Feature Article

THE SURVIVAL OF THE SCOTTISH FINANCIAL SECTOR

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The changes that have swept through the financial sector in recent years are well known. Big Bang and the removal of minimum commissions in the City together with the Financial Services and Building Society Acts have greatly changed the character and nature of many of our financial institutions and markets. The causes of these changes; the increased globalisation of world financial markets, the dramatic improvement in technology and communications and a greatly changed regulatory framework have been discussed extensively but relatively little attention has been given to their impact on regions outside London. This article examines the state of the financial sector in Scotland subsequent to these changes and questions whether, far from being helped by the technological revolution, Scotland is in danger of losing its importance as a financial sector.

The slow growth in employment in financial services in Scotland indicates that in relative terms Scotland has performed badly. Far from representing an area of strength as much recent comment would suggest financial services appear to be an area of weakness, failing to benefit substantially either from new growth in the financial sector as a whole or from the improvements in technology that have shifted employment out of London into the regions. Growth in the financial sector in other areas of the UK has been faster and more sustained inviting debate both as to its causes and its cure.

Section one reviews the major trends in financial sector employment and analyses the main competitive pressures faced by the major Scottish institutions. This is followed by a consideration of the benefits of a Scottish location and the causes of Scotland's failure to capitalise on its long history of involvement[1] in the financial sector. Finally the paper examines what can be done to reverse the current trends.

THE SCOTTISH FINANCIAL SECTOR

Employment

An important feature of a regional financial centre is the contribution to employment within the region.[2] UK growth in total financial sector employment[3] between 1981 and 1984 was 8.3% a continuation of the trend that saw employment increase by 25% in the previous decade. Scotland

Table 1 % Change in Employment 1981-1984 - Selected Areas

	East Anglia	London	South West	North West	Scot.	Total
Banking	32.7	4.9	15.5	0.8	3.9	8.5
Other fin. inst.	20.6	2.7	27.9	13.2	22.0	12.8
Insurance	3.6	- 6.4	13.0	- 8.6	-5.9	-2.1
Activities aux. to finance & banking	311.9	57.5	28.1	55.6	22.1	60.3
Activities aux. to insce.	10.5	18.9	15.3	37.7	33.5	20.8
Total bank/ finance	16.4	6.3	16.3	2.0	4.2	8.3

Source: Department of Employment

performed rather more modestly with a 4.2% increase only slightly more than the North (3.6%) and North West (2%) of England and significantly below the 16.4% of East Anglia, or even the 14% of Wales (Table 1). The pattern of growth represented a continuation of the trends of the previous decade. Within the different parts of the financial sector the picture for Scotland is only redeemed by a strong growth in the Other Financial Institutions group although even here Scotland lagged behind the South West and the East Midlands.

The regional pattern and trends of financial employment suggest that Scotland has not performed well. Scotland's share of total financial sector employment has fallen from 7.7% in 1981 to 7.4% in 1984 (7.9% in 1971) although absolute numbers employed have increased by some 2500 people. The relative position of Scotland can best be seen by looking at the location quotients[4] given in Table 2.

Table 2 Regional Locational Quotients - Selected Areas 1984

	East Anglia	London	South West	North West	Scotland
Banking	0.7	2.12	0.88	0.92	0.88
Other fin. inst.	0.66	1.51	1.07	0.78	0.71
Insurance	1.36	1.53	1.43	0.96	0.91
Activities aux. to finance & banking	0.27	4.42	0.23	0.38	0.41
Activities aux. to insurance	1.25	2.43	0.63	0.75	0.47
All	0.9	1.99	1.00	0.88	0.81
Total emp.	25794	278089	62645	80804	61896
% of GB fin. employment	3.1	33.2	7.5	9.6	7.4

Source: Department of Employment

Ignoring the very high levels for London, in which 33% of financial employment is concentrated, Scotland is middle of the league in UK terms, above the East and West Midlands, Yorkshire, the North and Wales but below the regions of the Southern area of England and the North West. In absolute terms Scotland has the fourth largest regional concentration of financial employment, marginally behind the South West which has overtaken it in recent years and more substantially below that of the North West and London.

