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The centrality of advanced business services

As we saw in Chapter 3, services, especially advanced business services (ABS) – banking, accountancy, insurance, logistics, law, advertising, business consultancy, high-level personnel recruitment – are central to the operation of the economy. Not only are they the ‘lubricants’ to all production circuits but also they have become increasingly dominant. For example, financial services are both circulation services, fundamental to the operation of every aspect of the economic system, and also commodities or products in their own right, produced and traded in the same way as more tangible manufactured goods are traded.

Money counts

Every economic activity (whether a material product or a service) has to be financed at all stages of its production. Without the parallel development of systems of mone- credit-based exchange there could have been no development of economies beyond the most primitive organizational forms and the most geographically restricted scales.

The geographical circuits of money and finance are the ‘wiring’ of the socio-economy ... along which the ‘currents’ of wealth creation, consumption and economic power are transmitted ... money allows for the deferment of payment over time-space that is the essence of credit. Equally, money allows propinquity without the need for proximity in conducting transactions over space. These complex time-space webs of monetary flows and obligations underpin our daily social existence.¹

Finance is also one of the most controversial of economic activities because of its historical relationship with state ‘sovereignty’. Ever since the earliest states emerged on the scene, the creation and control of money have been regarded as central to their legitimacy and survival.² Today, in the context of a globalizing world economy, this tension has become especially acute. The periodic financial crises that are endemic to the system intensify these tensions and also create legitimate fears over the accountability and responsibility of financial institutions.

A global casino

In 1986, Susan Strange coined the graphic term ‘casino capitalism’ to describe the international financial system:

Every day games are played in this casino that involve sums of money so large that they cannot be imagined. At night the games go on at the other side of the world ... [the players] are just like the gamblers in casinos watching the clicking spin of a silver ball on a roulette wheel and putting their chips on red or black, odd numbers or even ones.³
Twelve years later, she used the term ‘mad money’ to reflect the increased volatility of the financial system and the uncertainty it generates throughout the world economy. These terms are even more appropriate in the light of the 2008 global financial crisis. International financial flows and foreign currency transactions have reached unprecedented levels. They totally dwarf the value of international trade in manufactured goods and in other services and have done so at an increasing rate over the past three decades, as Figure 12.1 shows. In 1973, daily foreign exchange transactions were roughly twice that of world trade; in 2007, they were 100 times greater! Of course, some of those financial transactions are directly related to international trade (and production) and are essential for that purpose. But only a very small percentage of international financial transactions are of this kind. The remainder take the form of what are, essentially, speculative dealings – aimed at making short- or long-term profits as ends in themselves – through a bewildering variety of financial instruments. Of course, it is often difficult to draw a clear line between speculative and productively essential financial transactions.4

The structure of advanced business services

Advanced business services encompass a very broad range of activities. Figure 12.2 identifies the major categories of ABS firm, distinguishing between financial and

![Figure 12.1 - The growing disparity between foreign exchange trading and world trade, 1973–2007](image-url)
professional business service firms. They are all basically providers of highly specialized knowledge which facilitates the increasingly complex configuration and operation of global production networks. All are, in some sense, *intermediaries* in the processes of production, distribution and consumption. In the case of banking, the key function is

the pooling of financial resources among those with surplus funds to be lent out to those who choose to be in deficit, that is to borrow … With financial intermediation, investors in new productive activities do not themselves have to generate a surplus to finance their projects; instead the projects can be financed by surpluses generated elsewhere within the economy.\(^5\)

The process of intermediation has constituted the basic function of banks from the very beginning. Figure 12.3 shows the sequence of development of the banking system. The first two stages of credit provision to borrowers depend greatly upon the nature of geographically specific knowledge to legitimize lending and borrowing. The geographical scope of knowledge and trust grows through such developments as inter-bank lending (that is, lending outside the local area) in stage 3 and, eventually, of a central bank that ultimately acts as the lender of last resort to the banking system as a whole (stage 4). Subsequent developments, especially in securitization, create a totally different scale and complexity of financial activity.
Such increased complexity of the financial system has resulted in the development of a huge variety of different types of financial institution, each of which has a specific set of core functions (Figure 12.2). In fact, the boundaries between these individual activities and institutions have become increasingly blurred. The first three types of financial institution shown in Figure 12.2 are concerned with the creation and distribution of credit in various forms. The two remaining categories are concerned with different forms of risk indemnification (insurance companies) and with certifying the accuracy of financial accounts (accountancy firms).

<table>
<thead>
<tr>
<th>The stages of banking development</th>
<th>Banks and space</th>
<th>Credit and space</th>
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| **Stage 1: Pure financial intermediation**  
Banks lend out savings.  
Payment in commodity money.  
No bank multiplier.  
Savings precedes investment. | Serving local communities.  
Wealth-based, providing foundation for future financial centres. | Intermediation only. |
| **Stage 2: Bank deposits used as money**  
Convenient to use paper money as means of payment.  
Reduced drain on bank reserves.  
Multiplier process possible.  
Bank credit creation with fractional reserves.  
Investment can now precede saving. | Market dependent on extent of confidence held in banker. | Credit creation focused on local community because total credit constrained by redeposit ratio. |
| **Stage 3: Inter-bank lending**  
Credit creation still constrained by reserves.  
Risk of reserves loss offset by development of inter-bank lending.  
Multiplier process works more quickly.  
Multiplier larger because banks can hold lower reserves. | Banking system develops at national level. | Redeposit constraint relaxed somewhat, so can lend wider afield. |
| **Stage 4: Lender-of-last-resort facility**  
Central bank perceives need to promote confidence in banking system.  
Lender-of-last-resort facility provided if inter-bank lending inadequate.  
Reserves now respond to demand.  
Credit creation freed from reserve constraint. | Central bank oversees national system, but limited power to constrain credit. | Banks freer to respond to credit demand as reserves constraint not binding and they can determine volume and distribution of credit within national economy. |
| **Stage 5: Liability management**  
Competition from non-bank financial intermediaries drives struggle for market share.  
Banks actively supply credit and seek deposits.  
Credit expansion diverges from real economic activity. | Banks compete at national level with non-bank financial institutions. | Credit creation determined by struggle over market share and opportunities in speculative markets. Total credit uncontrolled. |
| **Stage 6: Securitization**  
Capital adequacy ratios introduced to curtail credit.  
Banks have an increasing proportion of bad loans because of over-lending in Stage 5.  
Securitization of bank assets.  
Increase in off-balance sheet activity.  
Drive to liquidity. | Deregulation opens up international competition, eventually causing concentration in financial centres. | Shift to liquidity by emphasis being put on services rather than credit; credit decisions concentrated in financial centres; total credit determined by availability of capital, i.e. by central capital markets. |
| **Stage 7: Response to 2008 crisis**  
Potential for redrawing of boundaries between different banking functions. | Possible deregulation at national and/or international scales. | Possible refocus on lending to domestic borrowers. |

Figure 12.3  The sequence of development of the banking system

Source: based in part on Dow, 1999: Tables 1 and 2

Such increased complexity of the financial system has resulted in the development of a huge variety of different types of financial institution, each of which has a specific set of core functions (Figure 12.2). In fact, the boundaries between these individual activities and institutions have become increasingly blurred. The first three types of financial institution shown in Figure 12.2 are concerned with the creation and distribution of credit in various forms. The two remaining categories are concerned with different forms of risk indemnification (insurance companies) and with certifying the accuracy of financial accounts (accountancy firms).
Dynamics of the markets for advanced business services

Demand for advanced business services is primarily driven by the increasing complexity and specialization of functions within economies in general and in production networks in particular. ABS providers are both the beneficiaries of such developments and also, in turn, contributors to that increased complexity, thus helping to create their own growing markets. This is especially the case as production networks have become increasingly global, creating more and more market opportunities for firms to follow their clients abroad. Very often the relationships established between ABS firms and their customers in a domestic context are transferred to an international context because of the build-up of trust. Alternatively, the geographical differentiation of rules and regulations between different national territories creates opportunities for ABS firms to construct more complex and geographically diverse operations and to build extensive networks.

