MEMORANDUM TO THE MONOPOLIES AND MERGERS COMMISSION

The principal authors of this memorandum are Professor J W McGilvray and Professor D R F Simpson.

In preparing this paper, we have had the benefit of discussions not only with representatives of the principal parties, but also with a wide range of individuals and organisations whose experience of banking and finance in Scotland, London and overseas we gratefully acknowledge.

INTRODUCTION

We recognise that the principal term of reference before the Commission is to ascertain whether the proposed takeovers of the Royal Bank of Scotland Group by the Standard Chartered Bank and by the Hongkong and Shanghai Banking Corporation would operate against the public interest. Acceptance of the Standard Chartered bid was recommended to Royal Bank shareholders by their Board of Directors. We shall show that acceptance of this bid was in the interest of the Directors but not of the shareholders, and that both proposed takeovers operate against the public interest.

Accordingly, our submission is presented as follows:

Section 1 - The Background to the Takeover Bids
Section 2 - The Takeover Bids
Section 3 - The Directors' Interest
Section 4 - The Shareholders' Interest
Section 5 - The Public Interest in the United Kingdom
Section 6 - The Public Interest in Scotland
Section 7 - Conclusions and Recommendations.

SECTION 1 - THE BACKGROUND TO THE TAKEOVERS

1.1 The Directors of the Royal Bank have made it plain that, in their view, a takeover bid for the Bank was inevitable, and that one such bid was desirable. In this section, we shall argue that the situation in which the Bank became vulnerable to a takeover bid arose as a result of a period of lack of development, for which the Directors must accept responsibility.

Lack of Development of the Royal Bank

1.2 The decade from 1971 was one of unprecedented change in British banking. New techniques of lending were adopted and expanded, while competition for deposits became more intense. The British commercial banks began to move more and more into longer term lending. As a consequence, opportunities arose which some Banks were quick to seize.

1.3 Without any shortage of capital for expansion, the Royal Bank failed to take advantage of these opportunities. Although it had been the first British Bank to acquire a finance house (in 1959) the decade of the seventies was unmarked by any comparable initiative. Amongst the more obvious missed opportunities was the failure to assimilate Williams and Glyn's with the Royal Bank, and the failure to open new branches of the former bank in England. Nor was the opportunity to acquire a merchant bank realised, while expansion overseas was half-hearted. The acquisition of a commercial bank in the United States or a merchant bank in Germany, for example, were among unrealised possibilities. As a consequence, the decade concluded with a poor earnings performance for the Bank, during a period when other comparable banks were doing better.

Size of the Royal Bank

1.4 It has been suggested by the Directors that a takeover bid is desirable because the Bank is insufficiently large to give it 'financial muscle'. This suggestion is contradicted by the evidence given to the Wilson Committee by the chief executives of the three Scottish Banks, of whom one was Mr John Burke, Managing Director of the Royal Bank. It is contradicted again by the evidence of the size distribution of commercial banks in other industrialised countries and also by the experience of a smaller Scottish bank, the Bank of Scotland.

1.5 In the course of their oral evidence to the Wilson Committee, the chief executives of the Scottish banks were repeatedly questioned by a member of the Committee about the capital base of the Scottish banks as a limiting factor in their activities. They denied explicitly that the size of their capital base limited their "financial muscle".

1.6 The Royal Bank ranks 125 in the world in terms of the size of its net assets. The Bank of Scotland ranks 192 by the same standard. Since there are more than 14,500 banks in the United States and more than 4,000 in West Germany, it is clear that by world standards, the Royal Bank is a large bank. Some comparisons of the size and performance of banks are given in sections 5.4 and 5.5 below.

1.7 With the development of parallel banking and syndicated lending in recent years, it is possible for a bank with a very small capital base to participate in the largest international loans. It has again been suggested that there are particular benefits accruing to the leading participants, and that a bank would be excluded from such a leading position by the size of its capital base. However, the Bank of Scotland is the leading bank in the consortium which is likely to finance the UK North Sea Gas Gathering Pipeline, at a cost of £2.7billion, one of the largest ever such ventures.