An aspect of the growth of financial employment in the seventies was the increase in the proportion of women in the labour force and particularly part-time female workers. Scotland was no exception. Table 3 reveals the changes for the period 1981-84. It would appear that the dramatic growth in female employment in the financial sector is now over. Over the previous decade female employment increased by 42% compared to a rise of only 2% in male employment. The increase in female part-time employment was even greater at 115%. However, between 1981-84 female part-time employment increased by less than 6%, total female employment by less than 3% whilst male employment increased by 14% with the majority of the rise in absolute terms concentrated in the Banking sector.

Most worrying is the reduction in insurance employment although information from the companies suggests that the upsurge of business in the last three years has seen some reversal of this trend. Insurance and banking represent the main stays of Scottish financial employment but the rapid growth in insurance broking and sales, investment business, building societies, other financial institutions, and other activities auxiliary to banking and finance has been a useful source of jobs. Recent problems of the building societies as well as of stockbroking and investment management may slow the growth in the other financial institutions category.

Within Scotland growth in financial employment has continued to be focused on Edinburgh (with a 14% growth)[5], a reflection of the growth of head office employment. Growth in Glasgow has been much smaller at 3% whilst Dundee recorded a 6% and Perth a 14% fall in employment, a reflection of the latter's dependence on insurance.

Overall, the employment consequences of the growth in the financial sector have not been as favourable as might be expected. The relative position of Scotland within the UK has continued to slip although Scotland continues to be a substantial financial employer in absolute terms. Most worrying has been the decline in the insurance sector although there are some grounds for believing this decline to have been reversed.

Table 3 Male and Female Financial Employment in Scotland 1981 and 1984

	1981	1984	% Change
Insurance (8200)			
Male	10390	9803	- 6
Female	8911	8361	- 6
of which female part-time	1386	1100	-21
Auxiliary to Insurance (8320)			
Male	10008	1257	25
Female	1579	2197	39
of which female part-time	434	670	54
Banking (8140)			
Male	11175	14432	29
Female	19209	19147	0
of which female part-time	3737	3897	4
Other Financial Institutions (8150)			
Male	2596	3154	21
Female	3611	4470	22
of which female part-time	838	1068	27
Auxiliary to Banking/Finance (8310)			
Male	454	583	28
Female	468	543	16
of which female part-time	70	97	39
Total			
Male	25623	29229	14
Female	33778	34668	3
of which female part-time	6465	6832	6

Source: Department of Employment

The growth in other financial institutions and activities auxiliary to insurance is encouraging but not sufficient in themselves to provide a substantial increase in employment.

STRENGTHS AND WEAKNESSES OF THE FINANCIAL INSTITUTIONS

Scotland's financial sector is concentrated in three main areas; banking, insurance and fund management which although they share many common features are, despite the removal of regulatory barriers and the movement to financial integration, still best considered individually. The gloomy employment figures for Scotland as a whole are not exactly mirrored by the major Scottish institutions although, as in any sector of the market, whilst many of the institutions have been experiencing significant growth, others have encountered more difficult conditions. A more serious problem than the growth of existing institutions in the traditional areas of strength has been Scotland's failure to grow in new areas.

