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# Feature Article 1

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## SCOTLAND'S EXPANDING FINANCIAL HORIZONS

by Jack Shaw\*, Scottish Financial Enterprise

All sectors of an economy need to be constantly aware of the challenges to be faced in keeping pace with change, whether legislative, economic or social. External criticism of a particular sector's performance or strategy is a necessary and useful spur to improvement; but constructive criticism must be informed and reflect accurately the current or potential circumstances and prevailing responses to them.

Whatever shortcomings the Scottish financial sector may have had in the past related mainly to its geographical environment, and these have now been swept away by technology. In direct contrast to the thesis of the article by Draper and Stewart in this publication in December on "The Survival of the Scottish Financial Sector", the evidence is that far from merely surviving, the sector has responded with both speed and efficiency to the challenges of the second half of the 1980's, with increasingly profitable results.

Scotland's success as a financial centre has been achieved by building on a long history in developing an independence of character rooted in specialisation, and particularly in banking, insurance and investment. That success has been in spite of a geographical location remote from the political capital as well as the main British and European markets in London. Opportunities for the financial communities in Scotland are hard won without the benefit of the built-in attractions of more sizeable centres, making the existing range of important Scottish-based institutions all the more impressive.

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## THE CURRENT POSITION

The Scottish financial community now looks after over £100 billion. More than half of that, £55 billion, is under direct portfolio management. In the life assurance sector, the Scottish offices hold £37 billion, representing a 20% share of the total UK market. The strength of independent Scottish institutions in the investment trust movement is equally clearly demonstrated by a 35% share of this UK market, which is nevertheless only a proportion of the £17.25 billion total funds managed by the independents, the balance made up by international pension fund and unit trust business.

The financial sector is one of Scotland's most important employers, being the area of fastest employment growth between 1983 and 1987. Its 9% share of the Scottish employment total means that one job in twelve is now in financial services. Scottish banks alone employ over 40,000 people in Scotland out of the country's business and financial employment total of over 165,000, more than the technology industry and tourism, and twice as many as the traditional heavy industries. Furthermore, crude statistics of Scottish employment understate our financial sector's importance because its members derive opportunities for business creation and employment elsewhere in the UK.

With one or two exceptions, Scottish financial institutions are relatively small on an international scale. This might be seen to leave them vulnerable to the advances of larger predatory outside interests. It might also be considered to leave them at a disadvantage as, for example, they cannot access the same scale of resources as foreign competitors to commit to research and development in meeting changes in markets and technology. However this is rendered

a superficial view by the recent record of the performance of the Scottish financial sector, representing the results of particular characteristics of flexibility and swiftness of response in their niche markets combined with the appropriate exploitation of technological advances. This record suggests that the small relative size of Scottish institutions is in fact an indication of their efficiency, and has been exploited as an important differentiation.

## THE BANKS

The Scottish banks remain at the heart of Scotland's status as a financial centre; the implications of their presence for the local economy are very substantial, not least, as already noted, in terms of employment. This is also reflected in their balance sheet assets, which showed a 32% growth between 1985 and 1988. Their involvement in the prospects for Scotland's continued economic health ranges from the development of highly specialised programmes and loans specifically for small business, to their considerable expertise and success, for example, in finance for the oil industry, including the technical assessment of the most ambitious multinational projects.

From 1982 when the Bank of Scotland was the first of all the UK banks to challenge the stranglehold of the building societies on high interest bearing personal accounts, the Scottish banks have been at the forefront of competition for new markets, and particularly that for mortgages. The determination of the banks to compete effectively is typified by examples such as that of the acquisition by TSB Scotland of a chain of estate agents to focus and complement its activities in the mortgage field.

Scottish-based banks have been pioneers of links to new markets by the appropriate use of advanced technology, for example through networks of ATM's, the development of EFTPOS and remote electronic banking. The same approach has been at the root of projects such as the relocation of the Bank of Scotland's Visa Card processing centre to Dunfermline, which will also handle accounts from other sources; another example is the Clydesdale's Access centre, recently opened in Glasgow.

The achievements of the Scottish banks in respect of the oil industry have been outstanding. At the end of 1985 the Bank of Scotland was invited to

co-lead the £650m financing of the ELF Alwyn North field, at that time the biggest single loan ever raised for a North Sea project. In this context, however, the Scottish banks have been aware of the risks inherent in undue dependence on a single economy, particularly in view of uncertainties over the price of oil. In anticipation of the Single European Market of 1992, steps have been taken to diversify well beyond Scotland and the UK.