The increased diversity (and volatility) of the market for financial services

From being fairly simple and predictable, the markets for financial services have become increasingly diverse and far less predictable. The intensity of competition for consumers (whether corporate or individual) has increased enormously. Four processes have been especially important:

- **Market saturation**: by the late 1970s, traditional financial services markets were reaching saturation. There were fewer and fewer new clients to add to the list; most were already being served, particularly in the commercial banking sector but also in the retail sector in the more affluent economies.

- **Disintermediation**: this is the process whereby corporate borrowers make their investments or raise their needed capital without going through the ‘intermediary’ channels of the traditional financial institutions, particularly the bank. Instead, they have increasingly sought capital from non-bank institutions, for example through securities, investment trusts and mutual funds. However, the process is extremely dynamic. Disintermediation may well be challenged by reintermediation, as new forms of supplier–customer relationship emerge (as, for example, through the Internet).6

- **Deregulation of financial markets**: financial services markets have traditionally been extremely closely regulated by national governments. One of the most important developments of the past 30 years was the increasing deregulation or liberalization of financial markets. Deregulation has facilitated:
• the opening of new geographical markets
• the provision of new financial products
• changes in the way in which prices of financial services are set.

**Internationalization of financial markets**: demand for financial services is no longer restricted to the domestic context: financial markets have become increasingly global. Three trends have been especially significant:

• the massive growth in international trade
• the global spread of transnational corporations
• the vastly increased institutionalization of savings.

Each of these forces for change in the demand for financial services is interrelated; together they created a *new competitive environment*. But, of course, such developments do not always run smoothly. Indeed, the inherent volatility of financial markets creates periodic large-scale upheavals. The history of the twentieth century provides clear evidence of such a succession of ‘financial disasters’: the bankers’ panic in the US in 1907; the Wall Street Crash in 1929; ‘Black Monday’ in 1987; the Asian financial crisis in 1997; and most recently the financial crisis of 2008, triggered by the collapse of the US subprime mortgage market. Such market volatility has profound implications for the ABS sector in general. Some ABS firms prosper – notably those concerned with corporate bankruptcies and restructuring – whilst others experience difficulties as demand for their services contracts. Advertising, for example, tends to be hard hit.

**Technological innovation and advanced business services**

*Centrality of information and communication technology*

Information and communication technology (ICT) is absolutely central to all advanced business services because they are all, essentially, providers of specialist information and knowledge. Information is both the process and the product of ABS. Consequently, the innovations in communication and in the storing and processing of information, discussed in Chapter 4, helped to shape ABS. This is overwhelmingly so in the case of financial services, whose raw materials are information: about markets, risks, exchange rates, returns on investment, creditworthiness. Their products are also information: the result of adding value to these informational inputs. In the words of one financial services executive:
We don’t have warehouses full of cash. We have information about cash – that is our product.\(^8\)

Indeed, money itself is primarily an item of information governed by rules. Money is therefore shaped by the development and adoption of information and communication technologies ... (how the information is managed, and to a degree the very nature of the information) and regulation (how information is ruled).\(^9\)

Not surprisingly, therefore, all the major financial services firms invest phenomenal sums in information technologies.

It is, of course, the speed with which financial services firms can perform transactions and the global extent over which they can be made that are especially important.

Travelling at the speed of light, as nothing but assemblages of zeros and ones, global money dances through the world’s fiber-optic networks in astonishing volumes ... National boundaries mean little in this context: it is much easier to move $41 billion from London to New York than a truckload of grapes from California to Nevada.\(^10\)

From a technological viewpoint, global 24-hours-a-day trading or ‘following the sun’ – whether this be in securities, foreign exchange, financial and commodities futures or any other financial service – is perfectly feasible.\(^11\) As Figure 12.4 shows, the trading hours of the world’s major financial centres overlap. In fact, genuine 24-hour trading is currently limited to certain kinds of transaction partly because, although the technology is available, either the organizational structure or the national regulatory environment creates an obstacle (see next section).
To the extent that electronic transactions do not require direct physical proximity between seller and buyer, they are a form of ‘invisible’ international trade. In that sense, therefore, financial services are one form of ABS that is tradable. The global integration of financial markets brings many benefits to its participants in the speed and accuracy of information flows and the rapidity and directness of transactions, even though the participants may be separated by many thousands of miles and by several time zones. But such global integration and instantaneous financial trading also create costs. ‘Shocks’ occurring in one geographical market now spread instantaneously around the globe, creating the potential for global financial instability. Financial ‘contagion’ is endemic in the structure and operation of the contemporary financial system. It is nothing new – just more extreme.

**An epidemic of new financial products**

Innovations in telecommunications and in process technologies, therefore, have helped to transform the operations of financial services firms. They have also helped to create new financial products. Electronic communications have contributed greatly to the bypassing of the commercial banks and the trend towards the greater securitization of financial transactions: the conversion of all kinds of loans and borrowings into ‘paper’ securities which can be bought and sold on the market. Such transactions may be performed directly by buyers and sellers without necessarily going through the intermediary channels of the commercial banks.

As a consequence, a whole new array – a virtual epidemic – of financial instruments (product innovations) appeared on the scene with increasing frequency, notably:

- those providing new methods of lending and borrowing
- those facilitating greater spreading of risk.

The most important product innovation since the mid 1980s has been the phenomenal growth of the derivatives markets. Derivatives are financial tools derived from other financial products, such as equities and currencies. The most common of these are futures, swaps, and options. The derivatives market aims to enable participants to manage their exposure to the risk of movements in interest rates, equities, and currencies.

Figure 12.5 gives examples of what some have called the ‘alphabet soup’ of such ‘structured financial products’. The underlying logic of these instruments is the spreading of risk. However, the 2008 crisis showed, with great force, that the nature and extent of such risks was simply not understood: ‘risk has become
It was the packaging, repackaging and selling on (and on and on) of mortgage-based securities (MBS) based on loans in the US sub-prime mortgage market (loans to individuals without the means to repay them) that triggered the crisis when borrowers began to default. Nobody, not even the financial institutions themselves, quite knew where the risks lay. When it is realized that ‘the notional value of the derivatives market was almost eleven times the value of the world’s financial assets’ then the riskiness of such risk-taking becomes apparent. No wonder the US investor Warren Buffett called derivatives ‘time bombs’ or ‘financial weapons of mass destruction’, or that Gillian Tett talked about ‘destructive creation’ – a neat reversal of Schumpeter’s notion of ‘creative destruction’ (see Chapter 4).