Banks

Within the banking institutions the four main clearing banks, the Bank of Scotland, The Royal Bank of Scotland, the Clydesdale and the TSB have all benefited from low exposure to developing countries debt[6] but expansion opportunities within Scotland have been limited and this has led to a search for new opportunities and markets. The movement of the Scottish public from their traditional preferences for savings accounts to current accounts has been a feature of the last ten years but this reflects in large part the increasing competition from other institutions for savings deposits[7] and the growth in the use of cheques in Scotland as a method of payment. This growth has been more than matched by the growth in the use and number of credit cards issued by the banks and by major retailers.[8] However, in the retail deposit market the Scottish banks face major competition from the Building Societies.[9] There has been a major expansion of building society activity in Scotland. In 1971 there were 119 building society branches representing 6.8% of the total clearing bank and building society branches in Scotland. By 1984 the number of branches had increased to 452 and represented 23.4% of the total number of bank and building society branches.[10] Between 1975 and 1984 building society mortgage advances in Scotland grew by a factor of five compared to 4.4 for the UK as a whole reflecting the rapid growth in the demand for owner occupation in Scotland.[11] This growth has also benefited the Scottish banks which have become increasingly important players in the domestic mortgage market.

The last 15 years has been noteworthy for the expansion of the banks into ancillary activities. The Bank of Scotland has used its subsidiary, the British Linen Bank, as its secondary bank offering a range of merchant bank facilities whilst the Royal Bank has devoted considerable resources to its insurance services as well as acquiring Charterhouse Japhet to strengthen its merchant banking activities and establish itself as a substantial protagonist in the UK market as a whole and a major competitor to British Linen in the Scottish market.

However the Royal and the Bank of Scotland have not had it all their own way and are competing against both local merchant banks such as Noble Grossart, the largest independent Scottish merchant bank, and UK and foreign banks. There is intense competition in the corporate sector and the Scottish banks have found themselves seriously squeezed in three main market segments; large Scottish companies with overseas export markets, international companies operating in Scotland and the Scottish financial institutions.

Insurance

The picture in the insurance industry is encouraging although the industry as a whole is seeing substantial changes in its competitive position vis a vis other savings media. In addition to General Accident, one of the largest composite insurance companies in the UK, there are nine Scottish life assurance offices including Standard Life, Scottish Widows and Scottish Amicable representing in total a 17% share of UK long term premium income and a slightly higher proportion of assets. Over the period 1971 to 1984 they experienced a ten-fold growth in premium income and eight-fold increase in assets, somewhat greater proportions than for UK life offices as a whole. There have been variations in the growth rate of premium income and net assets of the individual Scottish life offices over the time period but, because of the varying emphasis between companies on different life products sold, direct comparisons between individual companies are fraught with difficulties. A widely used measure of performance is the Economist's annual survey indicating how a policyholder paying £100 premium for a with-profits policy would have fared. A long-term analysis of these figures does not suggest that Scottish life offices have consistently outperformed their UK counterparts although comparisons based on the surveys of recent years do give a favourable impression of the relative position of Scottish life companies.

Expense-ratio calculations suggest that the Scottish offices should perform well[12]; in 1984 the ratio for the Scottish life offices was 15.8% compared to a national expense ratio of 21.7% but the average ratio hides a wide variation between individual offices whilst differences in the rate of business expansion (new policy expenses are much greater than renewal expenses), in the type of business written (group pensions business is less expensive than ordinary individual business) and in the selling and information costs which offices bear, make comparisons hazardous.

The Scottish life offices with one exception (Life Association of Scotland) are organised on a mutual basis so that increases in assets accrue entirely to the policyholders with no diversion to shareholders (a figure of 5-10% is often quoted for the share of the surpluses distributed as dividends to shareholders). The advantage of this arrangement is obvious although its opponents maintain that the system reduces managerial incentives since the management are unable to be substantial shareholders themselves, cannot be motivated by stock option schemes, and do not have to face external shareholder pressure to keep costs down, to innovate or to take risks. Critics of the Scottish life offices have suggested that their mutual ownership has meant, at least until recently, a more conservative approach to new markets and new ideas than would otherwise have been the case if management had to contend with large shareholdings and a share rating in the market. The case could be argued at length. Suffice to say that such incentive and motivation (Agency) problems are not experienced by mutuals alone. Indeed, a recent American study by Mayers and Smith (1986) suggests that such problems are reduced by the mutual form of organisation. Their empirical tests suggest that a mutual structure was in fact efficiency enhancing.