SECTION 2 - THE TAKEOVER BIDS

2.1 From the standpoint of size, there were therefore no grounds for the Directors to put the Royal Bank up for sale. Sale, however, may have commended itself as an effortless alternative to development, which the Board had conspicuously failed to attempt in the preceding decade. The manner in which the sale was handled throws further light on the judgment of the Directors.

The Standard Chartered Bid

2.2 The Chairman of the Royal Bank, Sir Michael Herries, states that the Board of Directors had concluded "by the end of 1980" that the interests of the Bank would be best served "if we could achieve a merger with a United Kingdom bank with a strong overseas presence". Less than three months later, on 17 March 1981, the Bank's directors announced that they were recommending acceptance of the Standard Chartered bid. So far as is known no attempt was made to discover whether other bids, and on what terms, might be made. This impression of unseemly haste is reinforced by subsequent conflicting statements concerning the organisation of the Royal Bank following takeover. Specifically, an attempt has been made to create the impression that UK banking operations in the enlarged Standard Chartered group would be run from Edinburgh, when it was already known that the designated chief executive would be London-based.

2.3 The short span of time which appears to have elapsed between the decision to sell the bank and the acceptance of the Standard Chartered offer can hardly have been long enough to examine carefully the suitability of Standard Chartered as a buyer. Whatever the recent failings of the Royal Bank's directors it remains a soundly-based bank. Given the advantages which Standard Chartered stand to gain from a merger a more enterprising board might have made a reverse takeover bid for Standard Chartered, thus retaining control. This would not of course have obviated the long-run problems of association with Standard Chartered, which are discussed below.

2.4 The directors of the Royal Bank recommended to shareholders on 19 March acceptance of the first bid from Standard Chartered, a bid which **valued Royal Bank at some 40% less than its net tangible asset value.** In other words, if the Royal Bank of Scotland Group Ltd had been liquidated, the shareholders would have been better off than if they had accepted the directors' advice.

2.5 The directors of the Royal Bank, as a further means of facilitating acceptance of the Standard Chartered bid, had agreed to sell to Lloyds Bank the Royal Bank's 39% share in the finance house, Lloyds and Scottish Ltd, if the Standard Chartered bid succeeded. However, the directors allowed themselves to be outmanoeuvered, and within one month of the initial announcement of the bid, Lloyds Bank had gained control of more than 50% of the issued share capital of Lloyds and Scottish, hitherto one of the most valuable assets of the Royal Bank Group.

2.6 The inescapable impression is created by these events that, if the Royal Bank directors had not proceeded with such haste in accepting the Standard Chartered bid, they could have secured terms much more favourable to the shareholders, if not to themselves.

The Hongkong Bid

2.7 This impression was confirmed by the subsequent bid from the Hongkong and Shanghai Banking Corporation (HSBC) for the Royal Bank, which valued the latter at some 50% above the Standard Chartered bid. While this offer was later matched in value terms by a second bid from Standard Chartered, it is generally accepted that, commercially, HSBC is much the more successful bank and, on those grounds should have been preferred by the directors, if they had been acting in the shareholders' best interests.

2.8 The Royal Bank directors offer two reasons for their recommendation of the Standard Chartered bid. The first is the greater influence which they claim they would have through a larger representation on the Standard Chartered Board than they were offered by the Hongkong bid. Since this influence would not last longer than the careers of the persons concerned, and since influence falls short of control, it would be of no permanent value to the Bank. Secondly, it is claimed that wider career opportunities would be available to Royal Bank staff within an enlarged Standard Chartered group than with the Hongkong bank. The available evidence suggests that the opposite is the case. The indigenisation of staff jobs which is proceeding rapidly in the African and Asia branches of the Standard Chartered Bank is likely to create an excess supply of British senior staff, which would certainly not be to the advantage of existing Royal Bank staff.

2.9 The preference of the Royal Bank directors for the Standard Chartered bid over the Hongkong or apparently any other bid must be interpreted in the light of the contrast between the offer of eight seats on the Standard Chartered board and their fate at the hands of any other buyer. In the case of Hongkong, it seems that there may be a conflict of personalities between the present Chairman of the Royal Bank, a former resident of Hongkong, and the Chairman of the Hongkong Bank.