In effect:

The modern financial services industry is a casino attached to a utility. The utility is the payments system, which enables individuals and companies to manage their daily affairs. It allows them to borrow and lend in line with the fundamental value of business activities. In the casino, traders make profits from arbitrage – differences in the prices of related assets – and from short-term price movements. The users of the utility look to fundamental values. The players in the casino are preoccupied with the mind of the market.

Without question, therefore, developments in information and communication technology, as well as in product innovations, have transformed the financial services industries. The global integration of financial markets has become possible, collapsing space and time and creating the potential for virtually instantaneous financial transactions in loans, securities and a whole variety of financial instruments. However, completely borderless financial trading does not actually exist, for the simple reason that most financial services remain very heavily supervised and regulated by individual national governments. Let us now see how the regulatory system works – or doesn’t – and how it has changed.

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**Figure 12.5  Examples of recent product innovations in financial markets**

*Source: based on the Financial Times, 13 October 2009: 33*
The role of the state: regulation, deregulation, reregulation

Although some ABS are ‘tradable’, most depend fundamentally on having a direct presence within their markets. This is especially true of legal and accounting services because both are subject to tight regulation at the national scale. Even within the EU, national regulatory structures still operate. But it is in the financial sphere that regulatory systems are especially significant. The history of the past six decades is one of a dramatic shift from tight regulation to looser – even to deregulation – until the 2008 crisis hit the world with such force that the whole regulatory system is again in question. Reregulation is back on the agenda.

A tightly regulated financial system

Before the 1960s a ‘world’ financial market did not exist. The IMF, together with the leading industrialized nations, operated a broadly efficient global mechanism for monetary management based, initially, on the post-war Bretton Woods agreement (see Chapter 17). At the national level, financial markets and institutions were very closely supervised, primarily because of concerns over the vulnerability of the financial system to periodic crisis and because of the centrality of finance to the operation of a country’s economy.

Financial services, therefore, have been the most tightly regulated of all economic activities, certainly more so than manufacturing industries. Such regulation can be divided into two major types:

- Those governing the relationships between different financial activities. National financial services markets have generally been segmented by regulation: banks performed specified activities; securities houses performed other activities. Neither was allowed to perform the functions of the other.
- Those governing the entry of firms (whether domestic or foreign) into the financial sector. Restricted entry into the different financial services markets has been virtually universal, although the precise regulations differ from country to country. Governments have been especially wary of a too-ready expansion of the branches of foreign banks and insurance companies. This is because, unlike separately incorporated subsidiaries, branches are far more difficult to supervise: they form an integral part of a foreign company’s activities. In almost every case, there are limits on the degree of foreign ownership permitted in financial services.

‘The crumbling of the walls’

Although many of these restrictions continued to exist, the regulatory walls crumbled – even collapsed altogether in some cases. The process was relatively
slow at first but accelerated rapidly after the late 1980s. Deregulatory pressures came from several sources, most notably the increasing abilities of transnational firms to take advantage of ‘gaps’ in the regulatory system and to operate outside national regulatory boundaries.

Money has a habit of seeking out geographical discontinuities and gaps in these regulatory spaces, escaping to places where the movement of financial assets is less constrained, where official scrutiny into financial dealing and affairs is minimal, where taxes are lower and potential profits higher.\(^\text{16}\)

The starting point was the emergence of the Eurodollar (that is, offshore) markets in the 1960s. Initially, Eurodollars were simply dollars held outside the US banking system largely by countries anxious to prevent their dollar holdings being subject to US political control. The rapid growth of this new currency market outside national regulatory control was reinforced by pressure from banks and other financial services firms to operate in a less constrained and segmented manner, both domestically and internationally. The internationalization of financial services and the deregulation of national financial services markets, therefore, are virtually two sides of the same coin. Forces of internationalization were one of the pressures stimulating deregulation; deregulation is a necessary process to facilitate further internationalization.

Major deregulation occurred in all the major developed economies. In the US, a series of changes since the 1970s both eased the entry of foreign banks into the domestic market and facilitated the expansion of US banks overseas, as well as allowing banks to become involved in a whole variety of financial services and to operate nationwide branching networks. In 1999 the Glass–Steagall Act, which prohibited the joint ownership of commercial and investment banking, was abolished. In the UK, the so-called ‘Big Bang’ of October 1986 removed the existing barriers between banks and securities houses and allowed the entry of foreign firms into the Stock Exchange. In France, the ‘Little Bang’ of 1987 gradually opened up the French Stock Exchange to outsiders and to foreign and domestic banks. In Germany, foreign-owned banks were allowed to lead-manage foreign issues, subject to reciprocity agreements.

Financial deregulation also occurred in East Asia. In Japan the restrictions on the entry of foreign securities houses were relaxed (though not removed) and Japanese banks could open international banking facilities. But the Japanese financial system remained more tightly regulated than elsewhere. In 1996, the Japanese government announced its intention to undertake a wide-ranging deregulation of the country’s financial system, a process made more difficult by Japan’s attempt to recover from its deep financial crisis of the 1990s. Even the Singaporean government has progressively loosened the restrictions on the financial sector in order to maintain the country’s position as a major Asian financial centre. Most recently, China has allowed foreign participation in big state-owned banks and has listed them on overseas stock exchanges.
Increasing deregulation of financial services has been an important component of the major regional economic blocs. A financial services agreement was part of the Canada–US Free Trade Agreement whilst, under the NAFTA, Mexico had to open up its financial sector to North American firms by 2007. EU reforms aim at removing the individual national financial regulatory structures inhibiting the creation of an EU-wide financial system so that financial services flow freely throughout the EU and financial services firms could establish a presence anywhere within the Single Market. The creation of a single European currency transformed wholesale financial markets in the EU but retail financial markets remained fragmented on national lines.

**Reintervention of the state**

The unexpected financial crisis of 2008 stopped this apparently inexorable trend towards the deregulation of financial services in its tracks. The collapse of major banks and investment firms, initially in the US and the UK, was a shock of unprecedented magnitude, at least since the Wall Street Crash of 1929. As a result of the virtual collapse of the financial system in 2008, the IMF estimated that financial institutions faced losses of $4.1 trillion. Governments have ploughed billions of dollars, pounds, euros, yen and other currencies into propping up their collapsing banking systems. Some institutions – like Lehman Brothers in the US – have been allowed to fail. But, for the most part, governments have stepped in with massive financial support. In effect, a number of leading US and British banks have been nationalized. Rescuing their banks became the preoccupation of national governments, simply because credit is essential for an economy to operate. The banks were regarded as being too big to fail. But the cost to the taxpayer has been immense and poses major problems for future public expenditure and for people’s economic well-being.