Unlike the Scottish life offices, General Accident is a publicly quoted company. As a composite insurance company its investment income is a much smaller proportion of its premium income than for the life companies. 40% of its premium income arises in the UK and about 10% of this from Scotland. General Accident dominates the UK private motor insurance market with about one sixth of the total and is well represented (about 6%) in the fire and accident insurance market. Experience of UK companies in these markets has not always been happy in recent years but there are recently encouraging signs of improvement.

Besides providing life assurance the Scottish life offices also play an active part in the pension fund business. All of the life offices write pension business offering group plans to companies and in some instances schemes to individuals. The life offices are not alone in this market. Some companies manage their own pension fund business whilst a number of investment management companies offer pension fund, particularly portfolio management, services.

Investment Management

The movement of investment management companies into the provision of pension schemes, highlights a major trend in financial markets in recent years. The demarcation lines between different activities have been progressively reduced as a result of regulatory, fiscal and innovatory changes so that intermediaries are often involved in a range of financial activities, either directly or through subsidiary or associated companies. This is particularly apparent in the field of investment management. Scotland has traditionally been strongly represented in the management of investment trusts and the experience gained has been employed in the management of other areas such as pension fund portfolios. Both long established management groups and senior employees setting up on their own have moved into this market sometimes with conspicuous success. There have been several determined attempts to break into the fund management market overseas by offering foreign investors and institutions specialist skills in managing particular types of assets. American pension funds, desiring increased international exposure in order to benefit from the risk reduction possibilities that have been demonstrated at both a theoretical and practical level, have been a major target, whilst several firms have linked up with Japanese banks and investment houses. Sumitomo life, for example, a Japanese insurance company is acquiring 5% of Ivory & Sime's equity with agreement to raise this to 20%, and Ivory & Sime aim to launch an investment sales initiative aimed at the Japanese market where Murray Johnstone through their links with Yamaichi International Management have attracted more than £300m since 1986.

Traditional investment management activities[13] centre around the provision of investment and unit trust management.[14] The Scottish industry includes a number of very large independent investment trusts such as the Alliance Trust of Dundee although the number of such trusts has been falling as predators, particularly pension funds, have attacked the sector. Joining a management group provides some means of defence against such predators, although it is not necessarily in the best interests of the shareholders. Indeed recently trusts within management groups have been attacked, recent examples being the portfolio of investment trusts managed by Ivory & Sime[15], and Crescent Japan. The raising of capital by Ivory & Sime through its links with Sumotimo Life also indicate a further threat to the independence of the sector. The need to protect investors as required by the new regulatory and supervisory requirements is forcing investment management firms to raise fresh capital to maintain adequate ratios. Such requirements may force some of the investment houses into partnership with larger, possibly non-Scottish organisations, and could, in time, lead to dramatic changes in the structure of the industry.

In contrast to the strength of the investment trust industry, unit trust management has until recently been poorly developed. Out of UK total funds under management of £15100m at the end of 1984 Scottish management groups managed around 3%. Since 1984 a transformation of the unit trust industry has been effected. The long overdue entry of the Scottish life offices into the market on a significant scale has been rewarded with a much increased share of the UK unit trust market. Standard Life's success has been remarkable with an increase in unit trust funds under management from £102.4m in 1984 to £2368.5m in 1987. At the end of 1987 it was the third largest unit trust management group and operated the two largest unit trusts in the UK. Other life offices had even faster rates of growth with Scottish Mutual up from £1.8m to £322.3m and Scottish Equitable from £9.4m to £406.6m. The independent fund managers also recorded substantial increases with Murray Johnstone, for example, up from £16.5m to £143.6m in 1987. By the end of 1987 unit trust funds under management in Scotland were around £4600m with Scotland's share of the unit trust market standing in excess of 12%.

Further evidence of the increased vitality of this sector of the financial community is provided by the influx of firms into Edinburgh. Templeton, Galbraith & Hansberger Ltd, for example, have set up their European operation in the City and intend to run from it unit trust, pension fund and institutional investment operations.