SECTION 3 - THE DIRECTORS' INTEREST

3.1 In whose interests is acceptance of the Standard Chartered offer?

3.2 A possible divergence of interest between directors and shareholders has for some time been recognised by academic studies of corporate behaviour. These studies have shown that whereas directors and managers are attracted by the prestige and status which is associated with **size** in the world of business, shareholders retain their traditional interest in maximum **profitability.** Such a divergence of interest is particularly likely to come to a head in situations of takeovers or mergers.

3.3 Under the terms of the Standard Chartered offer, the present directors of the Royal Bank are offered eight places, out of twenty-one, on the expanded Standard Chartered Board. The present Chairman of the Royal Bank will become Deputy Chairman of the Standard Chartered, and being younger than the Chairman, could reasonably expect to succeed him. By comparison, the Hongkong offer would provide only three places on the main board for Royal Bank directors; for age and other reasons it seems most unlikely that any of them could expect to succeed to the Chairmanship of the main Board.

3.4 It would be wrong to infer that in their recommendation of the Standard Chartered bid, the Royal Bank directors have been moved by considerations of personal financial gain. It seems more likely that in this, as in most other such cases, the interest of the directors lies in the enhanced security, prestige, and sense of power which comes with membership of the Board of an enlarged company. Unfortunately, the psychological rewards of size are seldom matched by profitability.

3.5 Studies of the consequences of takeovers and mergers in the United Kingdom in the recent past have shown that they have seldom been successful in terms of profitability, and that the expectations of their promoters are seldom realised in the long run. This is largely because of the difficulties of administration of large organisations. In the case of banking, as with other industries, there is generally an optimum size for a company. There is evidence, reviewed in paragraph 5.4,that the Royal Bank Group, as presently constituted, falls within that optimum size range, whereas the proposed expanded Standard Chartered Group does not.

SECTION 4 - THE SHAREHOLDERS' INTEREST

4.1 Size is of course of no benefit to shareholders: it is return on capital which matters, and as we have indicated in the foregoing paragraphs, increased size may be detrimental to return on capital.

4.2 In the case of banking, greater size **may** however lead to greater opportunities for profit in some activities. Specifically, international trading in major reserve currencies can be highly profitable, **if carried out successfully.** It may be suggested, however, that there are at least three conditions necessary for success in this sphere of operations. First, the bank concerned must have strong and skilful management. Secondly, it must have at its disposal large reserves of one or more of the major traded currencies. Third, it must be able to record all these transactions in one balance sheet; a Group holding company is not enough.

4.3 We have already commented previously in Sections 1 and 2 on the quality of the management of the Royal Bank. Less can be said about the past performance of the Standard Chartered management. However, it may be noted that the task of effectively managing a string of subsidiary companies, dispersed in sixty countries throughout Africa and Asia, where in most cases local interests have a minority or even a majority shareholding, must be a continuing source of strain. The contrast, in this respect, between Standard Chartered and the larger US and UK banks could hardly be more striking.

4.4 While balance sheets do not reveal the identity of the different currencies held as reserves by the various subsidiaries of Standard Chartered, consideration of the diversity of countries in which they are operating does not suggest that this bank has at its disposal large reserves of major currencies. Indeed, many of the currencies which it holds are non-transferable. This is revealed in a footnote in the second offer document, but the amounts concerned are not stated.

4.5 The banking regulations of most of the countries in which Standard Chartered operates are most unlikely to allow movement of reserves out of these countries, even when, in principle, the currencies are transferable. On the contrary, the tendency towards increasing local control is likely to continue, with the Republic of South Africa providing a case in point. By 1983 Standard Chartered will have to surrender control of its South African subsidiary.

4.6 Accordingly, while the proposed takeover of the Royal Bank would give the Standard Chartered a nominally larger asset-holding which would qualify it for the "Big League" in terms of size, it would lack at least three of the necessary conditions for profitable performance in that league. Indeed, it may not even qualify on grounds of size, since, after 1983, the assets and liabilities of the Standard Bank of South Africa will no longer be consolidated in the Group accounts.

