

International financial services cluster in london and uk economics essay



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COMPETITIVENESS IN UNITED KINGDOM

UK is one of the most developed countries in the world. The British economy has posted impressive performance over the past decade, with a strong record of GDP growth combined with high employment and low inflation. Main factor which makes the performance gap is labor productivity. One of the most significance clusters is financial cluster with several strong supporting clusters, including communications services, IT, publishing and printing, and, to an extent, transportation and hospitality. Relative to other advanced economies, the UK diamond is characterized by strong context and private-sector demand. While the government has made progress in reducing the complexity of the UK regulatory environment, there is still work to be done, therefore we consider that the UK overhaul its regulatory bureaucracy to remove barriers for new business formation and capital investment. Recent investments in roads, railroads, and public transportation have generated some improvements, but still UK road congestion remains a significant problem.

THE FINANCIAL SERVICES CLUSTER IN LONDON

In 1986 the London Stock Exchange became the first major European market to be deregulated, through a series of measures that came to be known as the “ Big Bang”. As barriers fell, competition increased and large American banks such as Citibank, Chase Manhattan, and Shearson Lehman moved in. At the heart of the London financial services cluster are its securities exchanges and over-the-counter (OTC) markets. The cluster has a number of promotional organizations, spanning the public and private sectors and designed to promote and support the cluster. We state, that opportunity of <https://assignbuster.com/international-financial-services-cluster-in-london-and-uk-economics-essay/>

increased capital mobility, London can gain an edge in European markets through the development of a platform for pan-European clearing and settlement system so as to increase efficiency and decrease transaction costs.

United Kingdom

United Kingdom's role at world market

The UK is a developed country, with the world's sixth largest economy by nominal GDP and the seventh largest by purchasing power parity. It was the world's first industrialised country and the world's foremost power during the 19th and early 20th centuries, but the economic cost of two world wars and the decline of its empire in the latter half of the 20th century diminished its leading role in global affairs. The UK nevertheless remains a major power with strong economic, cultural, military and political influence. It is a nuclear power and has the fourth highest defence spending in the world. It is a Member State of the European Union, holds a permanent seat on the United Nations Security Council, and is a member of the G8, NATO, OECD, World Trade Organization and the Commonwealth of Nations

London is one of the world's most important business, financial, and cultural centres and its influence in politics, education, entertainment, media, fashion and the arts contributes to its status as a major global city. Central London is the headquarters of more than half of the UK's top 100 listed companies (the FTSE 100) and more than 100 of Europe's 500 largest companies. The city is a major tourist destination for both domestic and overseas visitors, with annual expenditure by tourists of around £15 billion. London hosted the 1908

and 1948 Summer Olympic Games and will host the 2012 Summer Olympic Games.

London's largest industry remains finance, and its financial exports make it a large contributor to the UK's balance of payments. Around 325, 000 people were employed in financial services in London until mid-2007. London has over 480 overseas banks, more than any other city in the world. London is home to banks, brokers, insurers and legal and accounting firms. A second, smaller financial district is developing at Canary Wharf to the east of the city which includes the global headquarters of HSBC, Reuters, Barclays and the Magic Circle, which includes Clifford Chance, the largest law firm in the world. London handled 31% of global currency transactions in 2005 an average daily turnover of US\$753 billion with more US dollars traded in London than New York, and more euros traded than in every other city in Europe combined.

UK Economic Profile

Economy in United Kingdom was producing impressive numbers in terms of growth of GDP, real estate market, job opportunities and other major indicators of economic growth. That was all supported by more and more immigrants coming to UK offering cheaper labor force. This all allowed further growth of GDP and alone is expected to boost the GDP growth by 1%. The steep progress was then halted by global recession that started to significantly influence UK in April - June 2008 [0]. Growth of Gross Domestic Product has been stable in past 30 years until the impact of global recession, however data from the early 2010 shows highly possible recovery from the recession in UK (Figure 1) and (Figure 2). Unemployment has been low for a <https://assignbuster.com/international-financial-services-cluster-in-london-and-uk-economics-essay/>

long time and after recession slowly recovers and at present time is dropping below 8%. UK was characteristic by low inflation since 1990s and averaged 2.4%. Central Bank's inflation target is 2% at present time [0]

