THE ROLE OF FINANCIAL INTERMEDIARIES
IN MERGER ACTIVITY

A thesis submitted for the degree of
doctor of Philosophy at the University
of Surrey

by

K.R. Harris

30th November 1977.
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SUMMARY

The objective of this thesis is to examine, through an analysis of mergers and acquisitions, the fundamental changes in the structure and operations of the U.K. financial system since 1966. The structural changes were greatly influenced by the external growth of banks and other financial institutions which featured a series of complementary and diversificatory acquisitions. These were undertaken for two major reasons. The first was to increase the capital bases of the institutions. The second was to diversify their product range and geographical spread. The extent of this merger activity was such that in 1973, the total expenditure on acquisitions by financial companies equalled that by all manufacturing companies. In this part of the study an emphasis is placed on the rapid expansion of the eurocurrency markets and the growth of the secondary banking system, and the effects that these had on official policy and the banks' competitive environment.

In addition to their instrumental role in causing change in financial markets, acquisitions have been both engineered and regulated from within the financial sector. Thus, the second part of the study centres on the role played by financial institutions as advisers and supervisors in the market for corporate control.

The final part of the study examines the period since 1973 in which the characteristic optimism of the previous years suddenly disappeared and the secondary banking sector almost totally collapsed. The analysis attempts to explain the origins and effects of the factors which beset financial institutions in the short period from 1973 to 1975 and their implications.
ACKNOWLEDGEMENTS

The writings of previous academic authors form a fairly small part of this work. I am indebted, however, to Peter Franklin, whose friendship and critical commentary have been invaluable. Much of the raw material came from meetings with executives of financial institutions. I owe a great debt of thanks to all of those who helped either by providing information or by commenting on drafts.

The preparation of the final typescript was done by Sheila Bridgenshaw whose hard work, especially on a long Sunday afternoon, was very much appreciated.

The final word of acknowledgement should be to my supervisor, Lutz Haber. His encouragement, help and faith were three of the most important factors in enabling me to complete the thesis.
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INTRODUCTION

In the last ten years merger activity in all sectors of the U.K. economy reached record levels. This prompted considerable research into the acquisition behaviour of manufacturing firms, and from the resulting stock of literature, our knowledge of the merger phenomenon has advanced enormously. With the exception of Franklin's interest in insurance and Channon's pre-occupation with banking, however, economists' attention has been focused exclusively on the non-financial sectors. Thus financial institutions have a limited place in the merger knowledge inherited from economics.

The objective of this research is to increase our knowledge of the role of financial intermediaries in merger activity. As an integral part of a wider study into the power of financial institutions, the study aims to examine the relationship of financial companies to merger activity in two respects. First, we wish to examine the incidence, influence, nature and consequences of acquisitions and mergers by financial companies over the period 1966-1973. Secondly, we wish to analyse the ways in which financial institutions, and especially merchant banks, can influence the behaviour of other industrial firms in the market for corporate control - the so-called merger market. If evidence can be offered on these and other similar questions it will substitute knowledge for what some may regard as an excess of supposition and will thus provide a new point of reference for merger discussions.

Studies concerned with merger and acquisition activity of firms frequently confront the problem of explaining its causes. Numerous approaches to an explanation are possible, each consistent with a different level of aggregation. Three basic approaches are usually distinguished: one is concerned with the causes of aggregate merger activity, particularly the periodicity and amplitude of acquisition cycles; a second with merger behaviour at the industry level; a third with individual firms'
acquisitions policies and decisions. As none of the approaches is mutually exclusive, and each is able to describe at least some of the macro- and micro-economic perspectives within which acquisition policies are formulated, there is no justification for abandoning fully any of the three approaches available.

Explanations derived from any of these empirical approaches, however, and from 'a priori' analyses of merger behaviour must be treated with some caution. For reasons developed below therefore, I have eschewed a conventional approach employing the traditional micro-economic tools of industrial analysis. Instead, in the first part of the research, which investigates the causes of the merger and acquisition behaviour of financial institutions, the aims are limited to identifying the major influences affecting decision-makers' growth objectives, the speed and direction of expansion and the method of growth. It is considered erroneous to intend to reach definitive conclusions about the causes of any group of mergers, or of any particular merger - even if objective observations and information about the rationale of decision-makers were made available. Accordingly, I am reluctant, at this stage, either to postulate and test causes of merger activity undertaken by financial institutions, or to infer generalised explanations of a particular group of mergers. Furthermore, because financial intermediaries operate in dynamic, volatile environments, in which institutional, official and competitive pressures are liable to frequent and unpredictable change, I feel reluctant to volunteer general reasons for the extensive merger activity undertaken by financial companies over the last decade.
Nonetheless, without attributing or imputing definitive causes for financial company acquisitions over the period, it is necessary to consider observations in a series of perspectives, referred to throughout under the head of "competitive environment". Under this general label the various pressures - institutional, official and competitive - which seem most likely to have affected the merger behaviour of financial companies are considered.

It is necessary first to explain in detail the reasons for adopting the approach explained above which examines merger behaviour largely independently of theoretical considerations. The justification stems from the empirical problems and theoretical issues which confronted the research. Had these been ignored and the analysis conducted on traditional lines, the findings would have been biased and, furthermore, based on naive assumptions.

The methodological problems, moreover, seem to be of more general importance and significance than to this study. They involve, in particular, fundamental issues regarding the meaning of 'industry' and 'market': that is they involve economists' understanding of those innate characteristics of 'industry' and 'market' which differentiate one group of firms from another and thereby enable consistent boundaries to be delineated for empirical and theoretical analyses to proceed. Accordingly, although these problems are identified here by reference to the study of acquisitions in the financial sector, they should not be considered unique to the financial service industries nor to this particular type of analysis occurring in industrial economics.

The rationale for a study of the incidence and magnitude of merger activity is to provide an indication of resulting changes in industrial and market structure and possibly of changes in the concentration and loci of economic power.
To satisfy these aims, however, a major methodological problem is confronted: that of classifying acquiring and victim firms in a meaningful and consistent manner. This is essential if observers are to begin to understand and quantify the changing nature of acquisitions made by financial companies at a higher level of aggregation than that of the individual firm.

In the event, the method adopted in this study was to extend the Bank of England's own, and sometimes inconsistent, method of classifying individual firms according to their "main activity". This approach does not, however, enable definitive conclusions to be drawn. Rather, it is fraught with substantial weaknesses. First, by forcing multi-product, multi-industry, multi-process firms into single industry/market categories, the method understates the extent of product and process diversification experienced by individual financial firms and hence by any particular sector. Secondly, it requires the imposition of an almost implicit and artificial assumption that 'main activity' can and should be estimated by turnover - a market-, or product-, based measure which may not, in fact, reflect the firm's main process activity. Thirdly, it ignores the possibility that the notion of turnover may have little meaning, or indeed cannot even be measured, when applied to financial multi-product firms. This compounds the difficult problem of analysing the products and output of financial companies. Fourthly, it tends to invalidate statements about structural change resulting from empirical observations of firms' mergers and acquisition activity.

These weaknesses cannot be immediately or easily resolved, for they are not merely problems arising from pigeon-holing multi-product firms into single industry/market categories. Rather they are symptoms, first of micro-economic theory's inability consistently to allocate products to particular markets or market segments, and secondly of the confusion and difficulty of distinguishing 'industry' and 'market'.
The first weakness is a specific failing of a much wider topic concerning the applicability of received theories of the firm. The second weakness stems from a reliance upon traditional definitions upon which received theories were based.

Thus, if a meaningful understanding of the extent of structural change consequent upon acquisition is to be formulated, much will depend on the criteria used to determine which firms to include in any given industrial or market group. The criteria themselves are dependent upon an understanding of those characteristics of industry and market which enable one group of firms to be distinguished from another.

Accordingly, in order that empirical studies become meaningful it is necessary to consider the meaning of industry. Indeed, it is the absence of such fundamental considerations which question the validity of those empirical studies which have concentrated on industrial structure. Since the structural approach to the explanation and prediction of firm behaviour and performance is not based on firm considerations regarding the meaning of industry, it can seldom provide more than a superficial understanding of the extent and direction of change over time.

Few economists have attempted to explore the economic meaning of industry. While two or three have tried to establish criteria to enable us to distinguish between behaviour concerning the 'market' from that concerning 'industry', fewer still have made the next step of considering those characteristics which classify firms to a particular industry.
One possible explanation for this failure is that the neat symmetry assumed by the marginalist theory of the firm rarely occurs in practice. The typical firm is multi-product and multi-process and hence belongs to more than one industry and sells in more than one market. The industry, as conventionally understood, produces a range of different products, all of which are not close substitutes, and uses different technical processes of production.

In these circumstances the definition of the boundaries of that industry cannot be uniquely identified. Regardless of any particular imputed definition adopted (such as that chosen by a government department, trade association or wages council), it is clear that the 'industry' will normally include firms that are selling products which are not always close substitutes to buyers and/or purchasers belonging to different geographical markets. In these two senses the 'industry' will frequently be more broadly defined than the 'market'. On the other hand, the opposite can occur. Production activities may be linked to different industries because they use a different raw material or technical process although their products may be close competitors in the same markets.11

The existence of major discrepancies between the conventional concept of the industry and the economist's concept of the market, led a number of economists to propose that the economic analysis of industrial behaviour should be undertaken in terms of markets rather than industries.12 However, the use of the market concept is also confronted with problems. In an economic environment characterised by widespread product differentiation where substitutability is viewed differently by different consumers, it is not self-evident where one market ends and another begins. Traditional micro-economic theory unfortunately gives only inadequate assistance to resolving this problem; the empirical tools which it provides can rarely be applied in practical analysis. The simple traditional theories of consumer behaviour, for example, which do not explore the role and nature of the characteristics of products, do not provide tools
which are empirically useful. Indeed, even if the techniques of own-price and cross-elasticity of demand were quite perfect and able to produce measures with unambiguous meanings, there are no guide-lines or defined threshold-levels of cross elasticity which identify boundaries between markets and market segments. Thus in the last analysis the limits of the market must, like those of the industry, be arbitrarily drawn. Furthermore, any degree of sophistication in the definition of the market has often to be largely sacrificed on account of lack of data at the empirical stage of the investigation since such statistical information as exists usually relates to the 'conventionally' defined industry.

Contemporary approaches to consumer behaviour are at present marginally more helpful to the problem. Whilst the 'characteristics approach' does have considerable virtues - particularly in dealing with those objective properties of goods which fulfil the underlying needs, drives and perceptions of consumers - it provides an incomplete, although potentially practical tool for the delimitation of market boundaries. The characteristics approach challenges acceptance of the traditional concept of 'product', upon which calculations of cross elasticity are supposed possible. Unfortunately, however, as Lancaster has pointed out, classical micro-economics has largely ignored the characteristics of products. Hence the practical application of theoretical concepts regarding products, markets and demand, appears seldom to have been questioned. As a result theoretical analyses tend to be in terms of abstract products and markets, and these have too easily become models affecting our understanding of real markets and products. By focusing attention on the perceived and real characteristics of products, which both distinguish them, and also invest them with attributes from which consumers derive utility, the theory of demand and concepts of market structure are considerably altered - that is, for example, market share,
concentration ratios and monopoly - and are made redundant, changed or became invalid. Clearly, in the absence of tools to define consistent market boundaries, the use of concentration ratios to infer market power must be questioned. It is similarly invalid to apply a traditional structural approach (based on interpretations of concentration ratios as indicators of the loci of economic power) to the analysis of mergers and acquisitions. By virtue of the diversified product range and market spread of financial institutions, and due to the volatile nature of their competitive environment, acquisitions undertaken by financial companies tend to involve changes in market power which cannot be easily measured or proxied by traditional micro-economic measures.