4.7 The situation is, however, more serious than this. The Standard Bank's deep involvement in several African countries, many of whose governments and major commercial concerns are on the brink of bankruptcy, means that it is likely to be seriously exposed in one or more of these countries. Since reserves are not outwardly transferable, there is the risk of default. While the size of this risk cannot be known to outsiders, the consequences of default could be severe, and one of the few sources of reserves which could be called upon in such an event would be those of the Royal Bank.

4.8 It is evident from the foregoing paragraphs that the commercial advantages to the shareholders of the Royal Bank of the proposed takeover by Standard Chartered are likely to be negligible whereas there are substantial risks. Acceptance of the Standard Chartered bid cannot therefore be said to be in the shareholders' interests.

SECTION 5 - THE PUBLIC INTEREST IN THE UNITED KINGDOM

5.1 The principal effect of the proposed takeovers on the public interest in the United Kingdom will be in the way in which it effects competition in banking. The public interest in maintaining and promoting competition in banking, as in any other industry, is, we submit, not derived principally from limiting the market share of any participant so as to secure the lowest price for the provision of banking services. This argument has merit, but it is a short-run argument. The more important reason why the promotion of competition is in the public interest is because the greater the number of independent decision-making units that there are in any industry, the greater is the diversity of thought and decision and the greater are the chances of innovation and development.

5.2 The importance of this point can be illustrated specifically in the case of Scottish contributions to the development of the banking and finance industry in Britain. Although the Scottish banks together have formed no more than 10% of the total British system, their separateness has increased the number of independent units within the system and has thus permitted the following innovations to be made:

1. The introduction of banking on the limited liability principle.
2. The displacement of metallic currency by a note issue.
3. The development of the branch system of banking.
4. The invention of the cash credit (forerunner of the overdraft).
5. The development of deposit gathering reinforced by the payment of interest.
6. The adoption of joint-stock banking.
7. The practice, in times of stress, of banks being willing to hold each other's notes.
8. The first Savings Bank and the foundation of the savings bank movement.
9. The foundation of the investment trust movement.
10. The first bank to see the advantage of forming a finance house subsidiary.
11. The first mobile banks, including a boat bank for island services.
12. The first bank to introduce computerised bank accounts.
13. Innovating in the financing of North Sea oil developments.

5.3 Consent for the takeover of the Royal Bank would give the green light for a takeover bid for the Bank of Scotland, and perhaps for Lloyds or the Midland Bank, (c.f. the Allianz bid for Eagle Star). While the Scottish banks add only two independent units to the British banking system, this addition is not negligible where overall numbers are already so small. By the standards of all other advanced countries, the British banking system is extraordinarily concentrated.

5.4 The United States has 14,663 banks of which all but 19 are smaller than the Royal Bank. West Germany has over 250 commercial banks, 600 savings banks, and some 4,000 co-operative banks, of which all but 16 are smaller than the Royal Bank. Switzerland has 31 banks of which all but 3 are smaller than the Royal Bank. Japan has 75 banks of which all but 24 are smaller than the Royal Bank. The UK is thus extraordinarily concentrated, there being only eight independent domestic commercial banks.

5.5 Although data on comparative bank performance across the complete size range is hard to come by, US earnings tables suggest that profitability is greatest amongst banks with about $100 million in assets, small compared to the Royal Bank ($11,500 million) and Bank of America, ($100,000 million). In West Germany statistics collected by the central bank show that the three largest commercial banks have been on average rather less profitable throughout the past decade than most of their competitors. It may also be significant that the share of those three largest banks in the total assets of the banking industry has fallen from about 24% in 1950 to about 9% in 1980.

5.6 This concentration has had the inevitable consequence of reducing to a handful the number of independent centres of decision within the banking system of the United Kingdom. In any industry, this kind of situation is potentially harmful to innovation and development since it may seriously limit the diversity of thought and decision. As Professor Gaskin has pointed out in his authoritative study of banking, "it is particularly dangerous in banking where the forces of conservatism are peculiarly strong". In his book, Gaskin poses directly the question "Is it good for Britain as a whole that the Scottish banks should survive as separate entities?" and concludes that there is "a clear advantage from the national point of view".