Figure 1 - UK GDP Per Capita Growth vs. Peers

Source: World Economic Forum Report 2009

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Figure 2 - UK GDP Growth per Quarters

Source: Office of National Statistics, 2007

United Kingdom has made a significant progress in labor effectiveness comparing to past data, however due to instabilities in financial sector UK has slipped to 24th place in the ranking of financial market competitiveness (Figure 3) as according to World Competitiveness Report.

Figure 3 - UK Labor market efficiency

Source: World Economic Forum Report

Figure 4 - Quarter-on-quarter UK GDP growth (%)

Source: Office for National Statistics UK

United Kingdom labor productivity has been catching up with leading countries like Japan and USA and was by this successfully raising overall competitiveness of the country, in case recent evolution of recession in UK has not only stopped this progress but pushed it back to [2] past numbers.

However UK seems to quickly recover and in case it continues in previous trend, country will easily catch up with leading countries. So far main stress to improve the productivity was put on infrastructure, skill development and improving level of education.

Division of sectors according to contributions to Gross Domestic Product reveals that over 75% is made up by services and financial sector alone was making around 40% of this part alone. This whole was true until the recession. Adding up to 88% GDP is made through manufacturing sector. In comparison the same sector makes 23% in Germany's GDP. 12% are made through agriculture and "other" sectors. Based on this division it is quite obvious that the model of economy is not correctly balanced and diversified what with such a strong focus on one sector jeopardizes whole country's economy. [0] In case of United Kingdom the jeopardy became reality.

General deficit of government in 2008 - 2009 has reached 101 billion pounds. This deficit significantly exceeds Maastricht Treaty's Excessive Deficit Procedure which sets deficit and debt targets of 3%. This is record high number in UK's history and represents 7.1% of GDP

(Figure 5) At the end of March 2009 general government debt was £796.9 billion, equivalent to 55.5 per cent of GDP. [0]

Figure 5 - Deficit 7.1% of GDP

Source: Office for National Statistics

Economic performance of United Kingdom was overall impressive until mid 2008, however what began as financial crisis in USA and directly in United
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Kingdom later on evolved into global crisis pushing down United Kingdom performance substantially.

Cluster's economic activities mix and economy composition

Composition of sectors and their contribution to UK's economy is on one side not very well balanced but on the other hand for a long time contribution of financial sector to GDP substantially helped boost up economy and was helping UK to be more and more competitive.

When the cluster map is being considered, then we find out that financial sector together with business sector make up 4 out of 6 biggest clusters and are being supported by ICT, transportation services, printing and publishing and hospitality. (Figure 6)

Foreign Direct Investments fell by $\frac{3}{4}$ in 2007 to £5bn in 2008. The cause was the first stage of financial crisis that impacted mainly banks. (Figure 7) As the losses of foreign firms are recorded as a negative debit in balance of payments they had the effect of substantially raising UK net overseas earnings from £25bn 2008, to £12bn year earlier.

Figure 6 - UK Clusters: Global Share

Spurce ICCP 2007

Despite some of the most difficult economic conditions for generations, the UK maintains its position as the number one destination for foreign investors in Europe, and second in the world.

Figure 7 - FDI UK net overseas earnings of financial services

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Source: Office for National Statistics

Context of social, economic and political environment

“ What the UK has to offer is one of the best and most productive investment climates in the world. At a time when companies across the world are tightening their belts and focusing their investment in the sectors and countries where it will bring the most benefit, these results are testament to the fundamental strengths of the UK’s economy and will prove our ability to come through this downturn stronger, and ready for success.” [0]

Business Secretary Lord Mandelson

In 1997, Tony Blair came to power and previous agenda of Margaret Thatcher was not reversed. Bank of England was granted independence in decision making and set inflation target mark. Mr. Gordon Brown, the Chancellor imposed so called “ Golden Rule” which meant, that UK could only be borrowing throughout rising economy in economic cycles. Followingly, he lowered taxes from thirty percent to twenty seven, which made UK more competitive between G7 countries.