The reasons advanced above for treating the results of a market-orientated analysis with caution may be considered to be negative. These are, however, positive factors for using the industry concept for certain types of analysis. First, the fact that firms have bound themselves together in associations (for example, the Accepting Houses Committee or the Issuing Houses Association) or are regarded by others (including government departments and the Bank of England) as possessing an affinity of interest will usually mean that in certain respects at least they behave alike, react alike or are treated alike. In studies of collusive behaviour, of innovatory activity and of response to changes in firms' operating environment it may be that the use of an industry concept, based on an institutional or statutory reality, is more helpful than a 'market' definition. Secondly, given the prevalence of the multi-product firm and the widespread practice of business growth through diversification, the concept of the single product market will be too narrow to be useful for anything but short-run static analysis. This phenomenon, especially as it relates to potential competition, as for example from foreign banks entering international financial markets in London, is better handled using a broader concept of industry. Even this however is not sufficient to analyse the conglomerate which has interests in a number of disparate industries.
The growth of the multi-product firm has arguably been the most important feature of recent industrial development. The problems which this form of organisation poses for theoretical analyses of industrial structure have already been mentioned. The proliferation of conglomerate or diversified firms also figures in the problem of defining both 'industry' and 'market' boundaries and indeed in distinguishing between the two concepts. If conglomerates are viewed from the standpoint of the organisation of industry, then it may be observed that industrial interdependence, once effected through the market-place or by overt co-ordination of independent decision-making units, has been replaced by an interdependence exercised within individual firms. This trend, which is particularly pronounced in the financial sector, reflects the desire of firms, and their actual and potential competitors, to acquire knowledge and to extend technical and marketing skills.

This conclusion leads to a particularly confusing problem in the analysis of financial companies' acquisition behaviour. That is whilst it is possible to think in terms of markets with strictly defined boundaries (such as that for trade financing by members of the Accepting Houses Committee, or that for motor underwriting or underwriting fire insurance)\(^{17}\), it is much less easy to be sure whether to consider a single banking or a single general insurance industry. On the one hand, common skills should undoubtedly be applied in lending money or raising finance, or underwriting risks. On the other, however, the industries may be considered as segmented; these segment boundaries being determined by the existence of unique knowledge and experience which are neither transferable nor common to different industry segments.
The operation of the theory developed by Andrews relies considerably on whether these skills, expertise, knowledge and experiences which firms' managements possess can be identified. If satisfactory tools are not available and different investigators choose different populations of firms for their analysis of a "given" industry, then their empirical results are likely to be different, and argument as to their comparative validity, irrelevant.

Penrose stresses that skills and knowledge are neither possessed nor acquired by firms per se. They are instead immured within individual decision-makers and the various coalitions of which they form part. Moreover, the acquisition of knowledge and the extension of skills is a continuing process. At a given time a firm's product range and processes are determined by which of the skills and knowledge available within a firm are being severally exploited. Thus, as Penrose makes clear, the firm is likely to move into and acquire technologies and markets to which it was originally quite alien. The implications are that industry boundaries can be continuously receding such that the number of industries in which any firm is a member is always tending to increase. At the same time, the market may not change in nature, unless the skills necessary to participate themselves change.

This leaves then multi-industry, multi-product, multi-process firms competing in an environment in which, as skills are continuously acquired by different firms, industry boundaries are breaking down, becoming more apparent than real; matters of discretion for both the academic empiricist and for the manager who needs to identify his potential competitors.
The conclusion of this brief critique of industrial economics supports that of the earlier discussion of market analysis. Not only are we without tools to identify and measure skills and knowledge possessed and acquired by decision-makers - the so-called 'innate characteristics' of an industry - but analysis is greatly hindered by continual change of 'given' industries. The activities and markets of banks and insurers, for example, are increasingly becoming coincident and the skills of the latter, the property of the former. In the absence of artificial officially-created and - maintained market boundaries, what process and product boundaries that still exist seem likely to crumble.

The normative conclusions are to question the validity of empirical analyses based on traditional methods or on received micro-economic theories. A particular doubt which arises is in respect of that approach to analysis which chooses the structure of industry as its focus - presuming industrial structure to be the predominant or determinate influence in firms' conduct and performance. Criticisms of the paradigm of industrial economics have been developed elsewhere; in the preceding pages I have attempted to question whether the structural focus of much of the theoretical and empirical economic analysis of industry is acceptable, and to justify my particular approach to analysis of the merger activity of financial companies.

To summarise, the inherited stock of theoretical knowledge on merger and competition does not provide economists with consistent analytical techniques. The static frameworks of received theories of the firm were designed primarily to handle the determination of price and output of individual products. They are not well-equipped, however, to cope with firms which have a wide range of differentiated products, or with the acquisition and diversification strategies of oligopolistic competitors in a changing and uncertain world. The problem posed for empiricists is compounded by the difficulty of distinguishing between 'industry' and 'market' and the resultant concentration by a majority of economists
As a result, empirical studies of the relationship of mergers and the theory of the firm are often inconclusive and contradictory. Therefore, it was considered expedient, particularly in view of the unique mixture of interdependent markets and inter-firm relationships in the financial system, and the mixture of official and private control exercised in the financial service industries, not to adopt a traditional approach.

The scope of the research has meant approaching different parts of the study in different ways. In examining the frequency of financial sector merger activity and in considering some of the causes and consequences of financial companies' acquisitions, it is necessary first to adopt a highly aggregative and essentially statistical approach. The task is complicated, however, because the forces which have induced financial intermediaries to become more integrated and/or more diversified have changed over the period. In so far as these pressures are likely to influence the nature of financial company acquisitions, the statistical analyses must recognise changes in the institutions' competitive environments. To achieve this, another approach is required. This relies upon information obtained from interviews with officers of financial institutions as well as from published sources, and details of effects of events upon the strength and extent of the inter-dependencies between financial intermediaries. Emphasis is placed on the impact of Competition and Credit Control, the growth of the eurocurrency markets, the entry of foreign banks into London and the change in attitude of the Bank of England, all of which radically altered the conditions in the financial system. They increased competition and encouraged co-operation, acquisitions and mergers. A behavioural approach is also adopted to analyse the role of financial companies in the corporate merger market and to evaluate the consequences of financial sector merger activity on domestic and international financial markets.
The breadth of the subject has necessitated some specialisation and therefore some omissions which are explained in the relevant chapters. It must be recognised that analyses of the financial service industries are likely to become quickly 'out-of-date' as contemporary events overtake recent history. Nevertheless a serious analysis must be undertaken within fixed time boundaries; the choice of a terminal date was dictated by two factors. The first was practical, for when I started, 1973 was the last complete year for which comprehensive data was available; the second reason stems from the simultaneity of events in 1974 and the severity of their implications for the competitive environments of financial institutions. The abrupt end to the optimism which had been so apparent in previous years created an effective chronological watershed.

The markets which are singled out for attention in the study are those in which banking institutions, especially wholesale banks, compete. These cover a wide spectrum extending across the financial system and into such non-financial markets as corporate control. Banks have not only dominated the merger activity within the financial sector but have also played a pre-eminent role in the 'engineering' and 'regulation' of acquisitions in the corporate sector. The dissertation is divided into four parts. Part One consists of two chapters. The first provides the legislative background to the specific issues raised throughout the text by tracing the development of monopoly policy in the U.K. and analysing the current approach to the public control of mergers. In addition, some of the methodological problems connected with applying legislation to financial companies are noted. Chapter Two, comprises a detailed statistical analysis of the aggregate acquisition activity of financial institutions. It clearly shows the increase in financial sector merger activity in 1966-1973 as an important phenomenon and one which merits more detailed investigation.
Part Two represents the bulk of the study and develops the theme that the primary rationale for mergers and acquisitions in the financial sector stems from changes in the competitive environments within which financial companies operate. Chapters Three and Four concentrate on domestic pressures and examine the acquisition behaviour of banks, insurance companies and investment companies, distinguishing between firms which market similar and different products within the same industry and across industrial boundaries. In Chapter Four the importance of the financial multi-product firm is assessed and the incidence and causes of merger activity in the stock broking industry are analysed. Chapter Five concentrates on the geographical expansion of U.K. banks and the internationalisation of banking business - the growth of the euromarkets, the migration of foreign banks, participations in consortia and syndicates, and other forms of quasi and full merger activity.

Part Three, consisting of two chapters, begins with a digression which examines the behaviour and influence of financial companies in the mechanics of takeover bids. It is justified by the importance of financial institutions in, first, arranging and negotiating acquisitions, and secondly, in attempting to control behaviour in the merger market. In Chapter Six, the influence of the merchant banks and City public relations consultants is examined with reference to particular examples. In Chapter Seven, the focus is on regulation. Thus the role of financial companies in the design of the Takeover Code and its execution is discussed; finally, the philosophy of the City's form of self-government is examined and its relationship with the legislation to control merger activity is assessed. It is not considered necessary to restrict the analysis in Part Three to the period 1966-73 and it is updated wherever it is appropriate and useful.
Part Four contains the eighth and final chapter, the purpose of which is to summarise the main findings of the dissertation, to analyse the current situation and the changes since 1973, and to examine possible solutions to the problems which have arisen.
NOTES AND REFERENCES


5. There has been a tendency for 'a priori' explanations to infer a unicausal explanation of merger activity. See J.W. Markham, "Survey of the Evidence and Findings on Mergers", in G.J. Stigler (ed), Business Concentration and Price Policy, (Princeton University Press, 1955)


7. It should be noted that aggregate analyses of mergers tend implicitly to assume that an acquisition, whilst it inevitably entails a change in control, is always accompanied by a loss of the victim firm's decision-making autonomy. This assumption is by no means borne out in practice; nor does it have regard to the effects of time on the process of a shift in control or to the problems of integrating an acquired unit.


11. The foregoing remarks do not take account of the difficulties of defining and measuring the 'output' of financial companies noted earlier.


16. See K.R. Harris, "The Merger Activity of Financial Intermediaries: The Banking Institutions", *Economic Notes*, Monte dei Paschi di Siena, 1975. In West Germany, the cartel office has recently become interested in identifying and measuring the "financial power" of acquiring companies: see The Times, "Europa", October, 1976- "Big Mergers Face a Testing Time". G.J. Stigler also addressed himself to the measurement of monopoly power, but he was perplexed by what he himself described as the "inconclusive conclusions" to which he was led. Nevertheless he thought that the problem would repay further study - "To the theorist it offers a stimulating challenge: the merger movement does not fit too well into the received categories of stable competition and irresistible monopoly. To the student of social policy it offers the promising hypothesis: it is possible to change the trend of industrial organization by the lackadaisical enforcement of an antitrust law. And to the student of social sciences it offers the supremely optimistic - and pessimistic - suggestion: when economists agree that a movement is inevitable, it is not."


17. Such distinctions can be made in financial service industries because of government intervention/control and because of the unique nature of products offered.

19. Edith Penrose, op. cit., chapters III and IV


INSTITUTIONAL BACKGROUND

The purpose of this brief section is to give a resume of the nature of the competitive environment in banking, and other credit markets in the period leading up to the spate of mergers and acquisitions at the end of the 1960s. The aim is to indicate how the changing climate in which financial institutions were operating provided the motivation to combine. This analysis is concerned with several markets which are segments of the aggregate market for credit, both domestic and international, located in the U.K.

An appreciation of the relevant features requires initially an analysis of the prevailing institutional arrangements in the banking sector in the context of the objectives assigned to monetary policy, and the techniques of control adopted by policy makers. Comment on the competitive behaviour of the institutions can only be offered after an understanding of prevailing market conditions is secured.

The analysis focuses in the first place upon the clearing banks and examines the pressures in their traditional, domestic markets, which encouraged amalgamation and diversification. We then assess the factors which led to the growth of the so-called secondary banking system which arose alongside the main banking system of the clearing banks. It is appropriate in this context to examine the rapid increase in the number of "near banks" which competed for deposits with the clearing banks' subsidiaries. The scope of this section also covers the diversification of traditional finance houses and the influx of U.S. banks. These developments were all assisted by, indeed dependent upon, the growth of parallel money markets - both Sterling and Eurocurrency, and in particular, Eurodollars.
In its report on "Bank Charges", the Prices and Incomes Board (PIB) denoted two main functions performed by the banks among their various activities. The clearing or deposit banks are predominant in the first of these functions - the operation of the country's main payments system. Indeed, this role has dominated their behaviour. The second main function of banks is to act as financial intermediaries between borrowers and lenders. This function assumed a subordinate position in the deposit banks' priorities however.

The competition faced by the deposit banks in the performance of these duties was, as indicated by the PIB, quite different. Despite the existence of alternative means of making payments, as far as the transmission of money was concerned, the deposit banks dominated such institutional competitors as the Post Office Savings Bank (although the Post Office Giro had not then been introduced). In their role as intermediaries, however, the deposit banks were increasingly facing competition from other institutions, which offered liabilities that were close substitutes of bank deposits and yet paid a comparatively high interest rate.