The overall picture that emerges from this resumé of the sector is somewhat one sided since it concentrates on the existing institutions and activities. There are bright spots and areas of substantial growth but in general the Scottish financial industry is concentrated in traditional, slower growing activities and has been slow to exploit new avenues and opportunities for expansion. The opportunities provided by Big Bang are a case in point. Scotland's relative position has almost certainly declined since the entry of new players in the market has been predominantly concentrated in London and the South. The same is true of international banking and the newer financial markets such as futures and options where growth has been concentrated in the South. Scotland is heavily represented in the more traditional sectors of the market and whilst there are growth opportunities these are more restricted than in some newer areas of financial markets. They may have acquired greater attractions since the stock market crash of October 1987.

LOCATIONAL ADVANTAGES AND CENTRALISING PRESSURES

In the UK's completely integrated financial system with no controls on the flow of capital and resources there is little scope for differences in interest rates between Scottish institutions and English based institutions or protection against competition from non-Scottish institutions in a period of increased intra-industry competition. Regional financial centres must stand or fall on their own merits.

Dominant financial centres develop in the first instance to exploit the economies of exchange which are available from the centralisation of the payments and borrowing and lending activities of non-financial businesses. From this basic impetus there develop economies of agglomeration. In the financial centre the provision of specialist accountancy, marketing and legal services becomes viable. It becomes attractive to establish new financial services, instruments and markets with a greater prospect of success. At senior levels of management external relationships become more important than internal relationships. Proximity to other financial institutions and specialist services is regarded as essential. Further there develops a specialist labour market from which the financial sector can meet its changing requirements and which fuels the establishment of successive rounds of new enterprises specialising in the faster growing areas of financial markets.

The Scottish financial sector does not have a strong base in the non-financial sector where the rate of growth has been inadequate. This has had the effect of encouraging Scottish companies to pursue growth outside Scotland, with the prospect that headquarters activity might follow. Also merger activity with non-Scottish companies has resulted in head offices leaving Scotland frequently resulting in major financial decisions being undertaken elsewhere without any Scottish involvement. This merger activity has also involved the financial sector.

The abortive takeover of the Royal Bank contains lessons relevant to assessing locational advantage. The takeover led to extensive reorganisation of the Royal and the integration of different segments of the business most notably Williams & Glyns, into a more cohesive group. The result has been to strengthen its overall position and shift the emphasis of the group from being a Scottish Clearer with English subsidiaries to being a UK wide clearing bank. It illustrates very clearly the dilemma faced by Scottish institutions. To remain committed almost solely to the Scottish market is to restrict growth and ignore profitable opportunities elsewhere. To expand south of the border or internationally is to shift the focus of the firms operations leading possibly, in time, to the bank moving its headquarters further afield where the main financial markets are located. The appeal of England is graphically illustrated by the relative growth rates in different regions. The Bank of Scotland, for example, notes that its business south of the border is growing faster than its traditional business in Scotland. Half of its new mortgage lending came from England. This is partly a reflection of a different mix of activities with its activities in England targeted and highly selective but also a reflection of the greater incomes and growth particularly in London and the South. TSB (Scotland) is likely to be handicapped by being excluded from the high growth south east of England.

Takeovers are not necessarily disadvantageous to the regional economy. The acquisition of the Clydesdale from the Midland by the National Australia Bank is apparently part of that hank's strategy for developing its UK and EEC hanking business. In so far as new developments are serviced from Glasgow the takeover may generate a considerable increase in employment and growth in Glasgow as well as introducing new ideas and concepts which ultimately have beneficial effects on the whole of the financial sector. It is too early to comment on the success of this takeover or indeed, if successful, of the bank remaining in Glasgow but it does point to the positive aspects that may stem from outside takeovers.

There are, however, offsetting pressures which might encourage a wider dispersion of financial sector employment. These economies, however, do appear to become less attractive at distances much greater than 100 miles from London.