Inflation was not as targeted by Bank of England at 2% rate but 3.1 and therefore it was important to turn more attention on macroeconomic factors. The cause of the rising inflation was considered elevating prices of real-estate and oil. That all started to be seen like a rising bubble, however economic progress of UK was continuously advancing and sector of services was gaining on world wide importance every day.

When Mrs Thatcher came to power in 1979, she started to be further known for her euroscepticism and she did not support development of political union. She in contrast supported Single European Act that she considered to be necessary for free market in EU. In the same time she strongly disagreed with having Euro as a single currency for EU including UK. Even nowadays many voices from United Kingdom can be heard that oppose UK's membership in EU.[3]5

Figure 8 - RMT march against EU diktats

Source: UK National Union of Rail, Maritime and Transport Workers

Opinion of majority in the country at present time stands behind membership in EU however still understanding that UK has contributed to shared EU budget much more than it withdraw from it and that is one of the main roots of dissatisfaction. Economic evolution of EU countries has not been same for all the members right from the beginning. Still nowadays latest member countries lags significantly behind countries like Germany, Austria, France or United Kingdom. In addition to it Turkey is creating more and more pressure on EU parliament politicians to be admitted to "EU club" and this is one of the factors that can slow down UK's economic progress even more as in that case, another significant part of country's GDP would have to be invested into development of Turkey.

In terms of regional development, London and its southeast part have thrived, while regions outside London in majority of cases have struggled. Gross Value Added per capita in London is 36% higher when compared with country's average.

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Entering the UK's labour market for new members caused a widespread concerns at labour market, however the unemployment remained still low (disregarding times of economic recession).

National Diamond

Country's national diamond represent high competitiveness of United Kingdom. Vulnerability of country's diamond composition lies in less developed infrastructure, not too big stress put on innovation processes and big amount of unqualified work-force. On the other hand demand in United Kingdom is highly sophisticated and economy is overallly open.

UK National Diamond

Figure 9 - United Kingdom National Diamond

United Kingdom in past years lagged behind developed economies in R&D spendings, however since 2004 we can see rising of total expenditures on R&D and in the same time lowering R&D expenditures on military purposes. (Figure 9)

United Kingdom applies R&D Scorecard which allow it to compare results of R&D expenditure and results policy to other EU countries.

In 2008, £15.9 billion was spent on R&D performed within UK businesses, a rise of 2 per cent at cash (current) price compared with the 2007 total. Total R&D expenditure in 2008 represented 1.1 per cent of GDP, in line with recent years. (Figure 10)

Figure 10 - Expenditure on R&D performed in UK businesses in cash and real terms, 2004 to 2008

Source: Office for National Statistics

Figure 11 - R&D expenditure 2001 - 2008

Source: Office for National Statistics

Policy of rising R&D expenditures helps United Kingdom to gain competitive advantage over other economies. Their strong side became cooperation of universities and industries in R&D, which currently places UK on 7th position in competitiveness ranking of this field.

In matter of work force, United Kingdom still overallly poseses significant group of low qualified workers which is caused by inflow of low qualified workforce from other European countries as well as culture not supporting broadly secondary and tertial level university education. We can expect slow but continuous change of the trend as economy evolves and will create more demand for highly qualified workforce.

Question of infrastructure has always been problematic in UK. Spendings on infrastructure has caused highly congested roads not only in London, while mentioned city is Europewide being considered to be one of the worst to drive through.