5.7 It has been suggested to us that competition in British Banking might be improved by the amalgamation of Standard Chartered and the Royal Bank, thus providing a bank of similar size to the four major London Clearing banks. It is our view, however, and we believe that it is borne out by the evidence of economic history, that the kind of competition which is engendered by the creation of a **smaller** number of **larger** units is not the kind of competition which promotes the public interest. As we have stated above, oligopolistic competition fosters conservatism, whereas the public interest which lies in innovation is best served by maintaining a greater number of independent decision-making units. Combining two weak managements into one large group is a recipe neither for effective competition nor commercial success.

5.8 Now that the English Clearers have expanded competition in Scotland by ending the tacit agreement with the Scottish banks, on non-intervention there is no reason why the Royal Bank, given proper leadership, should not expand its activities in England, thereby increasing competition in the major part of the British banking system. Presumably, Standard Chartered, which is apparently anxious to establish a sound UK base for its operations, would also wish to do the same. Thus, consent to the takeover would mean a reduction in competition in English banking by eliminating two (Williams & Glyn's and Bank of Scotland) out of the eight British domestic banks.

The Benefits to the United Kingdom of Edinburgh as a Financial Centre

5.9 A takeover of the Royal Bank, with effective control moving from Edinburgh to London or to Hongkong, would do permanent and serious damage to Edinburgh as a centre of financial institutions. The following paragraphs outline the benefits to the United Kingdom (and to the EEC) which accrue from the present position of Edinburgh as a major financial centre, the only international financial centre outside London in the UK.

5.10 There are located in Edinburgh at present the headquarters of two commercial banks, seven merchant banks, six insurance companies, more than thirty investment trusts, fifteen fund management companies, and several other related financial institutions. In addition, there are the head offices of four insurance companies in Glasgow and several investment trusts, two investment trusts in Dundee, one in Aberdeen and an insurance company headquartered in Perth.

5.11 Measured by the funds under management as well as ownership, which are estimated to be in excess of £10,000 million, Edinburgh is the second most important financial centre in the EEC, and as such is a significant provider of invisible earnings for the UK as a whole. Edinburgh has a particular reputation in the field of investment expertise, and the investment trusts are a characteristic feature. Typically these trusts have small numbers of staff and they are, in ways which are often intangible, complementary to the banks. The staff strength, research potential, marketing impact and spokesmanship of independent banks can greatly help those fund management companies in the extension of their name and expertise throughout Europe. This is particularly important in winning business in the growing pension fund market.

5.12 It is a fact that much of the international business which is won by Edinburgh financial institutions is business which would not otherwise have come to the UK. This point is analogous to the one which was made by British Caledonian Airways in their successful application to the Civil Aviation Authority for licences for North Atlantic flights in competition with British Airways. Their argument that if there were two British carriers more business in aggregate would be obtained for the UK as a whole, was accepted over the argument that a single national carrier "with real muscle" was the right answer.

5.13 With its wide range of financial expertise, Edinburgh is the second financial centre in Britain after London. It is very much in the British public interest that not all decision making in the financial sector should be centralised in London, but that Edinburgh should play a competitive and innovative role, as an alternative community with expertise and ideas which can contribute towards a vigorous financial sector and act as an important source of invisible earnings. The emergence of a money market in Edinburgh, though still limited in scale, is a significant development in this context.

5.14 But the existence of a healthy financial centre in Edinburgh is critically dependent on the existence of indigenous commercial banks. It is difficult to think of any financial centre in Europe which does not also have headquarters of its own domestic banks.

5.15 Very often the links between commercial banks and other financial institutions are intangible, and difficult to quantify, but they are nonetheless real. The existence of domestic banking head offices is an important ingredient if a proper money market is to be maintained, and in the creation of opportunities for merchant banks. It is significant that more merchant banks have been set up in Edinburgh than in any other British city except London; and it cannot be denied that the future development of merchant banking in Scotland would be prejudiced by the disappearance of commercial banking head offices. We have noted above the links between the head office activities of banks and fund management companies in winning business abroad. The disappearance of Scotland's two indigenous banks would leave the investment trusts and the other financial institutions isolated, with their prospects of development severely diminished.