It is appropriate first to examine inter-clearing bank competition. In fact, competition between the clearers was inhibited by a number of conventions and agreements, and by the oligopolistic structure of their main operating market which had not changed significantly since the Colwyn Committee report of 1918. In particular they had agreed upon the rates of interest offered on interest-bearing deposits and the general level of interest payable on advances. They offered only two main types of deposit - current accounts which bore no interest, used by customers drawing cheques as the principal means of payment, and deposit accounts which were interest bearing and withdrawable on 7 days' notice. Because their liabilities were short term, the banks preferred to make advances in the form of self-liquidating overdrafts, although in practice some of their assets were represented
by fixed term loans and moreover, their overdraft facilities were often continuous.

As regard time deposits, a cartel existed between the deposit banks which limited the rate of interest paid to investors to 2% below Bank Rate. This agreement was characteristic of the oligopoly enjoyed by the deposit banks. In market structures where the number of competitors is small, it is usual to find a restriction on open "price" competition, and an emphasis on competition through service and innovation. This indeed was the case as will be indicated later. The decision not to bid competitively on rates, both with each other and other financial intermediaries, is attributable to the notion that the result of such competition would be the raising of costs for all banks while not necessarily substantially improving the position of one bank, vis-a-vis another.

With respect to deposit banks' assets, as noted, loans were normally on an overdraft basis and although nominally recallable on demand, tended to become "long-term" through a process of renewal. There were four main categories of borrowers under the arrangements that the banks agreed in 1951-52, on the revival of the monetary policy: nationalised industries at Bank Rate; "blue chip" companies at "ICI terms" of 1% over Bank Rate; other commercial borrowers at 1% above Bank Rate; and personal and small business borrowers paying 1-1½% above Bank Rate.

During 1964-65, borrowers were re-classified into five groups. The first two existing groups were retained; the third and fourth were amalgamated; a new group was formed comprising hire-purchase finance houses; and a fifth covering special arrangements for export credits was created. This last class encompassed two types of lending: short-term up to two years, at Bank Rate with a minimum of 4½%; and longer terms at a fixed rate of 5½%. The latter was chosen by the banks in 1962 under persuasion from the Bank of England, as a reasonable
average of expected future rates; in 1976, the arrangement was extended to domestic orders for shipbuilding.

Apart from any innate tendency towards cartelisation, the acquiescence of deposit banks in restraint of competition can be explained as a function of official attitudes towards the banking system and in particular its role in the operation of monetary policy. First, there was long hostility to modification of the traditional compartmentalisation of financial activity. There was also official preoccupation with financing the public sector and repeated credit restraint on the private sector which restricted the volume and character and profitability of banks' assets. It oriented them towards a higher ratio of public sector to private sector debt than they might otherwise have preferred; and official concern for a stable Treasury bill rate underpinned the relative inflexibility of banks' lending rates.

The specialisation mentioned above (as will be seen later) is particularly explicable by the pattern of monetary regulation to which the deposit banks were singularly subjected. The practices of the banks themselves were used by the monetary authorities as a basis for control. For example, the cash held at the Bank of England to settle inter-clearing bank accounts and the need to maintain a proportion of assets in a liquid form in order to be able to meet obligations to depositors. The deposit banks were actually required to hold 20% of total deposits in the form of specified liquid assets (bills, call money and refinanceable export credits) and a further 8% in the form of cash (in their tills and at the Bank of England). These minimum ratio requirements were supplemented by special deposits which were first introduced in 1960. In addition to these
quantitative restraints, control of bank lending also took the qualitative
form of a 'package' of official measures whenever the authorities
felt restrictive action was necessary. Selective controls over
bank lending operated for more than one-half of the ten years
1959-1969 and, save for a short period in 1967, quantitative
restraints on lending were continuously in force from the end of
1964.

Official guidance followed a common pattern with advances
related to home consumption, hire-purchase companies, property
development and other speculative transactions marked out for special
restraint. Selective controls, which involved some measure of restraint
on total lending, were reinforced to a much greater extent after
1965 by expressly indicated quantitative controls. These took the
form of an indicated ceiling for bank lending within which the total
was to be constrained, and earned the description by the Radcliffe
Committee of "the most drastic form of control of bank advances"
(paragraph 527).

Further indications of the inextricable link between
deposit bank behaviour and the conduct of monetary policy also exists.
The banks' own agreements about the rates of interest they asked on
"call" money (most of which was lent to the Discount Market) and
on advances, and the rates offered on deposits - all of which bore a
fixed relationship with Bank Rate, were, for example, features
around which monetary policy was built. Similarly, the fact that
the banks agreed not to tender on Treasury Bills in their own right
was a feature which necessarily conditioned the conduct of monetary policy.
The conclusion that is drawn from the nature of these arrangements (which implicitly assumes that the banking mechanism was the chosen instrument of monetary control) is that it is hardly surprising that the deposit banks did not compete for deposits while their advances remained subject to direct controls. Indeed it could be argued that while the banks were asked to operate under a system of tight credit control which restricted their ability to compete in lending, it would have been improbable that they could have made significant use of the opportunities for greater competition that abolition of the cartel would theoretically have provided.

A number of other aspects of the competitive environment in deposit banking markets must also be mentioned. In the absence of direct price competition, the deposit banks sought to compete vigorously through the opening of new branches, advertising and the provision of services. This was an expensive form of competition and probably an inefficient way of transmitting pressure from the more to the less efficient banks: rising interest rates, in the context of the cartel automatically provided rising revenues which helped banks to absorb higher costs, whilst maintaining satisfactory profits (true profits were not disclosed anyway).

In the competitive environment in which the banks operated, however, their management of their branch networks was probably rational. The costs of extending branch networks were considerable nevertheless and should be examined in the following perspectives. First, in the competitive environment described above, the unrestricted competitive expansion of business could only be attempted by the extension of branches. The result was the imposition of costs upon one another through the duplication of branches. Secondly, profit margins were threatened further, at the same time, by the upward movement of other operating costs, notably labour, and the heavy investment in data processing equipment. As an illustration,
expenditure on premises more than doubled in the period 1961-1965 to more than £33 million; in the same period, the number of branches in the London clearing banks' network expanded by 9% - at a faster rate than the growth of the population. By the end of 1967, the clearing banks had nearly 14,000 branches; at the end of 1945 this figure was 9,600. In those five years, the total cost of data processing equipment increased by 40% and in the seven years ended 1967, approximately £35-40 million was invested in automation equipment and computers. This investment was partly to provide the hardware to speed up and expand services to meet the competitive challenge posed by the National Giro which began business in late 1968. It was also undertaken as a means of reducing staff costs which accounted for 70% of the banks' operating costs. In aggregate, total costs rose by 42% in the case of London clearing banks between 1961 and 1965. As the PIB pointed out "there is no unique indicator of output against which to set these increases" (paragraph 135), but it should be noted that inflation, combined with the growth of the banks' industrial customers (there was considerable industrial merger activity during the 1960s), had led to an increase in the value of advances of 39% between 1961-1965.

To summarise then, the period preceding the inter-clearing bank mergers was characterised by steeply-rising costs, official restrictions on lending and an agreement on interest rates paid to depositors. The clearing banks competed with each other only in non-price variables, particularly in the provision of services as evidenced by the growth of branch networks. It should be remembered in addition that, the banks' adherence to the recommendations of the Colvyn Committee (1918), had effectively prevented the reduction of the number of the large independent clearing banks. Thus pressures towards combination, such as the need to increase resources to cater for expanding industrial groupings, the need to eliminate overlapping
branch representation and the need to spread and share the high costs of computer installation, were suppressed.

During the 1960s moreover, a further development adversely affected the clearing banks and cast doubts as to their predominance. This development may be considered under the head of the "secondary banking system" which grew alongside the main banking system to such an extent that, by 1969 Britain had two banking systems, each with its own money market. The growth was visible in the tremendous expansion of secondary banks' deposits; in 1963 their total deposits were under 40% of those of deposit banks whereas by 1970, their total deposits were 2.2 times those of deposit banks. While deposit banks' deposits increased by 28% to £12,451 million from 1963-1970, those of secondary banks grew by 637% to reach £27,526 million.

There were and are various types of secondary banks, comprising this secondary system each conducting a variety of business activities. Four main classes may be distinguished however: U.K. banks, British overseas banks, consortium banks and foreign banks. They ranged in type from the traditional accepting houses and British banks, to new breeds of financial institutions which were also referred to as merchant banks, to the branches of U.S. banks, to the subsidiaries of deposit banks. These banks had in common a fewness of branches (and thus did not compete in operating the payments mechanism) and concentrated on the financial intermediary role of banking. Both their deposits and advances were typically of fixed maturity ("term deposits" and "term loans") and quite often of several years' tenor. The balance sheets of the secondary banks typically comprised a small number of large accounts, a large proportion of which was denominated in foreign currencies. Their operations may be described as being of a "wholesale" nature.
This new banking system consisted, therefore, partly of banks which had existed for many years and which continued to perform their traditional functions, and partly of newly-founded banks. These banks were welded into this separate banking system by certain new types of business and by the growth of "parallel" money markets. The most expansionary of these - the international money market, which principally comprises dollar-denominated deposits - is discussed later. First, however, domestic factors are considered.

A period of innovation and change in financial markets commenced early in the 1950s. Several developments in the ensuing ten years or so provided greatly increased scope for the secondary banks: apart from the growth of the eurocurrency markets, there was the ending of the policy of "cheap money" and a rise in interest rates, local authority borrowing was substantially diverted into market channels and a market sprang up in short term borrowing by finance houses. The clearing banks were inhibited from taking a full share of the new business of these parallel money markets and consequently lost ground, as a group, in the face of keen and successful competition from both domestic and foreign institutions. Not only were they subject to repeated official requests for restraint and selectivity in their lending policies but they were hampered by the official requirement that they maintain fixed cash and liquidity ratios. These had the effect of limiting the earning capacity of the deposit banks and thus their ability to compete directly for high-cost deposits, whether in sterling or in foreign currencies. The deposit banks' solution was to operate in these markets through separate, specialist subsidiaries or associates which bid competitively for fixed term deposits at short and medium-term in substantial amounts, and to engage in the sort of fixed term lending which is the conventional counterpart of such borrowing.
The deposit banks' subsidiaries which engaged in 'money market' or 'wholesale' banking and 'near banking' were involved in three main lines of activity, hire purchase finance, international banking (the placing and taking of funds in the parallel markets such as the inter-bank market) and merchant banking (including advancing medium-term funds). The origin of the subsidiaries operating in the secondary banking system in 1964 and 1965 were of three distinct types: several were adapted retail foreign banking subsidiaries, others were small deposit banking subsidiaries which were turned towards secondary banking and the remainder were specially formed for the purpose, often in association with overseas banks or with accepting houses.

The deposit banks' interests in the provision of instalment credit stemmed from 1958 when a number of the deposit banks acquired equity interests in hire purchase finance houses. Barclays acquired 25% of United Dominions Trust; National Provincial and Midland bought 100% control of North Central Wagon and Forward Trust respectively; Martins and Westminster each took 20% of Mercantile Credit; and Lloyds 25% in Bowmaker. Their reasons then were probably only remotely associated with the need to provide their own customers with an additional type of service. The major impetus was provided by the desire to 'buy' into a business, hire purchase, at a time when freed from official restraints it was growing rapidly. The hire purchase companies for a time escaped the restrictions suffered by the banks and they were making substantial profits partly with the support of bank finance.
The banks insisted on keeping their finance house subsidiaries and associates separate from the main stream of their banking activities. The reasons put forward for the separation were as follows: first, the instalment credit business was a specialised activity requiring personnel with different training and qualities. Secondly, there was a notable difference in rates charged on hire purchase transactions and bank loans generally. This rate differential, with bank credit as much as 3-4% lower than hire purchase rates, would have caused problems to bank managers receiving requests from bank customers wanting instalment credit. Third, lending ceilings were imposed more heavily on the hire purchase industry. Thus there were fears that the degree of flexibility allowed to banks in their advances may have been curtailed if the only way of curtailing instalment credit given directly by the banks had been to make the curbs on their lending more specific and less flexible.

The squeeze on hire purchase had been more intensive for a number of reasons. In the first place, downpayments were increased and repayment periods shortened while, also, the companies' borrowings were limited. Secondly, it was difficult for finance houses to segregate from amongst their facilities those which were especially designed for, say, the finance of exports which would not therefore have been subject to restriction.

Beginning in the early 1960s, the finance houses initiated a considerable transformation which had far-reaching implications for the institutions themselves and their relationships with the clearing banks. Their business had traditionally been introduced through their dealer connections and associated with the finance of durable goods purchases - particularly motor cars - on the basis of a contract which ensured that at all times the outstanding debt was exceeded by the residual value of the goods. The combination of periodic recession in the motor trade, forcing the houses to look
more seriously at industrial businesses, and the 1965 Hire Purchase Act, which reduced the value of the security offered by a hire purchase contract, brought a steady development of the business being carried out.