In the short run the need is to stabilize the financial system, but in the longer run the need, clearly, is for a new financial architecture for the global economy. This is an issue we will explore in Chapter 17. Suffice it at this stage to note that the accepted wisdom of the past 20 years of the efficiency of free, unregulated financial markets and the benefits of derivatives and other exotic financial products has been destroyed.

**The state as capitalist investor: sovereign wealth funds**

A rather different state financial phenomenon has emerged in recent years: the state as a large and active investor in international financial markets. The mechanism is the government-owned sovereign wealth fund (SWF). Figure 12.6 shows the geographical origins and magnitude of the major SWFs in 2007. Their combined
value was $2.9 trillion, equal to around 2 per cent of the world’s total financial assets (bank deposits, bonds, shares). The leading SWFs are virtually all from emerging economies, notably those that are oil-rich. In effect, SWFs are a way to help recycle emerging-market surpluses. And yet suspicion about their motives could make their money much less welcome: rather than accepting investment from sovereign-wealth funds, countries could turn to financial protectionism … For some, the rub is that governments are less interested in money than in power … Others are worried for precisely the opposite reason: that the funds are interested chiefly in making money. This would not matter much but for the sheer size that some funds have now attained. They are big enough to shift markets.\(^{18}\)

The virtual collapse of Dubai World, a state-owned holding company, in late 2009 raised some critical questions about such funds.

**Corporate strategies in advanced business services**

**Concentration and consolidation**

The history of most advanced business services is a more or less continuous trend towards greater concentration into a smaller number of companies.
Much of this consolidation has occurred through the conventional route of organic growth and of merger and acquisition. However, in some ABS, like accounting, law and executive recruitment, for example, the development of alliances and networks has become especially apparent. As a result, virtually all ABS sectors are dominated by a small number of very large firms or networks (Figure 12.7).

The changes in banking have been especially marked. In 1989, no fewer than seven of the top 10 banks were Japanese, a reflection of Japan’s spectacular economic growth during the 1980s. However, Japanese banks suffered very badly in the collapse of the Japanese ‘bubble economy’ in the early 1990s. In 2009, only one of the top 10 banks was Japanese. Western banks, especially US and UK banks, still dominate, although it is highly significant that two of the top 10 banks in 2009 were Chinese. Mergers have been endemic in the banking sector for the past 20 years at least. For example, the Mitsubishi UFJ Financial Group has evolved from a whole series of mergers. First, the Bank of Tokyo, Mitsubishi Bank and Mitsubishi Trust merged to form MTFG. Then, Sanwa Bank and Tokai Bank merged in 2002 to form the UFJ Bank. Finally, MTFG merged with UFJ in 2005. In the US, Chase Manhattan Bank merged with JP Morgan to form JP Morgan Chase. Citigroup grew aggressively through acquiring a whole series of banks and financial services firms, including Travelers Group. In the UK, the major banks have all grown through merger and acquisition: for example, Bank of Scotland and Halifax combined to form HBOS.

**Figure 12.7  Dominant firms in advanced business services**

*Source:* based on data in The Banker, July 2009; The Lawyer, October 2009; Accountancy Magazine, June 2009; Faulconbridge et al., 2008: Table 3
In the aftermath of the 2008 financial crisis, however, many of these deals involving commercial and investment banks unravelled. For example, Bank of America acquired Merrill Lynch; in the UK, HBOS was acquired by Lloyds which, in turn, had to be rescued by the British government, as did the largest bank of all, RBS. Both are currently largely owned by the UK government. Not part of their corporate plan! In the investment banking sector, JP Morgan Chase acquired Bear Stearns; and the Japanese firm Nomura acquired the Asian and European operations of Lehman Brothers, which had been allowed to collapse in September 2008 by the US government. The collapse of Lehman was, without doubt, one of the biggest shocks of all. The UK company Barclays acquired some of Lehman’s core US assets. A great deal of financial blood was spilled.

Product diversification

It is a short, and supposedly logical, step from this kind of growth orientation to the notion that ABS firms should not only operate in their own core area of expertise but also supply a complete package of related services. The services conglomerate or the services supermarket arrived, greatly stimulated, in the case of financial services, by increasing deregulation. As we saw earlier, it became increasingly possible for banks to act as securities houses, for securities houses to act as banks, and for both to offer a bewildering array of financial services way beyond their original operations. A typical leading bank’s portfolio of offerings came to include: clearing banking, corporate finance, insurance broking, commercial lending, life assurance, mortgages, unit trusts, travellers’ cheques, treasury services, credit cards, stockbroking, fund management, development capital, personal pensions and merchant banking. At the same time, entirely new non-bank financial services companies emerged. In non-financial ABS sectors a similar trend developed. For example, companies offering accountancy, consulting and other services under a single umbrella became common.

The rationale for product diversification was the familiar one of economies of scale and scope. The argument for a strategy of diversified service operations was that it offered a complete package of services — a ‘one-stop shop’ — to customers. Their supply by a large, globally recognized, brand-name firm was supposed to give reassurance to potential customers that they would receive the highest-quality service. However, there is little evidence that such diversifying mergers lead to significant improvements in efficiency. One potential problem is the nature of financial services products themselves:

Mergers between car manufacturers or consumer goods companies allow production to be centralized because the products are essentially the same ... The same is not true for many financial services ... A bottle of beer is a real thing but financial products are intangible constructs of regulation, culture and behaviour. A current account is a different product in every country, while life insurance policies are tax-driven products and tax systems are not harmonised. Where will the synergies come from? 19
Nevertheless, the merger waves in the financial sector showed no sign of disappearing until the 2008 crisis intervened and threw such ideas into question.

**Transnationalization**

The provision of advanced business services to customers depends, more than in any other sector, on **geographical proximity**. Although it is certainly true that some services can be supplied at a distance – including, of course, many financial services – the need for face-to-face contact is hugely important. As their major customers have expanded their overseas operations, the pressure on ABS firms to follow has intensified. Not surprisingly, then, all the leading ABS firms have become increasingly **transnational** in their operations.20 In this section, we look at three examples: banking, legal services and executive recruitment (headhunting).

**Financial services**

Although banks have long engaged in international business – for example, through foreign exchange dealing or providing credit for trade – historically this kind of business was carried out from their domestic locations. Any business that could not be carried out by mail or using telecommunications was handled by local correspondent banks; there was no need for a direct physical presence abroad. A small number of banks certainly set up a few overseas operations towards the end of the nineteenth century. But even in the early part of the twentieth century, the international banking network was very limited indeed. Almost all international banking operations were ‘colonial’ – part of the imperial spread of British, Dutch, French and German business activities. In 1913 the four major US banks had only six overseas branches between them. By 1920 the number of branches had grown to roughly 100 but there was little further change until the 1960s.