SECTION 6 - THE PUBLIC INTEREST IN SCOTLAND

The Facts of Centralisation

6.1 In the post-War period an increasing number of major Scottish companies have merged, been taken over or simply migrated, with the effect that their headquarters, and thus control, have moved out of Scotland, usually to London. In the 1950s, the most notable losses were amongst the composite insurance companies, including North British and Mercantile, Scottish Union, Caledonian, Century, Northern and others. Within the last decade, the location of effective control of the following major companies has moved out of Scotland: SUITS, United Biscuits, Burmah Oil, and Stenhouse. Four of these are among the six larger Scottish-registered companies measured by net tangible assets. The cumulative effect of these, and other such movements, is that the number of Scottish-based companies quoted on the Stock Exchange has declined dramatically over the last twenty years.

6.2 The reasons for this accelerating drift, which has come to be known in Scotland as Centralisation, are not difficult to understand. For those Scottish companies which are serving a UK-wide market, it is often convenient to have factories situated close to their markets.

Consequently, the management of production and marketing operations is conducted in the South of England, and therefore it is natural to wish to have control exercised close to senior management. There is also the increasing importance of ready access to major Government Departments and to Trade Associations and other influence groups. In some cases, it may also be desirable to have recourse to English legal advice. The pressures of centralisation are facts of life which most Scottish companies have learned to live with - the constant gravitational pull towards the location of senior decision making in London and the South East of England.

6.3 It may be asked: why should they resist these pressures? Why not succumb to the forces of gravity? Very often, from the point of view of the company, (ie the interest of the directors and the shareholders), there may be an advantage in making the move - and this is why such moves are made. However, from the standpoint of the public interest in Scotland, there can be no doubt that such moves are extremely damaging to the long-run development of the economy.

6.4 The case for the damaging effects of centralisation has been frequently stated, and need not be repeated here. Indeed, the Monopolies and Mergers Commission itself has cogently presented the case in Appendix 6 of its own Report on the takeover of SUITS by Lonrho. To quote from this Report:

> "The primary task of industrial policy in Scotland today is to create conditions which favour natural growth and strenthen indigenous enterprises..... growth not simply in production but in key management activity including the conception, design and marketing of products from a Scottish base and, importantly, financial control of the company's operations. In other words, conditions have to be as favourable for headquarters functions as for branch operations".

Within the past decade the position has in fact worsened. The general pattern of post-War development in Scotland has resulted in the creation of branch plants and subsidiaries rather than the creation of new indigenously controlled firms. This growing element of external control made it inevitable that the ablest young men in management have tended to gravitate towards the point of control and away from Scotland.

6.5 It is therefore growth and innovation which are the greatest casualties of centralisation. A Scottish company which has been taken over, or whose headquarters have moved South, frequently exhibits what may be called the "neutered cat" syndrome. Outwardly, there is no deterioration, not even any sign of change. The company - or at least its Scottish end - just ceases to grow, that is to adapt to changing circumstances. It may not innovate in terms of markets, technology or products for fear of treading on the interests of its (now removed) parent company. In the field of banking, the Clydesdale Bank provides an example. A wholly owned subsidiary of the Midland Bank, it has maintained its presence in retail banking in Scotland - a continuing activity - but it has been unable to realise the other opportunities which have arisen in the industry in the 1970s. It has no merchant bank, no finance house, no international arm, and its leasing operations are conducted by the Midland Bank. Its market share of retail banking in Scotland has not increased, and it is generally accepted that it has been less innovative, entrepreneurial and vigorous than the other two banks over the past few decades. It can only look forward to a future of stagnation since diversification opportunities are closed to it.

6.6 The question of centralisation in Scotland is closely connected to the vital question of the climate of business confidence. A leading businessman, Mr Peter Balfour, now Deputy Chairman of the Royal Bank of Scotland Group Ltd, has put the matter in the following way:

> "I am personally appalled at the low morale in Scottish industry. We have heard speakers here this morning say, if you are successful, you will be taken over.... I find in my own business that I am continually trying to contradict the opinion-formers, the financial magazines and newspapers who say that my company must be taken over by some of its rivals in the south - in spite of the fact that those rivals in the south are smaller and less successful than we are. It seems to be part of our make-up at the moment, that we cannot think if we start in Scotland that we can thrive on our own account. It is this lack of confidence which is.... one of the real root causes of our problems in Scotland today."