Probably the most important factor initiating far-reaching changes in instalment credit markets came in the early 1960s in the form of official measures aimed at restricting consumer credit. This followed a boom in the provision of consumer durable finance during the late 1950s: from 1958 to 1960, hire-purchase debt practically doubled from £480 millions to £950 millions. The introduction of term controls in 1960, the subsequent period of losses experienced by finance houses and 'ceiling' restrictions added to the desire to diversify out of the cyclical motor hire purchase business encouraged the finance houses to expand their business activities. At first, most of the houses developed new activities closely related to their original areas of expertise; leasing, for example, and personal loans (which only differed from H.P. in that they afforded no security in the goods acquired).

With the ability, after the 1967 Companies Act, to gain Section 123 exemption from the Moneylenders Acts the trend became firmly established towards the use of the personal loan rather than the hire purchase contract.

The extent of this development is exemplified by UDT. As the largest finance house gained an increasing share of its profits from UK banking and lending activities. By 1972 this proportion reached 41%.
Generally, their diversification led the finance companies into more profitable areas, so that when 'ceiling' controls were exerted over the whole range of their sterling lending, they were able to divert funds into their newer operations. By this means, and by entering activities such as second mortgages which fell outside the scope of official controls, they were able to off-set the adverse effect which stagnating instalment business would normally have upon profits in a period of rising interest rates, such as 1966-1969. In 1967, for instance, finance houses were subject to a 105% ceiling on their lending and by a double package of curbs on the hire purchase business they were underwriting, consisting of a 40% downpayment and a comparatively short repayment period of two years for the balance. Nevertheless, over the bulk of their instalment lending, they were able to achieve no real growth in the latter part of the decade while a vast number of uncontrolled companies were able to take a large part of their potential business.

In their moves towards the provision of a comprehensive banking service (UDT's efforts were emulated by Mercantile Credit, FNFC and Hodge, as well) the finance houses met competition from the clearing banks whose traditional approach to the lending business was undergoing a transformation. Use of the personal loan was being extended for example; and the banks were developing their subsidiaries in medium-term credit markets. Thus, these two types of institution were competing directly for funds with the banks increasingly reliant on raising money in the 'wholesale' money markets which were also providing the source of much of the finance house resources. Indeed, in a period in which total bank advances doubled, loans from banks to hire purchase companies from 1960-1967 declined from £137 million to £114 millions, reflecting the restrictions on bank lending. For the finance houses, the main feature of the change
in their business, culminating in the acquisition of banking status, was the substantial development of the parallel money markets.

The subsidiaries of the clearing banks created specifically for the purpose of partaking of 'wholesale' banking business were a significant force in the parallel markets. As noted, they were formed, since 1964 and 1965, to compete with accepting houses, British overseas banks and foreign banks in the market for large, 'term' deposits and loans. Separate subsidiaries were necessary for this purpose because the clearing banks themselves were subject to obligatory cash and liquid asset ratios and were thus required to hold high proportions of liquid assets. This meant the business was unprofitable for them for money market deposits are more expensive to attract than 'retail' deposits and must therefore be employed as assets which earn a higher yield than deposit bank assets.

The subsidiaries which, with no other areas of business activity, were pure secondary banks became a very important force in the wholesale markets. By 1970, their deposits were exceeded only by those of the U.S. banks. They were formed, however, during the period in which quantitative limits on bank lending in sterling were imposed on all banks. Thus, although the subsidiaries could attract deposits, their ability to make profitable, sterling-denominated loans was severely restricted. Instead, a large part, indicated by Revell to be nearly two-thirds of their total assets, were employed in the parallel money markets. These markets have been noted for providing assets and liabilities of a much wider range of maturity than those of the discount market and with a higher level of yields.
Although the maturity of some of these parallel market assets is as much as several months, they yielded far more than Treasury Bills, commercial bills or money at call (traditional instruments in the discount market). They also have the advantage that they all appear fairly liquid when listed in balance sheets. Secondary banks have depended to a very great extent on the parallel markets, and the inter-bank market in particular, for much of their liquidity.

The remainder of this section concentrates on these markets and in so-doing examines the growth of the so-called 'fringe' banks and U.S. banks. These markets started first with the demand from local authorities for deposits with maturity of less than one year and extended to cover a similar demand from finance houses. As a result of a change of Government-policy (preventing Local Authorities (LA) the freedom to borrow at will from the Public Works Loan Board or the market) and historically high interest rates in 1955, L.A. treasurers began to raise funds in the form of short-term deposits. An impetus to the growth of this market came from finance houses, anxious to fund a boom in instalment credit yet unable to borrow from banks (Government restrictions were imposed on bank credits to finance houses after 1947). The alternative source of funds came in the form of deposits, initially from the public and then through the parallel market as it developed. They were able to attract deposits by offering comparatively high interest rates which appealed to secondary banks who themselves were borrowing in the market to on-lend.
It is important to mention, at this stage, a particular part of the 'inter-corporation' money market. This has been referred to by Revell as a 'grey' market in loans for companies unable to raise finance from their normal banking sources. In fact, like so many of the developments mentioned above, the inter-corporation market grew because of the Government-imposed credit squeeze and the resultant lending ceilings and other (qualitative) restrictive measures. These controls provided a major stimulus to the growth of institutions prepared to attract deposits by offering high interest rates in order to finance loans to sectors of industry which the banks were constrained from doing. Quite often the institutions in question, so-called 'fringe banks' were the creation of individual entrepreneurs such as Gerald Caplan (London and County Securities), 'Pat' Matthews (FNFC) and Alexander Stone (British Bank of Commerce). Characteristic of the 'fringe banks' was their growth in a few years benefiting from the distortions in the competitive environment created by the long period of physical controls on 'mainstream' lending. The emergent institutions had developed over the 1960s to the point whereby they had acquired the Board of Trade exemption for banks.

This exemption is indeed important. It stemmed initially from a court case in 1966 in which UDT sued Kirkwood for the repayment of debt. In this case, a decision was finally given in favour of the plaintiff in the Court of Appeal. The challenge that UDT had to meet was the charge that as unlicensed moneylenders they were not entitled to recover the debt owed them by the defendant. Their answer was that the Moneylenders Act exempts from the licensing requirement 'any person bona fide carrying on the business of banking', and UDT claimed to be bankers. Although UDT won the case, it was made clear by the Appeal Judges that it would not be safe to rely on the decision as a precedent. To meet the need disclosed in this case, Section 123
of the 1967 Companies Act made provision for the issue by the Board of Trade for the issue of certificates to approved applicants for Moncylenders Act exemption.

The 'fringe banks' had built up, through personal and professional connections, a deposit base and their clientele generated growth in this also. Whilst there was an accent on 'banking' during their early growth, several of the 'fringe banks' also took equity participations in industrial companies. In both respects, these institutions were characterised by a specialisation in property. Small builders and property developers were amongst the worst sufferers from the physical lending controls on 'mainstream' banking. The new banks responded to their need and, in an age of inflation, believed that freehold land was the most desirable ultimate form of security. Equity stakes followed lending at high interest rates; Dalton Barton had an association with Matlodge, a property dealing and development company; London and County Securities had a similar interest through Consolidated Securities. Some further aspects of the banks' activities were also property-related: second mortgages for example, in which Cedar Holdings specialised, and in which FNFC and Hodge also participated. It was not until some years later that the inextricable link between the property boom and the fortunes of these and some other secondary system banks was fully realised.

The final part of this section concentrates on the very rapid expansion of the international money market - that in which deposits and loans were made in eurocurrencies, and especially in eurodollars. In this connection we will also examine the growth of U.S. banking presence in London and the rationale for their participation in the eurodollar money market. The influx of US banks was one of the major events of the 1960s. By 1970 their UK branches accounted for 61% of the deposits of all overseas branches of US banks.
They became by far the biggest operators in the London eurodollar market, having by 1970 just over 50% of all liabilities in non-sterling currencies of banks in the U.K.

The growth of the US banks is examined in Chapter Four. Suffice it here to summarise the main factors in this expansion in the context of the eurocurrency system.

The major motivation of the US commercial banks in their aggressive exploitation of the eurodollar market was the need to seek eurodollar balances for lending to head office because of the tight monetary conditions in the US in 1966 and 1969. The peak of such lending was in 1969 when dollar balances with US offices of the parent bank reached 47% of total assets.

The origin of these dollar deposits which are held outside the US is popularly associated with the historic tendency of the US to run large annual balance of payments deficits leading to the accumulation of dollars in Europe. Such deficits do in the first instance provide European exporters with dollar claims on US banks. Although a necessary condition, it was the willingness of banks in Europe to pay higher interest rates on dollar deposits than those obtainable in the closely-regulated US financial markets which was a major factor contributing to the growth of eurodollar liabilities.

With the concept of dollar financing so readily accepted by borrowers outside the US and the rapid growth of demand for such finance during the early 1960s, the growth of the eurodollar market was consequent upon major international holders of dollars placing their deposits where the return was highest. During 1960 and 1961, the interest-rate paid on 3-month bank deposits in the US averaged 2.5% per annum, whereas that paid on eurodollar deposits fluctuated between 3.5% and 4.0% per annum. The principal reason for this difference was the existence of Regulation Q imposed by the Federal
Reserve Board to limit the interest rates that commercial banks could pay on deposits.

As the market matured, US banks became able to fund their head offices at times when domestic credit was not freely available. This was evident after 1965 when the escalating US involvement in Vietnam had the effect of causing domestic interest rates to rise steeply and of creating a drain on the banks' domestic deposit base on which interest payments were restricted (under Regulation Q) to below prevailing market rates.

The attraction to US banks, of developing a foreign branch network, apart from being able freely to obtain dollar deposits at market interest rates, were that no reserves were required to be held against borrowings from their foreign branches and that interest could be paid on deposits of less than 30 days (forbidden domestically by Regulation Q) so enabling the banks further to broaden their business base.

The presence of US banks in London and the growth of the eurocurrency markets provided both greater potential competition to UK deposit and secondary banks and wider opportunities for expansion. These developments stimulated the concept of consortium banking for example, in which the UK clearing and merchant banks participated. It also led to the strengthening of the clearers' wholly-owned subsidiaries, such as International Westminster and Barclays International.
It is appropriate to close this section which has detailed a period of despecialisation and of immense change in the competitive environment of banking markets, with a table showing the growth of UK bank deposits from 1963-1970. The summary contained therein should prove a helpful guide of reference for the remainder of this thesis.

Growth of U.K. bank deposits by type of bank, 1963-70

<table>
<thead>
<tr>
<th>Deposit banks</th>
<th>£ million</th>
<th>Ratio 1970/1963</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1963</td>
<td>1967</td>
</tr>
<tr>
<td>London clearing banks</td>
<td>8,337</td>
<td>10,262</td>
</tr>
<tr>
<td>Scottish clearing banks</td>
<td>879</td>
<td>1,070</td>
</tr>
<tr>
<td>Northern Ireland banks</td>
<td>182</td>
<td>253</td>
</tr>
<tr>
<td>National Giro</td>
<td>...</td>
<td>...</td>
</tr>
<tr>
<td>Other</td>
<td>(300)</td>
<td>(360)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>(9,706)</strong></td>
<td><strong>(11,950)</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Secondary banks</th>
<th>£ million</th>
<th>Ratio 1970/1963</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accepting houses</td>
<td>844</td>
<td>1,464</td>
</tr>
<tr>
<td>American banks</td>
<td>671</td>
<td>3,283</td>
</tr>
<tr>
<td>Subsidiaries of deposit banks</td>
<td>...</td>
<td>(800)</td>
</tr>
<tr>
<td>Other</td>
<td>2,219</td>
<td>4,050</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>3,734</strong></td>
<td><strong>9,597</strong></td>
</tr>
</tbody>
</table>

PART ONE: THE EMERGENCE OF MERGER ACTIVITY IN

THE FINANCIAL SECTOR
CHAPTER ONE

The Legal Environment

1.1: Attitudes to monopolies and mergers in the U.K. and the role of the state in controlling them

In an unregulated private enterprise economy, it is possible for actual market performance to fall short of what is considered desirable from the community's view-point because of the self-interest of suppliers. A divergence of social and private interests is most frequently encountered, in practice, in markets where one seller monopolises or controls a substantial proportion of industry supply, or where a number of sellers, acting collusively, effectively form an oligopoly. The possession of such monopoly power affords sellers the opportunity to manipulate conditions to their advantage and to the detriment of the consumer. Accordingly, most advanced industrial economies have found it expedient to introduce legislation to limit and control the exercise of market power.