As with TNCs in manufacturing industries, the most spectacular expansion of transnational banking occurred in the 1960s and 1970s. In both cases US firms led the initial surge, a reflection of both the focal role of the US in the post-war international financial and trading system and also the rapid proliferation of US manufacturing TNCs. The number of foreign affiliates of banks increased from 202 in 1960 to 1928 in 1985. At the same time, the geometrical composition of the international banking network changed. US banks became less dominant, whilst European and Japanese banks increased the size of their international branch network. Today, the extent of transnationalization among financial services firms is considerable but also variable, as Table 12.1 shows. Although size and transnationality are related, it is not necessarily the biggest firms that are the most transnationalized. It is notable that only two US firms are among the most transnational financial services firms: Citigroup and AIG. However, JP Morgan Chase plans to launch ‘a global business aimed at selling loans and commercial banking services to multinational corporations, pitting the US bank against Citigroup and HSBC’.21
Although the turmoil of the 2008 crisis undoubtedly clipped the wings of many financial institutions and brought their transnational expansion to a halt, some actually increased their transnational presence. The Nomura takeover of the Asian and European operations of Lehman, for example, ‘turned Nomura from a bank serving Japanese clients globally to a bank serving local clients in global markets’. Chinese banks are also beginning to pursue active transnationalization strategies.

The specific reasons for, and the pace of, the transnationalization of financial services firms may well vary from one case to another, but there is an overall general pattern.

- In the immediate post-1945 period, the major overseas function of the small number of US transnational banks was to provide finance for trade. But as the overseas operations of US TNCs in manufacturing and other activities accelerated in the early 1960s, the functions of the US transnational banks evolved to meet their particular demands. Thus, the staple business of US banks in London became that of servicing the financial needs of their major industrial clients who were rapidly extending their operations outside the US.
In the second half of the 1960s, transnational banking functions took on a significant additional dimension with the growth of the Eurodollar market. As a consequence, US banks could raise money there for relending domestically as well as overseas.

The attractions of transnational banking widened progressively both as the global capital market evolved and as local capital markets overseas developed. As banks from the other industrialized economies also transnationalized, the process became self-reinforcing. All large banks had to operate transnationally; they had to have a presence in all the leading markets.

The transnationalization of financial markets received fresh impetus in the 1970s from two sources: first, the ‘windfall’ capital acquired by the OPEC oil-exporting countries which they sought to lend abroad; and second, the progressive dismantling of exchange controls on capital movements by the Federal Republic of Germany, the US, Japan and the UK.

The major trend towards greater deregulation of national financial markets from the late 1980s and through the 1990s gave a fresh impetus to transnationalization, especially to transnational mergers and acquisitions in the banking and financial services sector in general.

Figure 12.8 summarizes the major phases of development of transnational banking. Such broad developments also pulled more and more securities firms into international operations.

Up to 1979/80, the US multinational investment bank had little more than a large office in London and perhaps some much smaller ones in other European countries, perhaps an Arab country and possibly (though less likely) Japan. From 1980 onward, the development of the US investment bank as a multinational changed qualitatively.23

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**Figure 12.8** Major phases in the development of international banking

*Source: based on Fujita and Ishigaki, 1986: Table 7.6*
As a result, all of the transnational financial services firms have been basing their strategy on a direct presence in each of the major geographical markets and on providing a local service based on global resources. They are, in fact, selling a *global brand image*, with the clear message that a global company can cope most easily and effectively with every possible financial problem that can possibly face any customer wherever they are located. This may, or may not, be what actually happen.

**Legal services**

The provision of legal services to companies requires a direct contact with clients in each of the territories in which they operate for two main reasons:

- Legal regulations differ from country to country, so a lawyer qualified and registered in one country may not be able to operate in another country. It is impossible to offer legal services at a distance.
- The nature of the information being transmitted and the high level of trust involved necessitates a high level of face-to-face interaction (see Chapters 3 and 4).

The leading law firms have, as a result, developed increasingly extensive and complex transnational operations.24

Because of the high degree of trust required, and the interpretative complexities of law, legal services work can thus only be acquired through repeated copresence. Acquiring and retaining legal services business is embroiled in close relations with clients which places extensive face-to-face interaction at the centre of lawyers’ work. Thus, the operational practices by which firms acquire new business are dominated by face-to-face meetings and discussions ... as firms seek to globalize, *transnational operations remain inextricably reliant on knowledge practices constituted through face-to-face interactions*.25

The jurisdictional constraints within which legal firms have to work have a major effect on the kind of organizational structures that transnational legal firms employ. These are very different from the conventional structures of TNCs discussed in Chapter 5. Legal firms are primarily organized as *partnerships*, in which the top individuals/partners own the company. A direct presence in individual markets is achieved by establishing an office staffed by local and/or expatriate lawyer staff. An indirect presence is usually organized through membership of a ‘legal network, such as Interlex or through the establishment of a “best friends” arrangement with “local” law firms in overseas jurisdictions’.26 An increasingly common way of operating transnationally is through ‘temporary teams’ that are formed to fulfil a client’s requirements and then disbanded ... The main strategy transnational law firms have used to manage this need for team-work is the practice group. As worldwide groupings practice groups act as an umbrella under which all lawyers with the same
legal speciality sit … the aim of firms is to make practice groups cohesive and
based on a common set of values.\textsuperscript{27}

However, perhaps more than many other kinds of TNC, legal firms face an especially
strong tension between creating a global way of working and local integration.\textsuperscript{28}

Table 12.2 lists the leading legal services firms, all of which are from either the
US or the UK. These leading firms tend to use their own direct operations rather
than work within a network.\textsuperscript{29}

The nature of transnationalization in the sector has marked regional patterns …
UK and European firms have extended their operations primarily into Asian
markets not North America, and conversely North American firms have
shown little interest in expanding into Europe. In that sense, the pattern
of sector transnationalization in legal services is a more complex and
fragmented one than in the investment banking sector.\textsuperscript{30}

\begin{table}[h]
\centering
\caption{The transnational scope of leading legal services firms, 2006}
\begin{tabular}{l|c|c|c}
\hline
Company & Headquarters & No. of lawyers & No. of offices \\
\hline
Clifford Chance & UK & 2432 & 28 \\
Linklaters & UK & 2072 & 30 \\
Skadden Arps Slate Meagher & Flom & US & 1699 & 22 \\
Freshfields Bruckhaus Deringer & UK & 2013 & 28 \\
DLA Piper Rudnick Grey Cary & UK & 2800 & 59 \\
Latham & Watkins & US & 1669 & 22 \\
Baker & Mckenzie & US & 2975 & 70 \\
Allen & Overy & UK & 1760 & 25 \\
Jones Day & US & 2178 & 29 \\
Sidley Austin Brown & & & & \\
& Wood & US & 1495 & 16 \\
White & Case & US & 1783 & 38 \\
Weil Gotshal & Manges & US & 1129 & 20 \\
Mayer Brown Rowe & & & & \\
& & US & 1331 & 14 \\
Kirklan & Ellis & US & 1056 & 8 \\
Sullivan & Cromwell & US & 589 & 44 \\
Shearman Sterling & US & 910 & 19 \\
Wilmer Cutler Pickering & & & & \\
Hale & Dorr & US & 976 & 15 \\
McDermott Will & Emery & US & 1018 & 14 \\
Lovells & UK & 1353 & 26 \\
Dechert & US & 831 & 18 \\
\hline
\end{tabular}
\textit{Source:} based on Faulconbridge, 2008: Table 2
\end{table}
Executive recruitment

The global executive search (headhunting) industry has a rather brief history, originating in the US in the 1950s, but growing very rapidly from the 1970s. It developed primarily out of the management consultancy sector. Headhunting exemplifies one of the key attributes of contemporary global business: the perceived importance of business leaders with transnational experience. Headhunters are firms which search out suitable senior managerial or board executives on behalf of corporate clients. It is an elite labour market function. As a rule, the target individuals are already employed in another firm, so the term ‘headhunting’ is rather appropriate.