The factors encouraging dispersion arise from easier access to information about regional customers and from technological developments in data processing and communications. Regional institutions have a degree of knowledge of local conditions that can only be learnt by close involvement with customers and companies. Communications and opportunities for funding new business are improved whilst local contacts enable institutions to accurately assess risk and meet the needs of existing and potential new clients by providing easily accessible and convenient facilities. Branch offices and agents are an expression of this need for close contact with clients.

The processing and communication developments permit the separation of front office from back office activities. The latter may be located where there are lower occupancy costs and lower labour costs, often with better quality labour, provided communications are efficient. The activities which are dispersed while securing employment do not usually involve the dispersion of senior decision makers from their central location.

The continued existence of the Scottish Life offices indicates that the process of growth has not inevitably led to relocation in London although at least two factors suggest that their experience is not typical. Firstly, the life offices are essentially portfolio management organisations and are not substantially involved in the short term money markets hased in London and elsewhere, and secondly, the life offices are organised on a mutual basis and consequently protected against takeover threats.

What the foregoing suggests is that for tbe Scottish financial sector to improve its standing it must attract tbe head office activities which appear to be necessary to encourage the development of a viable supporting services sector which is the hallmark of a thriving financial centre. The attraction of such employment produces the skills, products and processes necessary to bring about desirable change.

Improved communication has been a major feature of recent experience and promises to continue to be of great significance. The benefits of improved communication are most apparent in the provision of information and access to on-line databases. Access to such data has improved investment decision making and allowed deposit institutions, for example, to develop automated cash withdrawal facilities. Over the next decade, the effects on consumers of further improvements in communication will be substantial allowing the provision of a wider range of facilities in more accessible locations and with much improved information. These changes also herald a change in the locational needs of financial institutions. It is unlikely that the continued presence of financial institutions and markets in London or, indeed, in Edinburgh will be required. The activities of financial institutions may be easily and readily decentralised so that although tbe desire of participants in financial markets and institutions for face-to-face contact, the existing financial infra-structure and the existence of trained personnel are powerful forces putting a brake on change, increased competition and the need for cost savings may act to decentralise labour intensive financial processing activities to low cost labour and office locations. The Scottish banks have been successful in attracting company registrar and new issue processing business.

THE FUTURE

Responses to the drift south of the financial sector are many and varied. The simplest is to accept the slow relative decline in the financial sector as inevitable and let it happen. The development of Scottish Financial Enterprise suggests that the institutions are unwilling to follow this route and are aware that action needs to be taken. They have focused their attention on improved marketing and using the Scottish reputation for caution and financial probity to increase market share. Whilst such efforts are important perhaps of more significance are the two recurring themes of innovation and regulation, and it is useful to consider their implications for the future of the Scottish sector. The last decade has been noteworthy for the sheer scale of financial innovation. The causes of this innovation are the subject of much discussion and controversy. What is not in question is its extent, with innovations in new securities and financial markets particularly options and futures; new institutional forms notably the financial conglomerate or supermarket able to offer a wide range of financial services, and the boutique offering a very limited specialised range of services; and innovations in computer and communications technology with the advent of advanced information systems, automated tellers, electronic fund transfer, home banking and extensive computerisation of the clearing process in cheque transfer, the market making function in security markets and many record keeping procedures in banks, insurance companies and other institutions.

Scottish institutions have not been backward in their response to technological innovations.[16] Indeed, several of them have been at the forefront of UK innovations. They have, however, been slow to move into new securities and markets. Despite much discussion Glasgow did not follow the path of transforming itself into an unlisted securities market. Scotland has not been involved in the setting up of new markets such as options and futures although the possibilities were there. Scottish institutions have been slow to market new securities and have missed out on some fast growing sectors of the market.[17] The starting-up of new institutions particularly in investment management and on the fringes of merchant banking represents one of the few bright spots indicating vitality and innovatory activity but in general there has been too little innovation in the setting up of new, specialised financial intermediaries.