Scottish banks have sometimes been criticised for being overly cautious. That caution, which has left them relatively unexposed in loans to the less-developed countries, can be expected to underpin their strong commitment to expansion into foreign markets. The activities of the Royal Bank and Bank of Scotland in particular are evidence of positive expansionist thinking; while the latter has increasing interests in the United States and South America as well as a stake in the conversion of a major building society in New Zealand, the Royal Bank is diversifying out of the UK through its acquisition of the Citizen's Financial Group, also in the United States, and through its reciprocal stake in the Banco Santander Group in Spain, giving it direct access to German and Belgian as well as Spanish markets.

The merchant banking sector in Scotland is small, due in part to the relatively limited growth of the local economy during the 1960s and 1970s, which of course restricted opportunities for growth solely within Scotland. But now the prospects here too are exciting. Of the larger independent companies, for example, Noble Grossart has recently announced figures which show uninterrupted growth in profits since 1969, and which place the firm as one of the leading financial advisers in public takeovers throughout the UK.

That record is matched by the subsidiaries of the clearing banks, the local offices of 3i, and by the independents such as Quayle Munro, Noble and Co., James Finlay Bank and others. The success of the Scottish merchant banking sector is such that there is a tendency to forget that it has been created only in the past two decades. That success depends on its ability to provide attractive innovation in international markets well beyond its local Scottish clientele.

The development of professional services of a high standard is essential to the viability over the

long term of an important provincial business centre. The increase in overall numbers of Scottish-based merchant banks is of particular significance to Scotland's future success in attracting new business investment, and in nurturing the growth of business successes.

#### THE LIFE OFFICES

Amidst the challenges of regulatory changes and the Single European Market the message from the nine Scottish life offices is also one of strong growth, rooted in traditional life policy business and enhanced by continued successful expansion into newer markets.

The latest statistics on the sector show that the Scottish assurance companies have increased their assets under management by 17.5% to nearly £37 billion in 1988. The value of new annual premiums for individual life assurance and pensions policies rose by 37.5% to £642m. These figures are particularly encouraging at a time when other areas of asset management are still suffering the effects of the crash of world markets at the end of 1987, demonstrating the fundamental strength of the sector as well as a pragmatic approach in attracting new business.

The period of staff contraction after computerisation in the 1970s and early 1980s is now past. Sustained improvement in the sector's performance has been a substantial force for job creation, both in Scotland and across the United Kingdom; the Associated Scottish Life Offices report an increase in the number employed in the sector of 14.5% in 1988, bringing the total to 14,000, of which 9,500 jobs are in Scotland. Some individual cases represent dramatic change over the last five years: total staff numbers at Scottish Mutual, for example, have risen by 52% since 1984, with an 85% increase in employment at its Glasgow offices, while Standard Life has doubled its UK staff to almost 5,000 in the same period. At Scottish Equitable, staff numbers in the South of England have risen by 126% in tandem with a 90% increase in branches in the region since the beginning of 1985.

Entry into new markets and flexibility of approach to traditional markets have been key features in the expansion of the life offices, which in some instances has been very rapid: Scottish Widows, for example, increased their basic new business threefold in the period 1985-1988.

The responsive nature of the sector is demonstrated in examples such as the action by the life offices following the withdrawal of tax relief for new life assurance policies in the 1984 Budget, which was countered by the swift introduction of new lower cost policies. Equally, and despite the subdued nature of the market since 1987's 'Black Monday', the entry of the life offices into Unit Trusts has been a considerable success. Another example of a new product embraced by the Scottish assurance companies is PEP contracts, which have been marketed from the Plans' inception in 1987.

The more traditional area of pension funds has been one of outstanding growth; new pensions legislation - particularly the introduction of personal pensions - and changes in economic conditions have been met with the rapid design and sale of new products, involving new contract and support systems. A close focus on the market has led to the development of plans with a greater investment content and increased portability, to satisfy customer preference and capture an enhanced share of the investment savings and pensions market. The case of Scottish Equitable illustrates the scale of the success of such an approach, as the value of their new pensions business has risen from £19.1m in 1984 to £68.7m in 1988. Scottish Widows is another example where, in concert with an expansion of their sales force by 70% in two years, new pensions business in the second half of 1988 reached £30m against a total for all new business in 1987 of £94m.

The life offices are reaping the benefits of operating at the forefront of computer technology; investment managers are on line to all the major markets, branches and agents are linked into central information networks, developments in voice transfer and electronic mail communications systems have eased the conduct of business still further. Recent announcements concerning the linking of two of the largest English building societies with two of the Scottish life offices confirm the esteem in which the Scottish assurance sector is held outside its home market, and bode well for new business opportunities and employment in Scotland.