It is estimated that the top 10 firms listed in Table 12.3 account for around one-third of the global executive search market. These firms are hired by clients for a fee (based upon a candidate’s salary) to fill a vacant senior position (either actual or potential).

Whilst they are fundamentally offering the same service ... different firms have their own unique executive search cultures and styles ... Distinctions can be made between specialist boutiques that concentrate on headhunting in a limited number of sectors ... and integrated ‘complete service’ corporations that offer executive search in any major industry ... As with other producer services, a long ‘tail’ exists with firms that have some form of ‘international operation’ – circa 5000 firms.

It is the very largest headhunting firms that have expanded the most rapidly and aggressively.

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Table 12.3  The transnational scope of leading headhunting firms, 2008

<table>
<thead>
<tr>
<th>Company</th>
<th>Headquarters</th>
<th>Organizational form</th>
<th>No. of consultants</th>
<th>No. of worldwide offices</th>
</tr>
</thead>
<tbody>
<tr>
<td>MRI Worldwide</td>
<td>n.a.</td>
<td>Network</td>
<td>4500</td>
<td>65</td>
</tr>
<tr>
<td>Korn/Ferry International</td>
<td>US</td>
<td>Owned</td>
<td>426</td>
<td>73</td>
</tr>
<tr>
<td>Heidrick &amp; Struggles International</td>
<td>US</td>
<td>Owned</td>
<td>297</td>
<td>58</td>
</tr>
<tr>
<td>Spencer Stuart</td>
<td>US</td>
<td>Owned</td>
<td>292</td>
<td>49</td>
</tr>
<tr>
<td>Egon Zehnder</td>
<td>Switzerland</td>
<td>Owned</td>
<td>290</td>
<td>59</td>
</tr>
<tr>
<td>Russell Reynolds</td>
<td>US</td>
<td>Owned</td>
<td>133</td>
<td>33</td>
</tr>
<tr>
<td>Associates</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ray &amp; Berndtson</td>
<td>US</td>
<td>Hybrid</td>
<td>300</td>
<td>48</td>
</tr>
<tr>
<td>Amrop-Hever</td>
<td>Belgium</td>
<td>Hybrid</td>
<td>264</td>
<td>78</td>
</tr>
<tr>
<td>Globe</td>
<td>UK</td>
<td>Network</td>
<td>n.a.</td>
<td>15</td>
</tr>
<tr>
<td>EMA Partners</td>
<td>n.a.</td>
<td>Hybrid</td>
<td>130</td>
<td>42</td>
</tr>
</tbody>
</table>

Source: based on Faulconbridge et al., 2009: Table 1
By 2005 the leading fifteen global headhunters had increased their number of offices by 48% since 1992, from 461 to 684, with substantial absolute growth in Europe, North America and the Asia-Pacific ... Five of the consistently ranked global top-six headhunters had increased their regional office networks by 173%, from 100 offices to 273, between 1987 and 2005.33

As in other service sectors, headhunters use a variety of organizational forms to operate transnationally (see Table 12.3, third column 3):34

- **The wholly owned firm.** A firm that operates a tightly organized set of offices across the world, all of which work within the parent firm’s brand identity, control and work practices.

  The fact that all offices use the same brand name and corporate culture allows clients to trust that they will receive the same level and type of service wherever their executive search is in demand ... In addition, the owned firm is able to share successful practices and strategies in the form of ‘know-how’ management. These are then used to improve services and create demand in each market. Offices also share lists of ‘headhunted’ executives between offices such that they maximize the number of people they can offer to their clients in the shortlist, colloquially known as the ‘beauty parade’. (227)

- **The networked firm.** A strategic alliance between several independent firms:

  Networks are not businesses in themselves but architectures linking single country firms together into a global network of ‘best friends’ that can perform labour searches across many nations when needed ... Headhunting networks are temporary and dynamic interfirm collaborations that grow through repetitive use. There is no long-term lock-in to these collaborations, thus allowing the member firms the flexibility to draw on the resources and knowledge base of the most suitable firm in the network. (227)

- **The hybrid firm.**

  Part of a formalized global alliance bringing initially independent firms together to trade under one corporate name but operate as independent businesses ... Hybrids involve tighter integration than in a network which has only one office in each country and shared standards and approaches existing across the alliance. However, it is not as culturally, socially, or economically integrated as the wholly owned firm. Hybridity eliminates the potential for competition between different member firms operating in the same country as might be the case in the network. (227)

- **Combined Structures.** In reality, some of the biggest headhunting firms may adopt different approaches at the same time to meet specific circumstances, as Korn/Ferry demonstrates.

  Predominantly, Korn/Ferry operates as a wholly owned firm ... however ... in certain markets it adopts three other organizational structures – what it terms the ‘alliance’, the ‘satellite’, and the ‘affiliate office’ ... It shows ... how ... a blurred typology is a valuable way of engaging in internationalization that responds to locally variegated opportunities. (230)
Geographies of advanced business services

Cities as the ‘natural habitat’ for advanced business services

At first sight, ICT developments would appear to release business services, especially financial services, from geographical constraints. Such firms might seem to be especially footloose: they are not tied to specific raw material locations, whilst at least some of their transactions can be carried out over vast geographical distances, using telecommunications facilities. Their business, as we have seen, is information. Such considerations have led many to write geography and distance out of the script as far as financial services, in particular, are concerned.35

There is no doubt that the revolutionary developments in ICT permit information (including financial transactions) to whizz around the world electronically, and that deregulation has reduced the resistance of national boundaries to financial flows. But, far from heralding the ‘end of geography’, this has in fact made geography more – not less – important. Indeed, we find that, at global, national and local scales, advanced business services continue to be extremely strongly concentrated geographically. They are, in fact, more highly concentrated than virtually any other kind of economic activity, except those based on highly localized raw materials. However, there are some subtle variations according to the particular function involved: there is a division of labour within ABS firms, parts of which may show a greater degree of geographical decentralization.

The geographies of ABS are enmeshed and embedded in cities: cities of all kinds but, especially, the biggest cities whose top tier consists of the so-called global or world cities.36 The reason is the primary importance of face-to-face contact for all ABS. That has been the recurring theme throughout this chapter. Such services need geographical proximity to their clients. They also create, and benefit from, the kinds of traded and untraded interdependencies discussed in Chapters 3 and 4 – the ‘buzz’ that comes from localized clustering. The geographies of ABS, then, are synonymous with the geographies of big cities. These cities are their ‘natural habitat’. In this section we will focus on global financial centres but we should bear in mind that such centres are also the primary locations of the leading legal, accounting, consultancy, headhunting, advertising and other ABS. Indeed, they tend to form an ecology of ABS, in which each feeds upon the others.