The approach of U.K. antitrust policy has favoured the control of the conduct (behaviour) of those firms which possess market power (structurally defined by legislation) not its possession per se. Hence it has been concerned either with a specific abuse or, in particular, with non-competitive behaviour when it affects performance in a way considered to be against the public interest - where, for example, a dominant seller (or group of sellers in collusion) has used its market power to secure excessive monopoly profits, or where a merger threatens to create a situation where the merged entities gain a share of the market deemed sufficient to permit abuse of that achieved power. Government intervention in the private sector has therefore sought to encourage large scale enterprise where it appears efficient whilst making provision to guard against the potential dangers of a monopolistic situation.
Government control of mergers, and, in fact antitrust in general are relatively recent phenomena in the UK. It was not until 1965 that the passage of the Monopolies and Mergers Act subjected certain categories of mergers to a form of official scrutiny and control. But the economic philosophy which found expression in the Act, and in the subsequent Fair Trading legislation of 1973, together with the institutions and procedures of enforcement, are much less recent and have their origins in the earlier, formative periods of British attitudes to mergers.

Development to 1945

During the inter-war years government intervention came to be regarded as a superior method of regulating markets than free competition. Thus activities inimical to competition, such as price fixing and rationing, and the unchecked growth of oligopolies and restrictive practices became the dominant features of British industrial development. Unlike the Americans the British did not view the concentration of economic power with alarm. One observer suggests that this comparative disinterest is explained by the typically better, more socially-responsible behaviour of British combines and cartels. This may also be explained by political changes and a new climate in economic theory. With the eclipse of the Liberal Party, the traditional proponents of competition, the thrust of the economic reform movement, as represented by the Labour Party, shifted to socialism. This was accompanied by dissatisfaction with the manifest inadequacies of static economic theory and the desire to produce sensible criteria for policy which combined to influence the theory of 'workable' or 'effective' competition, most clearly associated with J.M. Clark. This incorporated the essential notion that if any of the conditions of perfect competition were absent then it no longer followed that it would be beneficial to maintain the remaining conditions. Moreover, advocacy of competition assumed that an increase in supply would be followed by lower prices, whereas the new theories of the period demonstrated that, in imperfect...
markets, supply increases would not result in lower prices. In effect, these contributions showed that the higher prices in a monopolistically competitive market would not necessarily be lowered by an increase in competition, that is an infusion of new firms into an industry.

In this context, competition was seen not as ensuring efficiency, but as creating excess capacity. Consequently, many traditional 'a priori' notions about the behaviour of firms and industries were rendered obsolete and gave way to thoroughgoing pragmatism. In varying degrees this attitude with its advocacy of a performance/conduct approach to mergers, has been the major influence on British policy ever since.

1945-1948: The 1948 Act

The election of a Labour Government in 1945 gave restrictionism and cartelization a longer lease of life, for nationalization rather than antitrust remained the emphasis in economic reform. This explains why, with a single exception, postwar industry reports (the official mode of postwar private sector supervision) contained no sweeping denunciations of monopolies or restrictive practices. In contrast the Simon Committee Report revealed the building material industry to be riddled with restrictive agreements, and, furthermore, condemned the restrictions.

Stirred by this report and frustrated in its attempts to implement a greater degree of centralized planning, the Labour Government turned its attention to the development of a monopolies and restrictive practices policy as a means of supervising the private sector and stimulating productivity. The result was the Monopolies and Restrictive Practices (Inquiry and Control) Act 1948, the basis of government merger control today.
Essentially the Act gave discretionary power to the Government, acting through the Board of Trade, to require the Monopolies Commission to investigate statutorily defined monopolies or restrictive practices and to report whether these situations were consistent with the public interest. A monopoly situation existed where at least one-third of the goods specified were supplied by a single firm or several firms acting in concert. The Commission's task was to investigate, report and recommend — the Government alone was empowered to seek remedial action through Parliament.

Thus, an essential feature of the 1948 scheme was the power left to the Government over the administration of the Act, thereby creating the likelihood that application would be subject to the vicissitudes of politics.

Substantively, the Act failed to define the public interest and, reflecting the earlier pragmatism, contained no presumption that free competition was prima facie better or worse than restriction or monopoly. Instead, the premise of the Act was that monopoly was not good or bad in itself, but possessed the power to be good or bad. Accordingly, the Monopolies Commission, in its reports, made the determination of the public interest turn on conduct and performance focusing, inter alia, on predatory acts, prices, profits, rates of return on capital, unemployment effects and innovation performance. Structural factors, which alone determined the possibility of reference, appeared rarely in the reports. Indeed, although diminution of competition was considered in every report, it was never treated as decisive.

Not surprisingly, many aspects of the Act and its administration provoked criticism mainly from industry and universities. Complaints from the former were that the procedure was unfair — inasmuch as the Commission combined the roles of investigator, prosecutor and judge, with the consequence that the firms concerned were required to defend the practices in issue without knowledge of the views of the Commission on these issues. Similarly the Commission occasionally refused industry the opportunity to see and rebut complaints. Other critics emphasized the excessive time required by part-time membership of the Commission for the
preparation of a report, the lack of power of the Commission both to select for itself suitable cases for investigation and to act except in an advisory fashion, and finally, the tendency of the Commission to recommend, in the tradition of the inter-war period, government-industry consultation and agreement in place of flat prohibition.

The greatest disappointment was the failure of the Commission, in the course of its work, to develop broadly applicable criteria of public interest. Only 12 reports were published by 1955 and they offered little opportunity for generalization inasmuch as each report reflected a myopic preoccupation with the matter under investigation. This was justified by the pragmatic approach of the legislation which effectively precluded the application of general principles.

Not until the 1955 Commission Report on Collective Discrimination was this obstacle overcome. Focusing not on a single industry but on a specified set of practices wherever they occurred, this Report concluded that the detriments were clear and probable, while the benefits were rare, and recommended legislation generally proscribing the practices with exemptions for special circumstances. This Report furnished some of the impetus for the next major British antitrust legislation, the 1956 Act.
1956-1965: The 1956 Act

This period, the most active and innovative in the development of British competition policy, began with the passage of the Restrictive Trade Practices Act 1956. By past standards this was a bold measure for it abandoned the traditional neutrality with respect to restrictive agreements in favour of a presumption of illegality. The Act, which has remained in force without significant amendment, requires the registration of all such agreements. Parties wishing to continue the arrangement must appear before a newly created court of law, the Restrictive Practices Court, and there, against opposition from the Registrar of Restrictive Trading Agreements, the Government's advocate, attempt to overcome the presumption. To succeed the parties must first satisfy the Court that each restriction at issue fits one or more of a number of less specific circumstances, which have become known as gateways.\textsuperscript{19} Next, having successfully completed this stage, the parties must persuade the Court that on some ultimate weighing of the social harms and benefits, the benefits prevail. If the parties fail in one or more of these steps, the Court can require the abandonment of the restriction.

There is a quite considerable difference both in substance and procedure between the 1948 and 1956 Acts. Procedurally, the adoption of a judicial solution with its adversary process and its separation of adjudicatory and prosecutory functions represents a sharp departure from, and at the same time, ameliorates some of the shortcomings of the administrative process of the Monopolies Commission and its antecedents. And the judicial process seems to have escaped much of the criticism which attended Monopolies Commission procedure.\textsuperscript{20} Another important procedural change was the withdrawal from the Government of the virtually complete control over the investigation of restrictive practices which it had exercised under the 1948 Act. Unlike the 1948 scheme, under which the Government decided which restrictive practices to investigate, and which,
if any, of the Commission's recommendations to implement, the 1956 Act requires the Registrar to refer every registrable agreement to the Court, which is (as any law court) independent of the Government.21

Some contrast in substantive content is also apparent. The 1948 Act was essentially devoid of positive policy content whereas the 1956 legislation with its Section 21 gateways, attempts to sketch the contour of public interest by listing a range of relevant considerations. However, the role to be played by the promotion of competition remains unclear.

The reports of the Court, like those of the Monopolies Commission have often relied heavily on various indices of performance, notably, the reasonableness of prices, profits and rates of technological progress. In general, structural considerations play relatively unimportant roles in the Court's decisions.

Such assessment as can be made of the Act reveals a sharp contrast in effectiveness to the 1948 legislation. One undoubted effect of the operation of the Restrictive Practices Act has been the dismantling of numerous restrictive agreements. By 1969 approximately 90% of the total 2,600 registered had been eliminated.22

At this point, then, the British antitrust stage was occupied by the Court and the Monopolies Commission; the former with jurisdiction over restrictive agreements, and the latter over conditions of oligopoly and single dominating firms. For all their differences, both have focused primarily on an industry's performance and not its structure in applying the public interest standard. Neither has viewed the public interest as invariably served best by the promotion of competition. This, then, was the history of policy and institutional developments which greeted and influenced the enactment of merger controls.
1.2: Objectives and principles of UK mergers legislation

Background to merger control

Government control of mergers is a rather recent development despite the existence, long before 1965, of both significant merger activity and some recognition of the need for merger control. Although the previous section offered some reasons for the late development of competition policy in general, it is worth considering here two explanations for the even later development of merger control. First, the early and continuing commitment to a pragmatic, conduct/performance approach in examining market power and restrictive practices virtually closed minds towards any possibility of ex ante control of mergers. Thus when an impending merger threatened to create a giant which, among other things, would have controlled 90% of the man-made fibre industry, the Government answered troubled members of Parliament first by reminding them that it had been the policy of successive governments not to prejudge the effects of monopoly, and then, by reassuring them that the public interest would be adequately safeguarded by the power to refer the merged entity to the Monopolies Commission if it later misbehaved.

The second reason was perhaps more influential as it concerned not the general philosophy of antitrust as it related to mergers, but the attitude towards the merger phenomenon itself. It was a long-established view in Britain that mergers were an inevitable consequence of, and indeed a natural remedy for, economic stagnation and unrealised economies of scale. As a result, the notion that some mergers were at best a mixed blessing was slow to develop. Eventually however, the merger movement accelerated and was frequently accompanied by questionable tactics. Consequently, the subject attracted increasing public attention and provoked considerable controversy. New calls for merger control appeared and in the election campaign of 1964, both main parties promised merger legislation. The passage of the 1965 Act confirmed the Labour Party's intention.
Predictably the judicial machinery of the 1956 legislation was rejected as a model for the new Act and instead the mergers legislation was essentially an extension of the scheme of the 1948 Monopolies Act. In essence, the 1965 Act makes certain classes of mergers subject to administrative investigation by the enlarged Monopolies Commission which is in turn directed to report whether the merger 'may be expected to operate against the public interest.'

The objectives and philosophy of UK mergers legislation are illustrated by its definition of the public interest, and the latter, by its continued adoption of a highly discretionary merger-by-merger approach to the evaluation of expected benefits and losses of proposed mergers. Accordingly, by exhibiting the belief that more competition is usually to be preferred to less, the legislation embodies the substantive results of the marginalist theories of competition; by creating a legislative framework which only disallows acquisitions where their expected consequences seem blatantly contrary to the public interest, the legislation contains the implicit presumption that merger activity is not, necessarily, inconsistent with the public interest, but a natural and satisfactory result of the 'competitive process'.

Of course, the objectives of the control of mergers could be realised in any of several ways; an alternative presumption - and rule - could be that all mergers necessarily contradict the public interest and de facto are therefore illegal. But as noted, the philosophy and framework of existing legislation follows precedents in earlier public policy - in particular the pragmatic monopolies legislation of 1948. Accordingly, the public interest provisions of the 1973 Act, which are concerned with the conduct and efficiency (performance) of firms, are made to appear distinct and quite separate from two simple economic/structural tests to which all merging parties are first subject; only if the proposed merger contravenes at least one of these tests is it possible for the antitrust
authorities to consider ex ante the likely effects on the public interest of the merger.

In practice, the likely competitive effects of a merger can only be examined when assets equal to or more than £5 million are to be acquired, or if the market share of the acquiring firm is extended to or beyond the 25% monopoly level.\textsuperscript{34} Even then, however, the public interest provisions may be considered only briefly: a reference to Monopolies Commission is an infrequent event;\textsuperscript{35} more usually other bodies review the public interest considerations 'in camera' and less extensively.\textsuperscript{37}

The framework of existing mergers legislation, however, is not influenced solely by historical precedent. Rather, the two-part structure of the legislation, wherein structural criteria have first to be invoked before the conduct and performance of firms can be formally considered, reflects the belief, based on positive economic theory, that the behaviour of firms is considerably affected - even determined by the structural characteristics of those markets and industries to which firms belong. The legislation, therefore illustrates the belief that structural measures provide some indication of the likely conduct and performance of firms. It affirms the particular belief that the nature and processes of competition are somehow affected by firms’ market shares and sizes. It adopts these two apparently simple and effective criteria in the belief that they are meaningful per se, and that they can be meaningfully applied to empirical situations.