The benefits of the financial supermarket over the specialised institution are still the subject of debate. The Scottish institutions have made few obvious steps in this direction. The merger of the Royal with its Williams and Glyns subsidiary, together with its purchase of Charterhouse Japhet heralded moves in the direction of a larger, more integrated, institution although the range of facilities it is able to offer is still comparatively restricted. Of the investment management firms a few undoubtedly have a long term future as financial boutiques offering specialised investment services but whether this is a viable alternative for all of the institutions is to be doubted. The removal of barriers to competition, whether regulatory or technical, must intensify competition and favour large institutions and resources or those able to respond quickly and effectively to changing conditions. The past performance of some Scottish intermediaries casts doubt on their ability to respond and provides grounds for concern.

The scope of regulatory activity in the financial services industry is particularly broad. Regulation affects entry; expansion including the types of securities offered; contraction including mergers; prices, charges, terms and conditions; supervision of management (financial and performance) and customer relations. The importance of each varies between different sectors of the industry but one prevailing concept in recent regulatory changes has been to introduce a measure of consistency in treatment together with a reduction in the restrictions on competition. There is a continuing concern to prevent fraud allied to a desire to allow innovation and change. The result has been a general loosening of the regulatory bonds bringing pressures, fuelled by innovatory changes, towards integration of different sectors of the financial markets. Barriers to entry have been reduced and it has become more difficult for institutions to shelter from competition. Such changes are both a challenge and a threat to the Scottish institutions. A challenge because they open up new opportunities. A threat because known and tested methods must sometimes be abandoned if enterprises are to continue. The decision by Lautro to enforce the disclosure of commissions provides a case in point. Disclosure will require a change in the way commissions are paid and hence in insurance broking. It may also have serious consequences for the Scottish life offices since they depend heavily on the independent intermediaries. It may require them to adopt new methods of selling or even to issue new types of securities. Success will accrue to those that innovate. Scotland's financial sector can only prosper if it adapts to the new environment. The customer is largely indifferent to ownership and headquarters location. It is the ability of the product to meet the actual and potential needs of the customer which determines success. Scotland's financial institutions would do well to learn this lesson if the sector is to survive and grow in the increasingly open and competitive conditions of the future. The potential (and threat) of European markets (and competition) should be in the forefront of their thoughts as the Single Market of 1992 approaches.

REFERENCES

Mayers, D and Smith C, 1986, The Mutualization of Stock Life Insurance Companies,

Journal of Financial Economics 16, pg 73-98.

FOOTNOTES

1. A Scotsman was responsible for founding the Bank of England whilst Scottish banking innovations include both the overdraft and the Trustee Savings Bank.

2. The most comprehensive and accurate sources of data on employment is provided by the 1984 Census and earlier Department of Employment series. Subsequent UK Labour Force Surveys and employment estimates provide data at a highly aggregated level which is of little practical use for our purposes.

3. MLH 860-862.

4. A location quotient compares a region's share of employment in a particular industry with the national share of employment in that industry. If the quotient is one then the region's share of employment in the industry is the same as the national share, if it is less than one the industry is under represented in the region, while if it is greater than one the industry is over represented.

5. Based on 1984 Travel to Work Areas.

6. It is claimed by critics that this is due more to conservatism and a failure to appreciate apparently profitable opportunities, than from good management. Up to the present the involvement of Scottish banks in international markets has been relatively small, but the opening up of financial markets implies that they cannot stand aside. Their industrial business is under constant attack from other banks and the provision of adequate overseas services to their clients is important. The Royal Bank is currently engaged in expanding its American operations through the acquisition of the Citizens Financial Group based in the Eastern US with particular strengths in Rhode Island and adjoining New England States and in Atlanta. The Royal Bank has also announced a cooperative arrangement with the Banco Soutander in preparation for the Single Market in 1992.

7. The growth in building society accounts has been remarkable. In 1968 only some 8% of adults held accounts in Scotland compared to more than 34% now.