The global network of financial centres

The network of global financial centres shown in Figure 12.9 has three major levels, with London and New York forming the top level. The widespread deregulation of
financial services during the 1980s and 1990s had an especially significant impact on the structure of this network. Such developments made it possible for footloose financial firms to set up directly in the world’s leading metropolitan centres rather than serving them from a distance ... International firms want to locate in these different metropolitan financial centres because each has a different financial specialization, and each is the hub of a different (although of course overlapping and inter-connected) continental global region. Foreign banks and related institutions have moved into these centres precisely because of geography, that is to expand their presence or gain access to specific markets, to capitalize on the economies of specialization, agglomeration and localization (skilled labour, expertise, contact, business networks, etc.) available in these centres, or to specialize their own operations and activities geographically.37

The locational attractions of international financial centres consist of four interlocking processes:38

- The characteristics of the business organizations involved in international financial centres: (a) much of the production of financial products and services occurs at the boundaries of firms and there is a strong reliance on repeat business; (b) the firms tend to be ‘flattened and non-hierarchical’ and based around ‘small teams of relationship and product specialists’; (c) firms need to cooperate as well as to compete, as in the case of syndicated lending; (d) firms need to compare themselves with one another to judge their performance; (e) there is a need for a constant search for new business and for rapid response.
These shared characteristics point to two important correlates. First, in general, these firms must be sociable. Contacts are crucially important in generating and maintaining a flow of business and information about business. ‘Who you know’ is, in this sense, part of what you know … ‘relationship management’ is a vital task for both employees and firms. Second, this hunger for contacts is easier to satisfy if contacts are concentrated, are proximate. When contacts are bunched together they are easier to gain access to, and swift access at that.\(^39\)

- The diversity of markets in international financial centres: (a) their large size which makes them both flexible in terms of entry and exit and also socially differentiated: ‘more likely to consist of social “micro-networks” of buyers and sellers, whose effect on price-setting can sometimes be marked’; (b) their basis in rapid dissemination of information which may lead to major market movements; (c) their speculative and highly volatile nature. Again, as with the case of organizations, there are the two obvious corollaries to these characteristics: the twin needs for sociability and proximity.\(^40\)

- The culture of international financial centres: (a) such centres receive, send and interpret increasing amounts of information; (b) they are the focus of increasing amounts of expertise which arise from a complex division of labour involving workforce skills and machinery; (c) they depend on contacts and such contacts have become increasingly reflexive because of their basis in trust founded on relationships. Such cultural aspects of international financial centres are actually increasing in importance.

- The dynamic external economies of scale which arise from the sheer size and concentration of financial and related services firms in such centres. Such economies include: (a) the sharing of the fixed costs of operating financial markets (for example, settlement systems, document transport systems) between a large number of firms; (b) the attraction of greater information turnover and liquidity; (c) the enhanced probability of product innovations in such clusters (the ‘sparking of mind against mind’); (d) the increased probability of making contacts which rises with the number of possible contacts; (e) the attraction of linked services such as accounting, legal and computer services, which reduces the cost to the firm of acquiring such services; (f) the development of a pool of skilled labour; (g) the enhanced reputation of a centre which, in a cumulative way, increases that reputation and attracts new firms. In other words, the constellation of traded and untraded interdependencies, described in Chapter 3, tend to be especially strongly developed in international financial centres.

In effect, therefore, a small number of cities controls almost all the world’s financial transactions. It is a remarkable level of geographical concentration. But such cities are more than just financial centres. There is clearly a close relationship with the distribution of the corporate and regional headquarters of transnational corporations (see Chapter 5). These global cities are, indeed, the geographical control points of the global economic system. They are what Cassis calls ‘the capitals of capital’.\(^41\)
But this does not mean that all global financial centres – even those at the top of the hierarchy – are identical. Far from it. Each has distinctive characteristics reflecting its specific history and geography. On criteria measuring both the breadth and depth of global financial activity, New York and London stand at the apex of the global financial hierarchy. London is the more broadly based international financial centre, particularly in terms of its strengths in foreign exchange, international equities and derivatives. The daily turnover on the London foreign exchange market is almost as large as the turnover in New York and Tokyo put together.

London’s significance as a global financial centre can be attributed to the following factors:

- The historical evolution of the City as a world centre has created both a large pool of relevant skills and also an almost unparalleled concentration of linked institutions within a very small geographical area.
- Its geographical position locates it in a time zone between Asia and New York.
- The regulatory environment has encouraged the growth of transnational banking. Foreign banks in London can operate as ‘universal’ banks.
- It has a key role as a ‘capital switching centre’: ‘the London market brings together in one place great diversity of market participants and, consequently, great diversity of risk preferences and profiles’.

London has the largest concentration of foreign banks in the world, with more than 470 foreign branches, subsidiaries or representative offices located there in 2001. In comparison, Paris had 214 and Frankfurt 320. In 2001,

London had 20 per cent of all cross-border bank lending worldwide, 52 per cent of foreign equity trading, and 31 per cent of all foreign exchange dealing; as much as its three closest rivals (New York, Tokyo, and Singapore) put together.

London’s strength as a financial centre, therefore, rests on the scale of its foreign exchange business and its deregulated securities markets. New York, in comparison, is the world’s largest securities market in addition to having a huge concentration of transnational banks and other financial activities. London and New York stand apart from Tokyo as truly global financial centres. The international significance of Tokyo has rested primarily on the strength of the Japanese economy itself. Tokyo’s financial community has been far more domestically oriented although, as we have seen, Japanese banks have regained some of their international strength. London also maintains its lead over such key European cities as Frankfurt and Paris, even though both of these cities have strengthened their financial centres. In addition, London has made strong efforts to become a global centre of Islamic finance.

Although this global financial network has certain stable features, it is by no means static. Financial centres may change their status in the network in response to changing conditions; new centres may emerge. But these are long-term processes.
It takes a long time for real change to become apparent, which is why it is impossible to predict, with any certainty, the effect of the 2008 crisis on London’s or New York’s standing. On the one hand, there are anecdotal stories of financial firms planning to move out of London because of the fear of increased regulation or higher taxation. On the other hand, a 2009 Global Financial Centres Index report showed London improving its standing among the world’s leading financial centres (as did New York). But especially interesting was the increasing status of East Asian financial centres, particularly Singapore, Hong Kong and Shanghai. The two latter cities are locked in competition as the leading financial centres of China.