This notion is based on a traditional interpretation of the paradigm of industrial economics which attributes causal sequential relationships between market structure, conduct and performance. The imprecision of this interpretation and hence inadequacy of the notion is revealed in more recent economic literature. Phillips (1970\textsuperscript{37} and 1976\textsuperscript{38}) for example considers the metaphysical problems involved with the nature and processes of causation. Moreover received theory nowhere considers the difficulty that in practice, given types of behaviour for example, identical prices
may be consistent with very different forms of market structure for example, oligopoly and polyopoly. It is relevant to point out, at this stage, that even this simplest use of the paradigm entails a duplicity of prediction and a confusion of understanding on which no legislation should be founded; but upon which the present framework of the mergers (and monopolies) legislation is apparently based. These reservations provide the initial doubts about the Acts which implement government merger control.
1.3: The operation of UK mergers legislation

Examination of the detail and operation of the legislation results in more concern. Whilst the pro-competitive bias of the legislation is founded in an extensive literature concerning the nature and welfare-advantages of competition there not only exists confusion about the nature and advantages of competition, but the awareness that the predictions of competitive theories are only as good as their assumptions. Additionally the literature on workable competition also illustrates the practical difficulties of identifying and applying competitive norms to real markets and firms. Possibly as a result, the meaning of competition as adopted in the legislation is largely permissive; in execution, the legislation involves an expediency and pragmatism which necessarily results in inconsistencies of interpretation as identified by other writers.

These worries are compounded by a number of further doubts. Firstly, the reliance on the two structural tests have been especially misleading and unsatisfactory in merger investigations, whether undertaken by the Monopolies Commission or independently. It is now more than a decade since the first introduction of merger legislation yet despite continued increases in market concentration the content of the referral criteria has remained largely unaltered. The size of assets criterion for instance, which was designed to control the proliferation and growth of conglomerate and vertical integration, is based on the notion that the acquisition of large firms may sometimes be detrimental to the public interest. Not only can this be criticised for its unchanged value of £5 million, but also for its naive understanding of size. These failings of the size of assets criterion, however, are much less significant than those involving the monopoly criterion.
The monopoly test is founded on the belief that economists can consistently delineate definitive market boundaries and measure the extent of the market(s) in question. Examination of the reports of the Monopolies Commission reveals the difficulties that have been experienced in defining the 'relevant' market which varies in breadth from one report to another. This failure is a manifestation of a more wide-ranging problem which relates to the theories of the firm and consumer behaviour, which are at the heart of micro economic theory. In particular, imperfections in the techniques of own-price and cross-elasticity of demand (the most readily applied method of estimating measures of substitutability and thereby identifying market boundaries) leave economists ill-equipped to produce measures of market extent which have unambiguous meanings; furthermore, there are no guidelines or defined thresholds of cross-elasticity which identify boundaries between markets and market-segments.

Whether this signals the irrelevance of economic theory to industrial policy or merely its inapplicability, the result has been the implementation of the monopoly criterion of the legislation depending on a frequently arbitrary understanding of the market relevant to the antitrust authorities. This not only involves delimiting the product constituents of a market, but also specifying its geographic extent. This was clearly not discerned as a problem by the authors of the early antitrust legislation. However, recent emphasis placed upon 'freer trade' (the EEC, for example) and penetration of world markets indicate that a nationalistic approach is no longer applicable, and indeed, was recognised in the Fair Trading Act.

The reduction of the monopoly criterion from 33⅓% to 25% in 1973, whilst reflecting the growing concern of economists and politicians at the trend towards greater industrial concentration throughout the British economy, barely confronts the problem of analysing market structure. The difficulties are accentuated by the profound structural change in the various sectors of the economy, which also reflects the ambivalence in official attitudes towards industrial policy and in particular towards mergers.
1.4: The paucity of interest in the financial sector

Until 1965 service industries were omitted from the scope of antitrust legislation. Hence financial companies could not be subjected to a Monopolies Commission reference. The widening of the scope of the legislation by the 1965 Act to include mergers and monopolies of service companies was thus an important development. The general distrust of behaviour in the City, fear of widespread restrictive practices within the financial sector and criticism of the clearing banks' interest rate cartel and lack of competition provided an eminently suitable background for a Monopolies Commission investigation. To date, however, all financial services have largely escaped scrutiny. Apart from the reference of the proposed Barclays/Martins/Lloyds clearing bank merger in 1968 and that of Eagle Star's proposed acquisition of Grovewood Securities and Bernard Sunley Investment Trust in 1973, financial companies' acquisitions and their conduct and performance have not been the subject of a Commission inquiry.

Thus consideration of financial companies, and their acquisitions, highlights an inconsistency in the execution of the legislation. More importantly however, it serves to illustrate methodological problems which confront the analysis of the financial sector, and the limited applicability of public merger policy.

The latter is most apparent where acquiring the acquired firms produce dissimilar products, and is accentuated where firms' output comprises a differentiated range of products which is sold in a number of international markets. The diversification of financial intermediaries across industrial and national frontiers has provided, for many financial companies, a broad product base upon which operations are conducted on an international scale. This inevitably obstructs the application of public merger policy to financial institutions. In addition, the 'monopolies criterion' of the legislation utilises measures of market power which refer to a firm's main activity as measured by turnover. In practice, turnover may not be an accurate assessment of a firm's main process and, moreover, the dynamic
competitive environments in which financial intermediaries operate
signal the need for caution when considering static estimates of market
power.

The measurement of market power in the financial sector, generally
frustrated by the problem of defining consistent market boundaries, is
further hindered by the nature of financial companies themselves. Factors
such as goodwill and reputation are of considerable import and may actually
increase market dominance; they are, however, intangible and their approximation
must be confined to subjective assessment.

The application of mergers legislation and indeed any analysis of
this sector is impeded in one further respect - by the very character
of the financial system, which comprises a series of distinct yet inter-
related markets. In consequence, confusion arises from decisions regarding
'product sameness'. This led Richards and Colenutt51 for example, to find
that it is quite possible to come to contrary views about market concentration
in the life assurance industry depending upon whether one considers the
'market' in its entirety or believes a more accurate interpretation of
the group of firms selling life assurance is made by distinguishing two
or more market segments. Although the segments over-lap and some
substitutability exists, it is not perfect. The banking industry can be
similarly examined with respect to a series of over-lapping yet different markets
and market segments with products and services ranging from overdraft facilities
to medium-term eurocurrency syndications, but also including advice on
investment management and corporate finance. The incursion of banks into
the insurance industry also means that they are equipped to offer various
broking facilities as well. The fact that financial companies are diversified
across such a breadth of the financial system, selling different products in
a variety of markets, makes it misleading to assert, on the basis of a
single concentration ratio, that a bank or insurance company possesses
'market power' let alone that they abuse it.
These observations, although illustrating the limited applicability of existing legislation to contemporary conditions in the financial sector, cannot be considered as an explanation of the paucity of interest.

First, diversification has not been restricted to the financial service sectors. Gribbin (1976) has demonstrated that the extent of industry diversification increased from 1963 to 1968 in all but two of the S.I.C. orders covering manufacturing industry. Furthermore in common with diversification in the financial sector diversification of manufacturing companies has also largely featured 'acquisition'. Thus Gribbin concluded: "... 'conglomerate merger' is part of a more general movement towards increased diversification in the UK economy and is more properly considered within this wider framework"

Unlike diversifying financial mergers, however, a number of industrial conglomerate mergers have been the subject of Monopolies Commission investigations. In the financial sector, the opposite has been the case. Indeed, with the exception of Bank of England, there has been no apparent scrutiny of the banks' diversificatory acquisitions. This failure may well have contributed to their profusion. The lack of official scepticism about certain acquisitions, such as that of B.O.L.S.A. by Lloyds Bank, and that of Montagu Trust by Midland Bank, may indeed have influenced banks and other financial intermediaries, in the choice of acquisitions within their overall diversification strategy.

Thus an explanation of the lack of official attention paid to financial company acquisitions must lie elsewhere. Several suggestions can be adduced, some positive, others speculative. They can be considered, however, in three broad categories: first, the conceptual and methodological problems associated with an industrial analysis of the financial services referred to above; secondly, an historical pre-occupation with manufacturing industry; and, thirdly, the effect of Bank of England intervention on the structure of the banking industry.
Conceptual and methodological problems of analysing financial companies

The consistent application of mergers legislation to financial intermediaries would require the financial services sector to be treated in the same way as any other industrial sector. The financial system cannot, however in strict logic, be considered in this way because of the special characteristics that distinguish its products from those of other private enterprises - especially those in manufacturing industry. The crucial difference between the banking industry, for example, and other industries is that whereas manufacturing firms generally supply real goods and provide after-sales service that the public demand, banks provide nominal money - funds denominated in various currencies, and services associated with the means of payment, while the public demand real balances - stocks of purchasing power. There is then a clear conceptual distinction between the financial service industries and the rest of economic activity.

These difficulties are compounded by the diversification of financial institutions across industrial frontiers which has resulted in single organizations marketing services in several distinct financial sectors. Thus the processes and output of the institution will vary according to its degree of diversification. The diversity of markets within each financial sector accentuates the problem of analysis. In the markets for merchant banking services, for example, a number of differentiated products are sold, which are often tailor-made, and span a wide range of dissimilar demands and activities. 55 Within the market for corporate finance, where the product is 'financial advice' relating to a firm's longer-term finance requirements - merger and acquisition negotiations, public flotations and new capital issues - the advice provided utilises experience and skills which are unique to the advising institution and, because the advice itself is unique and tailored to the needs and situation of the particular customer(s), the corporate financial products of merchant banks cannot be considered identical. 56
Moreover, in practice merchant banks tend to differentiate their products in this area and develop expertise appropriate to different market segments and different market demands.

This pattern of wide-ranging and differentiated activity is mirrored throughout the financial system. Insurance institutions, for instance, operate in highly dynamic environments in which one of the only constants is the existence of risk and uncertainty — and where, at any given moment composite insurance companies are diversified geographically, and across insurance markets, often to different degrees. They similarly tend to specialise in the provision of ancillary services and may be in competition with a merchant bank in such areas as the management of unit trust portfolios.

In summary, most of the markets within the financial sectors are fragmented in different ways. Many financial intermediaries of all types specialise in different parts of different markets where the product of a clearing bank will be similar to that of an investment trust management company. Furthermore a number of financial markets are very widely defined so that institutions that operate in, for example, the medium-term lending market, may well only come into competition at the margin, and although ostensibly marketing a similar product are, in fact, selling quite distinct commodities to different borrowers.

The implication is that each institution will supply a different product in each of the markets in which it operates, and in some markets may provide more than one. In consequence, it is very difficult to define the output variable for a financial institution; the one basic commodity being sold is funds and attempts that have been made to indicate the extent of market share have chosen an asset figure as an indicator of the funds over which each firm has some control.\(^{57}\) In the broader context of diversified financial companies selling differentiated products in very different markets, it is clear that such estimates should be treated with caution. It follows that the monopoly criterion of the mergers legislation
cannot accommodate the developments that have brought such far-reaching institutional, structural and environmental change to the financial sectors. Indeed Professor G.C. Allen, an original member of the Monopolies Commission, offered the opinion that methodological problems posed by these developments contributed to the preclusion of financial services from legislation until 1965. 58

In essence, this unsystematic methodology seems to originate from a combination of factors - some specific to financial companies, others concerned with the nature of the existing mergers legislation. Thus problems of definition and classification of financial products and markets are compounded by two major weaknesses found in the legislation but which originate from received economic theory. One involves the difficulty of allocating products to particular markets and segments; the second arises from traditional interpretations of the paradigm of industrial economics which has influenced the framework of the legislation, wherein structural criteria (market share or firm size) have first to be invoked before the conduct and performance of firms can be investigated.

