the parties in business over different countries. This situation implies that respective countries in an Integration will have to change their policies that are inherent in their respective banking systems with an aim of accommodating the other countries in the economic Integration, hence an impact in the banking policies. Decision making will also be impacted by the increasing economic Integration because each country will be expected to conduct its economic activities according to the rules that are set by the economic integration, thus a country will be restrained to behave in accordance to the set rules and not making its own decisions as all of the equal partners in the Integration, thus the banking sector will have to adhere to the set rules and regulations in the integration.

Governments of respective countries have the responsibility of controlling the banking sector and in the aim of entering into an international economic integration, the respective governments will be forced to ignore their hard lines in the control of the banking sector in the process enhancing international economic integration implying an implication on the domestic policies (Doone 1999). This situation calls for the convergence of the policies and institutions in the process of enhancing international economic integration.

ii) Critical evaluation of the effectiveness of the Banking sector response.

The increasing economic integration can be perceived as demanding respective governments to converge institutions and policies in attaining the full economic international economic integration, where all the economies involved countries in the integration will be treated equally. This seems to be restrained by a number of reasons given the varied requirements and desires for various governments in the world. This is discussed as below:

The banking sector in an important sector in determining the state of a given economy. It is a tool, which is used in accelerating economic growth through the extension of loans to the investors and also the altering of the interest rate, in order to encourage or discourage borrowing. The international economic integration implies that the banking sector will be converged to observing some policies. In addition to that, institutions are expected to work in a unified manner that is likely to eliminate any disparities, which are certain to disadvantage the location of business in any country within the integration. This scenario will contradict with the wishes of the various governments in improving their economic growth using the banking sector at an accelerating tool because they will not be having an absolute control over the sector due to international economic integration (Bhuyan, 1987). Therefore, this acts as a limiting factor to international economic integration because the interests of various countries toward economic growth will be conflicting implying that the domestic policies will never be completely substituted by the converging policies and institutions.

Taxation is also another factor that is likely to affect the international economic integration in relation with the banking sector. Taxation systems vary from one country to the other depending on the political desires of respective countries and also the government expenditure, and this means that some countries are likely to overtax compared to the other countries (Mathieson and Rojas L 1993). This factor is likely to undermine international economic integration in as far a the banking sector is concern, because the banking institutions in some countries will be treated in a unlike manner, which will disadvantage other banks as they will not be playing on a level ground, hence undermining international economic integration (Planlema, 1969). The over taxing of the foreign banks will have an impact of reducing the competitiveness of the banks in the domestic banking sector. Hence deteriorating the sector in general because the domestic banks will be operating like monopolies that involve a lot of market inefficiencies.

Various countries normally observe varied accounting standards which are limited for use to the country 's boundaries. This is evident in the various ways in which they treat transactions and the legal orientation of accounting practices. The United Kingdom has its own standard of accounting that is different to other countries like Germany, Japan, USA and Italy. This varied accounting standards call for reconciliation if data was to be compared (Jovanovic 1998).

The banking sector heavily depends on accounting more that any sector that one can think of because it takes it as part of its operations and for that reason the obstacles that limit the accounting process will affect the international economic integration negatively on involving the banking sector (Bain 2003). The International Accounting Standards have however been trying to set accounting rules but it has not broken through in the reconciliation of various accounting standards. The financing of the banks is also another factor that affects the banking sector in various countries in varied ways which in turn affects their accounting practises thus limiting international economic integration. The various bank branches of a similar bank will have the difficult of preparing its overall bank operation financial statements that are required for decision making because of the varied accounting standards across the countries.

Culture is also another factor that is likely to affect increasing economic integration as far as the banking sector in concern. Various countries' population practice a specified code of behavior when in business, where in some situations one country's culture is likely to conflict with the other, hence creating a situation of mistrust or lack of confidence in citizens from various counties. For example the population in Latin America is characterized of having less trust among each other in the sense that persons normally involve in business with much suspicion, compared other countries like the United States and also the United Kingdom, where trust is created on backing the business transactions with legal documentations. The banking sector in Latin America, for example Mexico, they do not trust their customers as they believe that they are likely to play unfairly in their transactions at the expense of the bank (Gordon and Williams 2001). This situation that is caused by the varied cultural will create a constraint in the banking sector as the practices will be varying across the countries and the establishment of a foreign bank in some country with a different cultural orientation will cause tension in the society as some practises will be conflicting with the expectations of the foreign country's population expectations, thus calling for the change of culture for the promotion of the international economic integration.

iii) Areas for improvement in the response of the Banking Sector

In relation to international economic integration considering the banking sector, some aspects need to be factored in response to the limitations that are likely to bar the sector from attaining an international outlook. They include:

The countries involved in the economic integration should ensure that friendly policies are adapted to provide an incentive for the establishment of foreign banks in their respective countries in the process of ensuring the success of the international economic integration. The policies should be designed in ensuring that the foreign banks in the country do not feel oppressed in their operations.

The countries that have opted to integrate their economy should set standard accounting procedures that need to be observed by the member countries in the integration as this will eliminate the task of reconciling the financial statements from different countries of origin. A bank will be having less difficulties in analyzing its financial statements in totality compared to the situations where branches in varied countries were to produce statements that are require an extra effort of reconciling (Greuning and Koen 2001).

Taxation policies should be revised on how foreign banks and other foreign investments should be taxed and this should be agreed upon by all the members in the Economic Integration. This situation will avoid the tendency of some countries taking an advantage of heavily taxing the foreign banks that is likely to affect their performance and profitability. The joint rules over the taxation of the banks will improve their competitive with the domestic banks hence promoting the international economic integration and also the performance of the banking sector.

The countries involved in an international economic integration should consider the cultural differences that are inherent in their respective countries before entering into an economic integration, that is, the countries with less cultural disparities or cultural practises which are compatible are the most appropriate countries to form an international economic integration if success was to be achieved. The respective governments should also try to discourage the cultural practises which are certain to undermine the economic integration where each country is supposed to recognize, appreciate and respect the cultural practices of various countries in the aim of promoting cooperation.

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