**Geographical decentralization and offshoring of business services**

All of the discussion of global financial centres suggests that the potential for other cities, outside the favoured few shown in Figure 12.9, to develop as significant centres of finance and related activities is very limited. In the UK, for example, the sheer overwhelming dominance of London makes it extremely difficult for provincial cities to develop more than a very restricted financial and ABS function. It is, of course, the ‘higher-order’ financial and ABS functions which are especially heavily concentrated in the major global financial centres. However, as we have seen, the essence of ABS activities is the transformation of massive volumes of information. Much of that activity is routine data processing performed by clerical workers. Such ‘back-office’ activity can be separated from the front-office functions and performed in different locations. The early adoption of large-scale computing by banks, insurance companies and the like from the late 1950s initially led many of them to set up huge centralized data processing units. To escape the high costs (of both land and labour) in the major financial centres, such units were often relocated to less expensive centres or in the suburbs. Access to large pools of appropriate (often female) labour was a key requirement.

The introduction of dispersed computer networks made such centralized processing units unnecessary and the trend changed to decentralize back-office functions more widely. At the same time, the distinction between back-office and front-office functions became less clear. In fact, it is not only routine back-office activities that have been decentralized. It has become increasingly common for some of the higher-skilled functions to be relocated away from head office into dispersed locations, both nationally and, in some case, transnationally. However, centralization of back-office functions is by no means obsolete. For example, Citicorp gathered all its back offices from around the world and recentralized them in large and more efficient centres to achieve economies of scale. Even in the case of back offices, therefore, geographical centralization is far from dead.

Beyond the continued tendency to retain their major presence in key centres, the major ABS firms have become increasingly involved in offshoring some of their
functions. (Note that the term ‘offshoring’ in this context does not have the same meaning as the ‘offshore financial centres’ discussed in the next section).

In 2006, over 75 per cent of major financial institutions had offshore activities, compared with less than 10 per cent in 2001 … The main activities offshored are those involving the use of IT, lower value-added activities (such as payroll) and lower value-added contact with customers (such as scripted outbound sales calls). But offshoring has spread across nearly all business functions, with significant growth in transaction processing, finance and various aspects of human resources activity. Even activities requiring specific skills, such as financial research and modelling, have the potential to be ultimately offshored as well.47

As the extent of offshoring has increased, its particular organizational form has become more varied, as Figure 12.10 shows. Initially, most offshoring by financial services firms was vendor direct outsourcing to a foreign firm located overseas. As major financial services firms became increasingly involved in offshoring they began to establish systems of captive direct offshoring: setting up their own subsidiary operations in other countries. The third and most recent arrangement, vendor indirect offshoring, reflects the tendency for specialist outsourcing companies to establish their own transnational networks to serve more diverse customers. So, for example, one of the leading Indian IT outsourcing companies, Tata Consultancy Services (TCS), has recently established its own operations in Hungary as part of its increasingly global network.

TCS first opened a software centre in Hungary in 2001 … it is now building a global delivery network so that projects can be completed closer to the customer where necessary … TCS chose Hungary because, as well as English, many Hungarians can speak other European languages, including German, French, and Italian. ‘We want to provide a European front and [point of contact] for our European customers’ … TCS preferred eastern Europe over western Europe because it was much cheaper … Eastern Europe is where India was a decade ago.48

However, India itself remains by far the most popular offshoring location
with around two-thirds of global offshored staff employed in the sub-continent. A number of other countries have also attracted offshoring activity. These include South Africa, Malaysia and the Philippines, where financial institutions can find the necessary skill and work quality. These countries have large pools of young, educated, technologically competent and English-speaking workers. There are a large number of graduates with finance, accounting or management and information technology backgrounds, who are ideally suited to offshore work in the financial sector.

### Offshore financial centres

Scattered across the globe, a series of little places – islands and micro-states – have been transformed by exploiting niches in the circuits of fictitious capital. These places have set themselves up as offshore financial centres; as places where the circuits of fictitious capital meet the circuits of ‘furtive money’ in a murky concoction of risk and opportunity. Furtive money is ‘hot’ money that seeks to avoid regulatory attention and taxes.

The speculative nature of financial transactions and the desire to evade regulatory systems have led to the development of a number of offshore financial centres (OFCs). With few exceptions, the sole rationale for such centres is to operate outside the regulatory reach of national jurisdictions. They attract investors through their low tax levels and ‘light’ regulatory regimes. For example, although more than 500 banks are ‘located’ in the Cayman Islands – with more than $500 billion in their accounts – only around 70 of these actually have a physical presence there. The vast majority are no more than ‘a brass or plastic name plate in the lobby of another bank, as a folder in a filing cabinet or an entry in a computer system’. Similarly, there are roughly 300,000 companies registered in the Virgin Islands, although ‘only 9,000 of them show any signs of activity locally’.

Figure 12.11 shows the geographical distribution of offshore financial centres. Each tends to fill a specific niche which it exploits in competition with others centres in the same geographical cluster and with similar niche centres elsewhere in the world. Much of their growth occurred in the 1970s, in places that were already operating as tax havens, to act as banks’ ‘booking centres’ for their Eurocurrency transactions.

By operating offshore booking centres international banks could act free of reserve requirements and other regulations. Offshore branches could also be used as profit centres (from which profits may be repatriated at the most suitable moment for tax minimization) and as bases from which to serve the needs of multinational corporate clients.

The location of these offshore centres, and especially their geographical clustering, is partly determined by time zones and the need for 24-hour financial trading. There is now a concerted international drive to crack down on these offshore tax havens. Such action was initiated by the OECD but has been followed by
specific actions by the US, UK and other European governments. These initiatives reflect the fact that huge tax losses are being incurred as firms and individuals hide their profits offshore. A notable breakthrough was the ‘raid’ on German accounts held in Liechtenstein. It is not only developed countries that are affected by offshore tax havens. Oxfam estimated that developing countries are losing out on annual income of up to $124 billion because more than $6 trillion of developing country wealth is held in offshore accounts.56

NOTES

1 Martin (1999: 6, 11).
2 See Braithwaite and Drahos (2000) for a discussion of the history of money and its regulation.
3 Strange (1986: 1).
5 Dow (1999: 33).
7 Financial Times (18 March 2008).
8 Financial Times (16 March 1994).
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16 Martin (1999: 8, 9).
17 Financial Times (22 April 2009).
19 Financial Times (26 May 2000).
20 Jones (2005).
21 Financial Times (29 January 2010).
22 The Financial Times (9 September 2009).
24 This section is based primarily on Faulconbridge (2008) and Jones (2007). See also Beaverstock (2004).
27 Faulconbridge (2008: 504).
28 Faulconbridge (2008: 504).
31 This section is based upon Faulconbridge et al. (2008; 2009).
32 Faulconbridge et al. (2008: 214).
33 Faulconbridge et al. (2008: 222).
34 Faulconbridge et al. (2008: 226–7, 230). Numbers in parentheses refer to pages in this mark.
36 There is a large literature on world cities, notably Sassen (2001), Taylor (2004). See also the Globalization and World Cities Research Network (GaWC) based at Loughborough University, UK: www.lboro.ac.uk/gawc.
38 Thrift (1994). Quotations as from that mark.
41 Cassis (2006).
42 Lewis and Davis (1987).
44 Financial Times (8 February 2002).
45 Financial Times (22 September 2009).
46 Karremans and van der Knaap (2009).
48 The Financial Times (3 August 2005, emphasis added).
54 Financial Times (7 December 2001).
56 The Guardian (14 March 2009).