Indeed, adoption of a method which classifies and considers multi-product firms according only to their 'main activity', and attempts to condemn them or their acquisition activity on this 'structural' basis, reveals several substantive failings. Firstly, by forcing multi-product, multi-industry, multi-process firms into single-industry/market categories, the method understates the extent of product and process diversification experienced by individual firms. Secondly, as noted, such an approach requires an implicit and artificial assumption that 'main activity' can and should be measured by turnover. Thirdly, it ignores the incomparability of the products of multi-product financial companies, which as stated, are conceptually difficult to assess anyway. Finally, and with special relevance for the application of legislation, this approach questions the validity of statements about structural change resulting from empirical observations about firms' merger and acquisition activity. 59
Traditional pre-occupation with manufacturing industry

As noted, antitrust policy has been almost totally concerned with concentration in the manufacturing sector of the economy. Indeed U.K. industrial policy in general has been confined to structural problems and reorganization in the private industrial sector. This became particularly apparent recently with the evolution of a positive approach to rationalization during the term of the 1964-70 Labour Government. Their policy was broadly-based and ambivalent; on the one hand, it recognised that it was desirable to promote mergers and rationalization within manufacturing industry in the interests of efficiency and international competitiveness, and on the other, that there was some need to control 'potentially harmful' structural arrangements.

The most important aspect of this policy was the Industrial Reorganization Corporation (I.R.C.), created in 1966, with the purpose of fostering the development of larger, more viable units in British manufacturing industry, partly through the selective encouragement of mergers. Its activities were concentrated in specific manufacturing industries: principally in the electrical and electronics industries, the heavy and mechanical engineering industries, the machine tools industry, the scientific instruments industry and the motor-car industry. As noted, the agencies responsible for the control of mergers have assumed a similarly narrow approach, and the majority of references to the Monopolies Commission has involved proposed mergers in similar fields: motor-car manufacture, suspension cables, engineering - in general, manufacturing industry.

Whilst understandable, given the evidence presented above, this discrimination should be considered further in the following context. Firstly, the manufacturing and financial sectors are inter-dependent, and their merger activity is both characteristically similar and subject to the same influences - being subject to cyclical patterns and involving similar methods and patterns of finance, for example. Moreover the natural day-to-day inter-relationships are manifest in the various services which
are offered by financial intermediaries: loan and overdraft facilities, deposit-taking and money transmission functions, advice on new issues and corporate finance, the provision of risk advice, cover and management, and the management of pension funds.

The financial sector is similarly dependent upon manufacturing industry-technology, investment, innovation and performance of industrial companies inevitably affect the operation of financial institutions. The introduction of computers and automated money-transmission mechanisms was attendant upon technological innovation in the industrial sector. Moreover the growth of manufacturing companies during the merger boom periods of the last ten years was fuelled by merchant banks and created enterprises of a size that demanded larger units in other areas of the financial sector, notably clearing banking and insurance underwriting. Thus one can postulate that the behaviour of the two broadly-defined manufacturing and financial sectors is inter-related and that their merger activity and performance should not be considered separately.

Furthermore, the danger of monopoly or market power, as traditionally perceived, is that it leads to the development of unaccountable concentrations of economic power which may utilise these positions in the pursuit of monopolistic practices, such as the charging of excess prices to recover large profit margins. In the context of unprecedented merger activity in the financial service industries and the recognition of a high positive correlation between merger and increasing concentration, the omission of the financial sector from the purview of public merger policy should be questioned.
Unwritten rules and control by the Bank of England

The critique should, however be considered in the wider framework of the comprehensive system of supervision enacted by the Bank of England, which offers a pretable explanation for the neglect described above. In the U.K., control over bank mergers of an 'informal' but nevertheless effective sort, designed to prevent acquisitions in restraint of competition, was introduced after the wave of mergers that occurred at the end of the first world war. As a result of the Report of the Colwyn Committee in 1918 clearing banks were forbidden to merge without prior consultation with the Bank of England, which in turn had to consult the Treasury. The implicit acceptance by the banks of the strictures laid down by the Central Bank meant that recourse to legislation was averted, but, nevertheless, banking mergers initiated by the major clearing banks were effectively regulated. Indeed, it was not until the Report of the Prices and Incomes Board in 1967 that wholesale structural change was contemplated. In its attack on the lack of price competition and the profuse spread of branch networks, the P.I.B. suggested that "amalgamations could permit some rationalization of existing networks". As a result a number of clearing bank links were effected. The subsequent reference of the proposed amalgamation between Barclays/Lloyds/Martins to the Monopolies Commission, its adverse majority report and consequent Government prohibition, appears to have halted once again structural change in the retail clearing bank market.

The Bank of England's influence over banking merger activity extends beyond its unwritten rules regarding horizontal clearing bank links. Its role has remained undefined, however, and is often clearly visible only when a ruling which has hitherto been upheld, is relaxed. For example, it controlled the acquisition of acceptance houses by clearing banks and E.E.C. banks by an unwritten, yet largely observed regulation, which gained publicity only when it was relaxed in 1972. This signalled the acquisition
of Montagu Trust by Midland Bank and the Warburgs-Paribas joint-venture. Bank of England permission is still required, however, for acquisitions if more than 15% of a bank's capital.

This mode of regulation - by suasion rather than by statute - has been particularly prevalent in the banking sector, and as a consequence, has not always been recognised. With respect to public policy, Bank of England intervention remains vague but represents yet another barrier to be crossed by financial institutions proposing acquisitions.
NOTES


3: See 'Labour and the new Social Order', (1918), manifesto of the Labour Party.

4: J.M. Clark, 'Towards a Concept of Workable Competition, American Economic Review, June 1940


6: Distribution of Building Materials and Components, Report of the Committee of Enquiry appointed by the Minister of Works (1948), HMSO No. 70.553

7: S 14 of the 1948 Act gave the following vague guidance to the assessment of the public interest:
"all matters which appear in the particular circumstances to be relevant shall be taken into account and ... regard be had to the need ... to achieve
(a) the production, treatment and distribution by the most efficient and economical means of goods of such types and qualities, in such volume and at such prices as will best meet the requirements of home and overseas markets;
(b) the organization of industry and trade in such a way that their efficiency is progressively increased and new enterprise is encouraged;
(c) the fullest use and best distribution of men materials and industrial capacity in the UK; and
(d) the development of technical improvements and the expansion of existing markets and the opening up of new markets."

8: See the Report on the Supply of Electric Lamps, Session 1951, HC 287, HMSO

9: Every report contains a consideration of these factors


11: See the Report on the Supply of Insulin, Session 1951-1952, HC 296, HMSO

12: In P. Guenault and J. Jackson, The Control of Monopoly in the United Kingdom, (Longmans, 1960), the authors argue that this criticism was unfounded since the Commission's findings carried no legal force and thus the prosecutor or judge analogy did not exist, p. 125. This overlooks the fact that, under certain circumstances, the Monopolies Commission's recommendations could be given legal force. Moreover, the industrialists' criticism in the 1950s is closely akin to that expressed of the City's Takeover Panel which has no statutory powers at all (see Chapters 6 and 7).
13: See Guenault and Jackson, op. cit., pp. 126-127 and Rowley, op. cit., pp. 84-86


16: See the Report on the Supply of Cast Iron Rainwater Goods, Session 1951, HC 18, HNSO

17: The hope that the Monopolies Commission would do this was expressed during the debates on the bill, 449 H.C. debs., cols, 2046 et seq., 1948


19: S 21 of the 1956 Act


24: One of the first calls for merger control was the recommendation in the Colwyn Committee Report that there should be no further mergers of joint-stock banks without the consent of the Government.

25: See the remarks of the Rt. Hon. F.J. Errol, then President of the BoT, on the proposed merger between ICI and Courtaulds in 651 H.C. debs, cols, 1546-2548 (1961), and 625 H.C. debs, cols, 895-904 (1962)

26: Many of the notable manufacturing stalwarts of today were formed as a result of the earlier periods of merger activity; for example, WPM (1900), Imperial Tobacco (1901), Tate & Lyle (1921), Distillers (1925), ICI (1926) and Unilever (1930). More recently the Industrial Reorganization Corporation (1966-70) was established because the size of UK firms was considered too small to achieve scale economies or to keep pace with growing competition in world markets. Mergers played an important role in the IRC's brief history of rationalization. See also the quote attributed to the then prime minister Harold Wilson that mergers were influential in dragging Britain 'kicking and screaming into the twentieth century.' (quoted in W. Davis, *Merger Mania* /Constable, 1970)
27: Especially the so-called 'Aluminium War' in 1958 (see chapter six)

28: The ICI/Courtaulds contest (1961) probably provoked the greatest controversy and dispelled the belief, if only temporarily, that merger and rationalization went hand-in-hand.

29: For example, the Report of the Royal Commission on the Press (1962: Cmd 1811), See also the Monopolies Commission Report on the Supply of Wallpaper, in which the Commission recommended that the dominant firm should not further acquire its competitors without prior consent.

30: 'Monopolies Mergers and Restrictive Practices', White Paper (1964: Cmd 2299); Bow Group, 'Monopolies and Mergers' (Conservative Political Centre, No. 270, 1963); Poole Committee, 'Monopolies and the Public Interest' (Conservative Political Centre, No. 273, 1963)

31: The Public Interest provisions of S 84 of the Fair Trading Act 1973 state: "In determining for any purposes to which this section applies whether any particular matter operates, or may be expected to operate, against the public interest, the Commission shall take into account all matters which appear to them in the particular circumstances to be relevant and, among other things, shall have regard to the desirability - 
(a) of maintaining and promoting effective competition between persons supplying goods and services in the UK;
(b) of promoting the interests of consumers, purchasers and other users of goods and services in the UK in respect of the prices charged for them and in respect of their quality and the variety of goods and services supplied;
(c) of promoting, through competition, the reduction of costs and the development and use of new techniques and new products, and of facilitating the entry of new competitors into existing markets;
(d) of maintaining and promoting the balanced distribution of industry and employment in the UK, and
(e) of maintaining and promoting competitive activity in markets outside the UK on the part of producers of goods, and of suppliers of goods and services in the UK"

32: Clauses (a) and (e) of S 84 uphold competition per se to be desirable, for the first time in the history of competition policy

33: Restrictive practices are considered by the R.P. Court to be contrary to the public interest unless proven otherwise

34: The pioneering Monopolies and Mergers Act 1965, chose the market share level of 33 1/3% articulated in the 1948 legislation

35: Of 1038 mergers falling under the legislation from 1965-1974 only 35 were referred to the Monopolies Commission

36: For example, the Office of Fair Trading and the Inter-Departmental Mergers Panel. In 1975, 315 mergers occurred. In the same year, whilst 157 proposals came under the two criteria of the mergers legislation, only four were actually referred to the Commission. Where the proposal is not referred, "unless unusually difficult circumstances arise, (the OFT) give advice on mergers ... within about three weeks of the proposals becoming known to this office."

38 : A. Phillips, 'A critique of empirical studies of relations between market structure and profitability', Journal of Industrial Economics, June, 1976: ' ...Better theory, better data, and above all, better econometrics are needed before policy can be based on anything other than in-depth institutional studies of particular markets', p. 248

39 : A brief discussion of these difficulties appears in J.F. Pickering, Industrial Structure and Market Conduct, (Martin Robertson, 1974) pp 275-6

40 : J.M. Clark, op. cit. Also, his Competition as a Dynamic Process, (Brookings Institute, 1961)


42 : Several writers have been interested in measuring changes in concentration due to merger; most recently, S. Aaronovitch and M. Sawyer, 'Mergers Growth and Concentration', Oxford Economic Papers, March 1975. Others, including the Monopolies Commission and Government Departments also think in terms of mergers being 'horizontal', 'vertical' and 'conglomerate'. The critique developed in P.J. Franklin & K.R. Harris, 'A critique of UK policy towards acquisitions and mergers from an examination of its micro economic foundations' City of London Polytechnic, Working Paper No. 19, December 1976, challenges those views which presume it possible or meaningful, to identify mergers in this way, and those which make inferences about concentration changes from a naive analysis of mergers and acquisitions which have been ordered into these three categories.

43 : This is only one measure of size - and an absolute measure which is particularly relevant to non-financial companies. Possibly a relative-measure would be more appropriate: assets/turnover for example. In any case, the value will change with the type of products and processes employed; and also alter according to the different valuation principles used.

44 : BICC/Pyrotenax, Session 1966-1967, HC 490, HMSO; Ross Group/ Associated Fisheries, Session 1966-1967, HC 42, HMSO; UDS/ Montague Burton (1967 : Cmnd 3397); and Boots/House of Fraser, Session 1974, HC 174, HMSO

46: For example, the 1948 Act emphasised that domestic markets alone, should be considered for reference.