Activity in the infrastructure sector illustrates the lack of capital investment. As the UK has been severely hit by the global recession, it seems that government spending and incentives are not enough to boost investor

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confidence in the infrastructure sector. According to the forecast of United Kingdom Infrastructure Report Q3 by Repor Buyer British construction industry will contract in real terms by 13.44% y-o-y during 2009, and estimated value of the industry to be worth £71.74bn. For 2010, we forecast the industry's value to decline further to £67.64bn, with real growth of -7.12%. [0][4]

Improperly developed infrastructure in UK makes it much more difficult for companies and new investors to expand to surrounding parts of London and properly calculate logistic costs. The quality of railways ranks particularly low, but the port infrastructure and even the telecommunication infrastructure register as relative disadvantages. That all slows down countries development.

Institutions for Collaboration

Institutions for collaboration create a linkage between companies organized in clusters and the intercluster cooperation. These institutions, IFCs, support interaction between companies and employees and universities and many others. They include:

chambers of commerce

industry associations

professional associations

trade unions

technology transfer associations

quality centres

‘ think tanks’

In the UK, there is anecdotal evidence that these critical institutions are less numerous and less effective than in competing locations. The weaker presence of IFCs makes it a competitive disadvantage for UK. UK lag in adopting modern management techniques. Some new management techniques are difficult to communicate in the abstract. They are best learned through interaction with other managers or professionals in the same cluster or industry – processes which institutions for collaboration facilitate and support. Conservative approach of management in accepting modern techniques and insufficient presence of IFCs slows down development of companies in clusters.

It is important to say that comparing to past figures UK has turned more attention on university-industry cooperation.

Expectedly, few IFCs exist relating academia to commerce. Lately, a lot of activities have been taken in both business and universities and successfully IFCs have been set up. For instance, for better cooperation senior industry executives and university vice-chancellors encounter to speak about local issues. In the Northeast of England exists Knowledge House which encourages transfer of knowledge between science environment and industry.

Role of The Technology and Strategy Board (TSB) is to stimulate technology-enabled innovation in the areas which offer the greatest scope for boosting UK growth and productivity. TSB promote, support and invest in technology

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research, development and commercialisation. They spread knowledge, bringing people together to solve problems or make new advances. Programmes and activities are often jointly funded with research councils, government departments, regional development agencies and the devolved administrations of Scotland, Wales and Northern Ireland.

Strategic Issues and Recommendations

Countries which were moved into the efficiency-driven stage of development, which means it has to start to develop more efficient production processes and increase product quality. “ At this point, competitiveness is increasingly driven by higher education and training (pillar 5), efficient goods markets (pillar 6), well-functioning labor markets (pillar7), sophisticated financial markets (pillar 8), a large domestic and/or foreign market (pillar 10), and the ability to harness the benefits of existing technologies (pillar 9). Lastly, as countries (for instance UK) change into the innovation-driven stage, they are able to sustain higher wages and the associated standard of living only if their businesses are able to compete with new and unique products. At this stage, companies have to contend through innovation (pillar 12), producing new and different goods using the most sophisticated production processes (pillar 11).[1]”[5]The Global Competitiveness Index 2009-2010 ranking shows, that after having dropped three positions in the last edition, the United Kingdom misplaces its position to settle at 13th this year. Market size, technological readiness and labor market efficiency are in first top 10 in Global Competitiveness Index: Efficiency enhancers. However low financial market sophistication, low goods market efficiency and not so well high education and training restrain

fast development. “ The country continues to have sophisticated (12th) and innovative Businesses (15th), characteristics that are important for spurring productivity enhancements. Significant and growing weakness remains the United Kingdom’s macroeconomic instability (71st, down 13 places since last year), with low national savings, an exploding public-sector deficit (related in large part to recent efforts to bail out the financial sector), and consequential public indebtedness.”[6]The most problematic factors for doing business in UK are: Access to financing, inefficient government bureaucracy, tax regulations, tax rates and policy instability.

THE FINANCIAL SERVICES CLUSTER IN LONDON

Development and history of cluster.