6.7 It is against this psychological background that one of the major consequences of a successful takeover of the Royal Bank may be understood. In terms of market capitalisation, the Royal Bank is the second largest company with its head office in Scotland. It is not putting it too strongly to say that if the Royal Bank goes, it will be the beginning of the end of the indigenous private sector in Scotland, with all which that implies for the regeneration of Scottish industry. The decline in confidence in this sector has proceeded **pari passu** with a decline in performance, which has accelerated in the past two decades. Equally, it must be said that this failure is not inevitable, and that it is open to government to create the policy environment in which it may be reversed.

6.8 The principal harmful effect of centralisation is the loss of some of that very small number of people who have the capability of successfully realising new commercial opportunities. These are largely the same people who take responsibilities in public life. Consequently, their departure marks a simultaneous decline in the quality of public life.

6.9 There is a critical minimum size for the Scottish business community, below which the gravitational pull of London becomes irresistible.

The departure of the Royal Bank would set in motion a chain of events which would bring that community very close to its minimum point. The immediate consequence would be the takeover of the Bank of Scotland, and thus the disappearance of all headquarters activity from Scotland as far as banking is concerned. We have already indicated the effect which this is likely to have on other financial institutions based in Scotland. Since major firms wish to have continuing access to top level financial advice, the movement of senior bankers out of Scotland would strengthen powerfully the centralising forces operating on the Scottish business community. The inducement to move their own headquarters south would be even stronger: the sense of isolation would become still more acute.

6.10 Other more tangible effects of a takeover of the Royal Bank may be identified. So far as employment is concerned, the banking, insurance and finance industry has been one of the major post-War growth areas of the Scottish economy. This has undoubtedly been associated with the presence of much headquarters activity. So far as the Royal Bank itself is concerned, the takeover might be marked by only a small direct loss; more important is the less perceptible failure of future job opportunities to materialise. The indirect employment effects of head office activity - in printing, advertising, insurance broking, legal services, catering, retailing, etc etc would certainly be noticed. And of course reduction in the number of head offices will reduce the rateable value of the city or district concerned.

6.11 In the short-run, a takeover of the Royal Bank by either of the two bidders, unlike the closure of a shipyard or a car assembly plant, would have little impact on the man in the street. Even in the long-run, it would scarcely be noticed by the customer for retail banking services. However, we believe, that for the reasons stated in this paper, such a takeover would have much more damaging effects for the future growth of the Scottish economy, and thus for the loss of employment in the long-run, than would the closure of a shipyard or a car assembly plant.

6.12 Support for the arts and local charities would diminish. The directors of a London-based bank would understandably take a more personal interest in Covent Garden than in a commitment to the success of Scottish Opera or the Edinburgh Festival. The further depletion of the already shrinking community of senior decision-makers would aggravate the existing social imbalance of the Scottish community. The complete organisation of a branch factory or branch office economy will inevitably result in a society of hewers of wood and drawers of water. This need not happen if Government is willing to assert the primacy of the public interest, and to lend its support to regional centres of gravity, that is centres of decision making which are strong enough to resist the gravitational pull of London.

6.13 In the matter of the proposed takeover of the Royal Bank, there can be no doubt where the public interest in Scotland lies. It is agreed on all sides, and the history of the composite insurance companies illustrates the case, that there can be no such thing as effective safeguards. If the Monopolies and Mergers Commission concludes that there is a substantial danger to the public interest in Scotland, its only realistic safeguard is to disallow the merger.

SECTION 7 - CONCLUSIONS AND RECOMMENDATIONS

7.1 In the course of preparing this paper, we have had discussions with a wide range of individuals and organisations, representative of all sections of economic life in Scotland. It is significant that we have not found anyone, other than those associated with the banks concerned, who regards the proposed takeovers as operating in the public interest in Scotland. Because of the small size of the business and financial community, many are reluctant to say so in public.

7.2 We see no conflict between the public interest in Scotland and the public interest in the United Kingdom as a whole in this matter. On the contrary, we believe that a healthy British banking industry, which is to be vigorously competitive both at home and abroad, should have a larger, rather than a smaller, number of independent decision-making units.