8. All the major banks have participated in this growth, the Bank of Scotland having particularly benefited from administering, from the outset, the very successful Marks and Spencer card amongst others. It has also announced agreement to process the Halifax Building Society's credit. In contrast, the Royal Bank has been investing in debit cards and is now offering with the National Westminster and the Midland the "Switch" card which eliminates much of the paper work of credit card operations and fits into the Electronic Fund Transfer Point of Sale (EFTPOS) system allowing direct debit of customer accounts. Apart from being cheaper than present credit cards such system will bring the banks once more into a central role in providing credit if they overcome customer resistance. The banks should he able to offer credit more conveniently and cheaply than retailers.

9. These are predominantly English. The total number of Scottish building societies has declined to 5 with only one society, the Dunfermline, of any size.

10. Approximately a quarter of all building

society staff are employed in head office and in non-branch activities and in this area Scotland fares poorly in employment terms.

11. Growth is also apparent in the receipts and lending activities of the societies. In 1970 net funds available in Scotland arising from that year's activities, were £101m. Lending was £83m and the difference provided a surplus of £18m. By 1974 the surplus had disappeared, and this deficit pattern has been repeated in every year since. By 1985 lending was £1811m against net funds available of £1338m resulting in a deficit of £473m and a flow of funds from the rest of the UK to Scotland.

12. Low management expenses are not necessarily an unmitigated blessing since they may stem either from an efficient, cost conscious management or from a dormant management team that is failing to investigate new opportunities. Innovation in both products and technology may be expensive in the short turn but lead to growth and economies of scale in longer term. Although evidence of innovation is hard to assess in at least one fast growing sector of the market, life assurance linked unit trusts, the Scottish societies have been slow to respond and innovate.

13. Scotland accounts for some 36% of the UK investment trust sector.

14. Stock Exchange activities have also been a feature of the Scottish financial sector for more than 150 years. A series of amalgamations resulted in a regional Stock Exchange floor concentrated in Glasgow with its own stock jobbers and stockbrokers servicing it. Although useful it accounted for a very small per cent (by value) of total UK Stock Exchange transactions and several Scottish brokers bypassed it completely, using London direct. Big Bang has made the Stock Market floor redundant. The largest of the Scottish brokers, Wood Mackenzie, has become part of County Nat West emphasising its UK prominence. In contrast, Parsons joined forces with the London broker James Capel and Postel (The Post Office pension fund) as part of a regional broking network, Allied Provincial Securities consisting of 25 offices run from Glasgow. More recently it has acquired another Glasgow broker, Penney Easton and Co., which ran into trouble as a result of settlement problems.

15. In an attempt to staunch the potential loss of funds Ivory & Sime offered investors a range of alternatives including the possibility of unitisation or access to a specialised venture capital trust. After initial difficulties the proposals were accepted and should strengthen its position in the investment market.

16. Scottish institutions have invested heavily in automation. The banks have made considerable progress in introducing ATMs and automating the transfer of funds and the Bank of Scotland has developed HOBS (Home and Office Banking System). The assurance companies have been in the forefront in automating their branch offices, but there is little reason to believe that they have secured significant competitive advantages as a whole from this source. Scottish institutions have been as successful at innovating for the purpose of reducing costs as other large UK institutions. Their weakness has been in product innovations which have been largely defensive and represented a response to changes in policy and regulations. There are signs, particularly in some of the fund management organisation, of a more aggressive and responsive policy towards innovation aimed at providing financial instruments which the institutions feel they can market successfully or which meet new needs of customers, but the overall picture remains one of a defensive conservation posture which may inhibit new growth and development.

17. This is well illustrated by the Scottish life offices. By concentrating on their traditional business they increased their market share but their expansion in other areas of financial markets, particularly unit trusts and unit linked assurance, was poor. The recent success of several of the institutions in unit trust promotions shows their strength but also raises questions relating to their adaptability and speed in developing new lines of business.