The City of London is a small zone within Greater London, England. It is the historic core of London around which the modern metropolis grew and has held city status since ancient time. The City’s boundaries have endured almost unaffected since the Middle Ages. In 1132, Henry I documented full County status for the City, and by 1141 the whole body of the community was considered to establish a single community. The size of the City was constrained by a defensive perimeter wall, known as London Wall, which was constructed by the Romans in the late 2nd century to defend their strategic port city. It is often mentioned to as the City or the Square Mile, as it is just over one square mile (1. 12 sq mi/2. 90 km²) in area. One of the main roles of London by 1900 was providing wide supplies of short-term liquid assets. British was handling party of bills which were used as credit among Travers. In that time The city was one of the most important market in the world for Balitc Exchange, Metal Exchange. After World War I UK was worrying by

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rebuilding and compensation of war debt, the US economy had grown up very fast, which contributed to development of New York financial cluster. The Stock Market Crash of 1929 showed, that unregulated financial market can result in falling down the global economy. London lost its significance on international financial arena. Lately, during World War II London was demolished, British currency was devaluated, The City was imminent to breakdown. The increase of the Eurodollar market in the 1950s showed a vital improvement for London as a foreign currency trading, high growth was caused of relatively light regulations in British banking law. This attracted foreign investors, who establish their banks in UK. One of the reasons were also well-qualified workers.

Deregulation helped London to be the first key European market in eighties. Broadly known the London Stock Exchange attracted big American banks such as Chase Manhattan, Citibank, and Bank of America. In 1998 the City's regulators were integrated into the Financial Services Authority (FSA), „ an independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000. Aims of FSA are: promoting efficient, orderly and fair markets; helping retail consumers achieve a fair deal and Improving business capability and effectiveness.”[7] Regulation in UK has stayed light, especially in compare to the USA, which applied Reg. FD (public disclosure) in 2000 and Sarbanes- Oxley (various investor protection measures) in 2002. Nowadays officials are wondering to regulate the banking sector and to tax manager's bonuses.

Mapping the Cluster

International Financial Markets in the UK

The table above presents percentage of share of the UK in International Financial Markets. As we can see London has got the biggest share in International bonds-secondary market (70%) in the world and also in derivatives including over-the-counter (43%), foreign equities turnover (43%) and foreign exchange turnover (31%). The city has significant share in Cross-border bank lending (20%). The USA as the major competitor is better only in two parts: fund management and hedge fund assets.

The development of insurance-related services containing loss adjustors, claim handlers and actuaries was caused by the UK non-life and reinsurance divisions that situated on Lloyd's, the world's leading marketplace for globally traded insurance. The fact that the City is the principal of the North Sea port and with its existence of the Baltic Exchange, London has strong marine services and has market information about international shipping brokering.

“ The Financial Markets Group Research Centre at LSE is one of the leading centres in Europe for academic research into financial markets. The Group has developed strong links with the user community, in particular investment banks, commercial banks and regulatory bodies and attracts support from a large number of City institutions, both private and public.” Financial services cluster is regulated at two different levels European Union (Basel Committee on Banking Supervision and European Economic Area) and regional (City of London, HM Treasury, Bank of England, UK Financial Services Authority)

Many firms provide trainings, higher education learning, courses in finance and economics (for instance CFA). Main worldwide known institutions are Oxford University and the London School of Economics. Business hospitality is highly developed in the City, the best hotels, restaurants offer variety of services for business partners and visitors. London is a place for professional services industry and it's related to cluster areas of business services. UK Trade&Investment established by British government to promote and support organizations inside the cluster, also encourage foreign investors to do trade with the UK. That is one of an example of promotional organizations existing in the cluster. Financial Times and The Economist are the most recognizable and professional newspapers providing information, advices and solutions for financial business.

London Financial Services Cluster Map

Figure 12 – London Financial Services Cluster Map

Cluster Performance

London as one of the most important world's financial system provides wide range of services pushed by innovation in derivatives and Islamic finance. Internationalism helps the city to be more attractive for foreign investors. Huge size of the market makes enormous liquidity, which is base of market efficiency. Participation in major international financial markets (for instance OTC, International bonds) gives large opportunity for London's financial service cluster.