7.3 It is no part of our argument that the two remaining Scottish banks should be protected from competition. On the contrary, we believe in the efficacy of competitive forces operating within a framework devised to serve the public interest. But we do not believe that the formation of large units by takeover and merger enhances competition. In this regard, we are heartened by the evidence of the tightening-up of the laws relating to competition in other industrialised countries. Most major industrialised countries have a much less concentrated banking system than does the United Kingdom, and all place restrictions on the possibility of their commercial banks being taken over. We invite the Monopolies and Mergers Commission to consider what view they would take of a takeover bid for Lloyds Bank or Midland Bank.

7.4 Since we have argued that **either** takeover of the Royal Bank would operate against the public interest, both in Scotland and the United Kingdom, we have not hitherto referred to the question of whether the Standard Chartered bid is to be preferred to that of the Hongkong and Shanghai bid, or **vice versa.** So far as the private interest of shareholders in the Royal Bank is concerned, the Hongkong and Shanghai Bank appears to be the more attractive. But from the point of view of the public interest, both bids are equally unacceptable.

7.5 These bids, understandably, come at a time when there are substantial international opportunities for Scottish banking companies. Within the context of Europe in particular, the Scottish financial institutions are well-placed for a major expansion of their activities in the investment and merchant banking fields. Given the support of their own domestic banks, they could project themselves forcefully throughout Europe over the next ten years.

7.6 In banking, as in any other business, the vigour of the directors and senior management of a company, **not** its size, is the critical factor in its success. Judged by their performance over the past decade, culminating in the fiasco of the Standard Chartered bid, the present leadership of the Royal Bank is not equipped to face the challenges and opportunities which lie ahead. The refusal of the Monopolies and Mergers Commission to approve the proposed takeovers would create the opportunity for a new leadership, with more financial experience and greater self-confidence, to direct the Bank.

NOTES

1. It has been represented to us that the Standard Chartered bid constitutes a merger rather than a takeover. Since the merger would be effected by the Standard Chartered making offers for the whole of the issued share capital of the Royal Bank, and since Standard Chartered would have control of the Board of Directors of the enlarged group, it is difficult to see what meaning can be attached to this distinction.

2. The Wilson Committee, (Committee to Review the Functioning of Financial Institutions), **Evidence on the Financing of Industry and Trade**, volume 6, HMSO London, March 1978, pp132-133.

3. **The Banker**, June 1980.

4. Letter to Royal Bank shareholders, 29/4/81.

5. An excellent survey of the evidence is to be found in the Green Paper on Competition Policy, **A Review of Monopolies and Mergers Policy**, Cmnd 7198, HMSO, London, May 1978, Annex D.

6. "A Substantial part of the (Standard Chartered) Group reserves held overseas is not freely available for remittance to the United Kingdom due principally to local banking regulations" Offer Document 29/4/81, p22.

7. We have in mind here such developments as the establishment of the International Energy Bank by the Bank of Scotland. The Scottish Banks as a whole have played a positive role in North Sea oil development. The Scottish Banks' 6.8% share of total Clearing Banks' loans and commitments to licensees in August 1976 totalled over £113 million or 18.5% of the total for the London and Scottish Clearing Banks combined. This percentage can be compared with the Scottish Banks' assets. (**Source:** Wilson Committee, Vol 6, para 6-11).

8. Barclays, Natwest, Midland, Lloyds, Standard Chartered, Royal Bank of Scotland, Bank of Scotland and Co-operative Bank.

9. Sources: **Banking Systems Abroad**, Inter-Bank Research Organisation, April 1978; **The Banker**, June 1980; **Financial Times**, 16 June 1981 and 23 June 1981.

10. M Gaskin, **The Scottish Banks** George Allen and Unwin, London 1965, p215.

11. Monopolies and Mergers Commission, **Lonrho Ltd and Scottish and Universal Investments Ltd and House of Fraser Ltd, A Report**, HMSO London, March 1979.

12. Scottish Council, (Development and Industry), **The Influence of Centralisation on the Future**, Edinburgh 1970, p87.