The Scottish life offices' leadership of CAMIFA emphasised the importance to the individual investor of the independent intermediary. Apparently unloved by the new regulatory regime, the genuinely independent intermediary's place in

UK financial markets is now ensured because of this resolute action. The arrangements made by individual offices ensure that their policyholders will be able to choose the outlet they prefer - either the familiar product conveniently available from the tied agent, or professional guidance through the whole range of alternatives from the independent adviser. And of course that independent advice is important for savers and investors in all forms of long-term investment.

Although it provides the spread of general insurance, no review of the Scottish financial scene would be complete without reference to Perth-based General Accident; the UK's fifth largest general insurance company, it now employs 10,000 people, 2,000 of whom are in Scotland. Strong growth in both life and non-life income has been the result of expansion throughout the UK, with a chain of 600 estate agents to provide business and a source of distribution. This position will be a stable platform from which to capitalise on opportunities stemming from the Single European Market.

#### INVESTMENT HOUSES

Scotland's pre-eminence in the field of investment management is already well established in the minds of UK and foreign investors, and has been reaffirmed by the performance of the independent investment houses in recent years. Along with an increasingly technological approach and the development of marketing skills, these companies have dramatically reduced their reliance on any particular type of investment vehicle, for example Investment Trusts, in favour of diversification into such areas as Pension Funds, Unit Trusts, Venture Capital and property investment services. They are a unique resource providing century-long experience and knowledge of the world's financial markets, dedicated exclusively to the profitable and secure management of portfolio funds.

Against a background of the generally slow recovery of UK stock markets in 1988, the Scottish independent fund managers increased the value of their portfolios by in excess of 16% over the year to £17.25 billion. In contrast to the redundancies made necessary in other major financial centres by the reduced volumes of business and lack of investor confidence, the Scottish investment houses continued to expand, staff totals increasing by 12% to bring numbers employed in the sector to 1,000.

In individual cases and specific areas of investment, expansion over the longer term has been very marked; for example, growth at Murray Johnstone over the five years to the end of 1988 has been 25% per annum, and Baillie Gifford report increasing tenfold the value of their pension funds managed over the same period.

Successful expansion has not been confined to UK markets, as companies follow a flexible and prospective approach typified by the example of Ivory and Sime, who have now established a presence in each of the time zones relevant to world financial markets, tied with Sumitomo Life for access to Far Eastern investors, and established a Luxemburg-based fund for ease of entry to EC markets. Others have established strong relationships with American - and Japanese-based associates. Such strategies have important implications both for improved service of existing clients and for prospects of further growth on an international scale.

#### THE SECTOR'S FUTURE IN ITS PEOPLE

Alongside all these 'core' activities, the corporate lawyers, tax advisors, stock brokers, pensions consultants and others have generated new business, strengthened their practices and expanded their horizons.

On the most recent evidence, therefore, it is clear that the Scottish financial sector has more than met the requirements of a changing financial environment. It has made areas of that environment its own through sustained growth based on specialisation, sensitivity to current market needs and flexibility in the face of new opportunities, all made possible by swift adaptation to the most up-to-date information technology. The Scottish financial community does not need any form of protectionism. Instead it is enjoying an enhanced status as profitable, well-orientated and responsive to the potential of the Single Market in the new regulatory climate.

The emerging Single European Financial Market is a very exciting prospect. The strengths of the Scottish financial sector lie particularly in the retail savings and investment market, and in the regionally-based corporate market. These are markets which Scottish practitioners are likely to approach most successfully in joint ventures and in association with partners in other European regions committed to the same standards of

professional excellence. Such partnerships and alliances have already been formed; others are being developed and explored. Scotland's financial sector is poised to participate both in financial Europe and Europe of the regions.

It is plain that the Scottish financial sector does understand the overriding importance of the market in determining the most appropriate product or strategy. Competitive pressures have ensured that Scottish institutions are not unique in having learned this lesson; however, the methods of Scottish financial practice are seen to be increasingly attractive compared with those of other financial centres. Practitioners here are agents rather than principals in financial dealings. There is a sharp focus on the requirements and interests of the client, and that focus is a careful balance between the specific needs of the individual client and a commitment to upholding the highest professional standards.

The chief attributes of the Scottish financial community lie in consistency of method and performance, and in dedication to financial goals over the long term. These in turn reflect the quality of the personnel it employs, whose availability is a tribute to an exceptionally strong Scottish educational system. The sector overall has an enviable tradition of well-qualified entrants, largely graduates, very many of whom are also professionally qualified.

The resulting competence of financial services staff is demonstrated not only by the continuing growth of the sector, but also by the self-discipline and probity of Scottish financial practice. The difference is in the people. The fact that the people will not change justifies confidence in the continuing future expansion of the Scottish financial sector.