The current economic crisis has showed, that well functioning financial sector contribute to economic activity. It caused globalization and connection

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between financial markets itself around the world and real economies.

Investors allocate their financial resources by financial markets governed by expected rates of return, rather than the political reasons. Thus economies need sophisticated financial markets that can make capital available for private-sector investment, with restriction of well-regulated securities exchanges, venture capital, and other financial products. To work properly banking sector should be trustworthy, transparent, and financial markets need suitable regulation to protect investors and other actors in the economy.

The graph below depicts advantages and disadvantages of the UK Financial market sophistication and place in ranking among 134 countries. Most of inferences will be based on assumption, that data in the table concern London financial cluster, because of its significant share in the UK financial sector. Legal right index (5th place), strength of investor protection (9th place), financial market sophistication (7th place) all these things determine great advantage of the UK financial cluster.

The Cluster Diamond

The success of the cluster bases on geographical characteristics and on history. The cluster is traditionally open to the world and co-operate with it, especially long-time relation with continental Europe. The population uses language number 1. of global of business and is internationally oriented.

How it is mentioned above London is open to the world. This factor pulled foreign firms to London. Global companies can find here developed markets and skilled people on the labor market.

Financial services firms in London are in an environment with less tied regulation. In contrast the environment in New York is under higher regulation like Sarbanes-Oxley and Reg. FD. A shift in regulations in 1995 opened flexible AIM market for LSEs as an additional market to more established Main Market. The result of the shift was fast movement of IPOs from US to the UK markets.

The AIM has raised almost £24 billion for more than 2, 200 companies. Flexibility is provided by less regulation and no requirements for capitalization or number of shares issued. Some companies have since moved on to join the Main Market, although in the last few years, significantly more companies transferred from the Main Market to the AIM.

The AIM has also started to become an international exchange, often due to its low-regulatory burden, especially in relation to the Sarbanes-Oxley Act. As of December 2005 over 270 foreign companies had been admitted to the Alternative Investment Market.

The 2006 GCR ranked the UK 3rd on both “ presence of demanding regulatory standards” and “ effectiveness of antitrust policy.”

London is a very attractive place to live and work because of political, legal, economical, social and cultural environment. It is a magnet for people, especially for professionals in financial services. Thus, skilled labor is the very important factor that brings competitive advantage to London in global the market.

Moreover, political environment brings lot of benefits to the financial cluster. Because the cluster plays a very important role in UK economy, there is a high alignment in the government of the UK and the City.

Figure 13 - The Cluster Diamond

Indications of Vulnerability

The global financial market share of the cluster in the UK has been decreasing for recent years (Figure 14). Growth of the financial services in other parts of the world, especially in Asia is higher than the growth of London financial cluster.

Possible reason why the London cluster has been losing market share is declining influence of co-location for services. Because younger financial clusters in other parts of the world provide services on lower cost, they can become substitutes to London.

Figure 14 - Cluster Is Losing Global Share; Impact of Hedge Funds on the Cluster

SWOT Analysis

Strenghts

Opportunities

Historic tradition - Status as a global financial centre

International financial centre

– made up of wholesale insurance, asset management, exchanges, investment banking, hedge funds, private banking and private equity – that London is truly unique for

London's continuing importance as the capital for many of Europe's wholesale financial markets.

Market leader in cross-border bank lending (20 percent of the world total in 2007) and foreign exchange turnover

250 branches and subsidiaries of foreign banks in London (more than in any other centre worldwide).

A third of these banks were from the euro area

Offer the most comprehensive range of

specialist maritime services in the world

Leading Western centre for Islamic finance

London contains a powerful set of direct supporting industries, notably financial media, accounting, consulting and legal.

Between them, these industries employ more than

150, 000 people in the capital

Effective systems and support services, including technology, media and professional services

Top three international law firms