47: Fair Trading Act 1973, S 84, clause (e)


49: Rowley has referred to "the monstrosity that is British industrial policy", C.K. Rowley, 'Industrial Structure, Competition and Efficiency: A Review Article', Scottish Journal of the Political Economy, June 1975, p. 199. Also cf. philosophy of the IRC and the Monopolies Commission.

50: See for example, the attacks by J.M. Samuels, C.S. Goddard and R.E.V. Groves (and ripostes by I. Fraser) in the Banker 1976 (February, May, June and September editions).


53: Gribbin, op. cit., p. 35

54: For example, Unilever/Allied Breweries, Session 1968-1969, HC 297, HMSO; and Rank/De la Rue, Session 1968-1969, HC 298, HMSO

55: Merchant banking services can be considered as the provision of finance and advice to private and institutional clients. The range of products sold by merchant banks is normally considered with respect to four quite different areas: corporate financial advice; investment/portfolio management; banking (including acceptance credits); and, 'international' services (including foreign exchange dealing). In addition merchant banks tend to specialise in activities not covered above, for example, bullion dealing, leasing, factoring and the provision of venture capital.

56: Examination of the acquisition advice offered by merchant banks apparently confirms this. In 1972, for example, Samuel Montagu managed 44 mergers valued on average at £5 million; in contrast the corporate finance department of the Drayton Corporation handled only 12 mergers in the same year, valued at an average consideration of £26 million. Similarly, in terms of expenditure on acquisitions managed by the banks, 90% of those arranged by the Drayton Corporation were on behalf of the acquired firm, whereas Samuel Montagu acted mainly for acquiring firms, representing the offeror company in 75% (by consideration) of the acquisitions it arranged. (Calculations from data in The Times 1000, 1974-75).

58: Discussion with the author, October 1975


60: For a comment on the structural change brought about by the I.R.C. see C.L. Pass, 'The Industrial Reorganization Corporation - A positive approach to the structure of industry', Journal of Long-Range Planning, September, 1971

61: See Chapter 6

62: See Chapters 3 and 4 respectively


64: see Joseph Sykes, The Amalgamation Movement in English Banking 1825-1924, (P.S. King & Son, 1926)

65: Cmd 9052, op. cit.


67: See Chapter 3

68: See Chapter 5

CHAPTER TWO
The Emergence of Merger Activity in the Financial Sector: Industry Analysis

2.1 Introduction

This chapter explores the scale, incidence and nature of acquisition activity by U.K. financial institutions for the period 1966-73. The analyses are conducted at high levels of aggregation. Inevitably, therefore, the results are limited in scope, for the data on acquiring firms does not distinguish different types of bank - deposit and secondary, nor different insurance institutions - underwriting companies and brokers. Similarly the data gives no indication of the market activities of acquired firms. These failings are circumvented in subsequent chapters which examine in detail, the acquisitions effected by financial intermediaries engaged in different market operations. Nevertheless, the contents give an insight into the pronounced increases in financial sector merger activity, and provide a useful statistical background to the more comprehensive investigations which follow.

The analyses utilise raw data made available by the Bank of England, but also examine statistics compiled and presented in the Bank of England Quarterly Bulletin. Unfortunately discrepancies appear between the Bank's calculations and the data themselves, and a note to that effect is included under Table 2.3; this reservation applies equally to other tables and comments which are drawn directly from the raw data. Furthermore, the names of financial institutions involved in 'contested bids' are not published but the values are aggregated; where possible, searches of the financial press (the primary data source) reveal the identity of the firms in question.
As implied, the major stimulus to the present study was the apparent neglect of the merger and acquisition activity of financial companies, due in part to the parallel merger movement in manufacturing industry. To the extent that the innate characteristics of the financial and industrial sectors are different it is probably justifiable not to aggregate studies of merger activity in the two sectors. However in the analysis of merger activity, it would seem to make as little sense to undertake studies of the mergers of dissimilar manufacturing industries, as it does to exclude financial companies from examinations concerned with the aggregate merger behaviour of the company sector per se. The interdependence between the two sectors, noted in chapter one, reinforces this view; as does Figure 2.1 below which clearly shows the cycles of acquisitions of financial and non-financial companies to be closely related.

Moreover, closer examination and comparison of the increase in expenditure on acquisitions by financial and manufacturing companies confirms the relative importance of the former. The comparison presented in Figure 2.2 is in index form with 1966 as base year.
Figure 2.1: Mergers and Acquisitions by financial and non-financial companies 1966-1973

Source: Bank of England Quarterly Bulletin; Business Monitor M7
Figure 2.2: Indices of acquisition expenditure, financial and manufacturing sectors 1966-1973

Source: Bank of England Quarterly Bulletin; Business Monitor M7
The focus on the acquisitions of financial companies can be justified on several grounds: the pronounced increase in the scale of acquisition activity in the financial sector; the causes and effects of financial companies' mergers on the behaviour of the financial system of the economy; and the absence of any substantive systematic analysis of the merger activity of financial institutions. Indeed a clue to the significance of acquisition activity in the financial sector, is given in the introductory note to the Bank of England's statistical series:

"... there has been a marked increase in recent years in the numbers and importance of takeovers and mergers by banks and other financial companies."

2.2 Measuring merger activity

There are two main ways of measuring merger activity, first by number, and second by value of acquisitions. Assuming the information is available, the 'number of firms acquired' has some clear advantages as a measure of merger activity. First they can be aggregated over time without the problem of the valuation of the asset size or market valuation of firms. This is especially acute when firms are acquired by way of share exchange. Second, since every acquisition is treated as equally important the measure avoids the swamping which value measures generate whenever there are occasional but very large acquisitions. On the other hand, while the number of firms acquired indicates the number of independent decision centres which have been extinguished, it gives no information about the resources involved.

The value of acquisitions and mergers provides information which numbers alone cannot provide. They measure (albeit in an imperfect way) the scale of the resources involved and permit a distinction to be drawn between insignificant and substantial mergers. Moreover they enable studies of the relation of size and growth of firms to important aspects of their behaviour. The contribution of merger activity to changes in concentration cannot be estimated without value measurement.
Clearly the measures chosen will reflect in some way the hypothesis and aim of the analysis. If, for instance, the importance of increasing market power is one of the factors in the analysis, the size of the acquiring and acquired firms and the total and sectoral scale of the acquisitions will be more relevant than the number of firms acquired. It remains true, however, that in absolute terms such a series is affected by occasional large acquisitions, and extreme observations pose difficult statistical problems. In the series for financial sector acquisitions, reference is made wherever distortions are pronounced, as for example in 1968.

The terms 'acquisition' and 'merger' will be used interchangeably throughout this study. The latter generally defined as amalgamations effected by arrangement between companies, are valued as if the larger (or largest) company has acquired the smaller. Values recorded refer to the consideration paid in respect of acquisitions and mergers, whether in cash or in some form of securities. So far as possible, the latter are included at the date at which a bid is declared unconditional or a contract to purchase is signed; this measure therefore reflects the valuation placed by the acquiring institution on the acquired firm. Clearly, however, since share exchange has been a major method of financing acquisition and merger, values will vary with share movements as well as with the relative importance of share exchange in any given purchase and overall for any given time period.
2.3 Merger activity in the financial sector

The Bank of England's statistical series classify acquiring and acquired firms according to their main activity. The former are categorised into six classes: Banks; H.P. (finance) houses; insurance companies; investment trust companies; unit trust management companies; and miscellaneous financial companies. Acquired companies are classified similarly, but with an additional category for non-financial companies.

The following analyses give an indication of the nature of acquisitions initiated by financial companies; the tables classify acquisition activity with respect to level; size; direction; methods of finance and sector. In order to consider the changing patterns which emerge, the period is divided into halves, the first from 1966-69, and the second, from 1970-73.

2.3.1 The level of takeover activity in the financial sector

Table 2.1 indicates the numbers of financial companies that were engaged in acquisitions in the U.K. from 1966-73.

<table>
<thead>
<tr>
<th>Year</th>
<th>Total No. Acquiring</th>
<th>Total No. Acquired</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966</td>
<td>36</td>
<td>38</td>
</tr>
<tr>
<td>1967</td>
<td>31</td>
<td>38</td>
</tr>
<tr>
<td>1968</td>
<td>62</td>
<td>73</td>
</tr>
<tr>
<td>1969</td>
<td>80</td>
<td>98</td>
</tr>
<tr>
<td>1970</td>
<td>86</td>
<td>100</td>
</tr>
<tr>
<td>1971</td>
<td>63</td>
<td>77</td>
</tr>
<tr>
<td>1972</td>
<td>102</td>
<td>121</td>
</tr>
<tr>
<td>1973</td>
<td>91</td>
<td>108</td>
</tr>
</tbody>
</table>

Source: BEQB
The incidence of acquisitions and mergers by financial companies appears to have increased significantly with 247 companies being acquired over the period 1966-69, whereas 406 were acquired during the second four years.

These trends are also repeated in terms of financial institutions' expenditure on acquisitions as measured by 'value of mergers and acquisitions' (Table 2.2). From these, total expenditure increased from £1027 million in the first four years, to £1382 million over the second period.

Table 2.2: The value of acquisitions and mergers by financial companies, 1966-73

<table>
<thead>
<tr>
<th>Year</th>
<th>Value (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966</td>
<td>42</td>
</tr>
<tr>
<td>1967</td>
<td>68</td>
</tr>
<tr>
<td>1968</td>
<td>590</td>
</tr>
<tr>
<td>1969</td>
<td>327</td>
</tr>
<tr>
<td>1970</td>
<td>284</td>
</tr>
<tr>
<td>1971</td>
<td>254</td>
</tr>
<tr>
<td>1972</td>
<td>406</td>
</tr>
<tr>
<td>1973</td>
<td>438</td>
</tr>
</tbody>
</table>

Source: BEQB

But these dimensions conceal other information about the incidence of financial company acquisitions, particularly in respect of the temporal distribution of the acquisitions, and of the discrepancy between the two measures of acquisition activity. The uneven spread of mergers and acquisitions is shown in Figures 2.3 and 2.4.
Figure 2.3: The number of companies acquired by financial companies 1966-1973

Figure 2.4: The value of companies acquired by financial companies 1966-1973
Possibly most interesting, however, is the very high level of expenditure on acquisitions recorded in 1968. Indeed total considerations in the second quarter of that year alone exceeded those in the previous nine quarters.

The marked increases in expenditure from 1967 (£68 million) to 1968 (£590 million) can be largely attributed to four very large mergers. Three of these involved major deposit banks – Barclays/Martins (£105 million), Royal Bank of Scotland/National and Commercial Bank of Scotland (£49 million), National Provincial/Westminster (£178 million) – and the fourth amalgamated two leading life assurance companies – Guardian/Royal Exchange (£64 million). It is not surprising therefore that this trend in expenditure was not reflected in the number of companies acquired. By this measure, 1968 figures showed a large increase on 1966 and 1967 but were well below those for subsequent years.

Any description of the pattern of merger activity throughout the period must therefore take into account both indicators of the value and number of acquisitions, for quite different trends emerge, depending upon which measure is employed. For instance, in terms of numbers of companies acquired, 1972 and 1973 were the peaks of a gradually increasing trend; in terms of value of total considerations, however, the end of the period marked the emergence from a three-year plateau, following the earlier peak in 1968.
### 2.3.2 Takeover activity by size category

The classification in Tables 2.3 and 2.4 is by size category of the victim firm based upon the consideration paid for the equity.

#### Table 2.3: Size Distribution of Acquisition Expenditure 1966-69

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>0-</td>
<td>27</td>
<td>3.9</td>
<td>22</td>
<td>3.7</td>
<td>31</td>
<td>6.7</td>
<td>36</td>
<td>7.2</td>
<td>116</td>
<td>52</td>
<td>21.5</td>
</tr>
<tr>
<td>0.5-</td>
<td>5</td>
<td>3.8</td>
<td>6</td>
<td>3.8</td>
<td>8</td>
<td>5.8</td>
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<td>9.7</td>
<td>32</td>
<td>14</td>
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<td>8.6</td>
<td>6</td>
<td>12.0</td>
<td>15</td>
<td>38.4</td>
<td>18</td>
<td>40.9</td>
<td>42</td>
<td>19</td>
<td>99.9</td>
</tr>
<tr>
<td>5.0-</td>
<td>1</td>
<td>8.9</td>
<td>-</td>
<td>-</td>
<td>2</td>
<td>10.8</td>
<td>5</td>
<td>34.2</td>
<td>8</td>
<td>4</td>
<td>53.9</td>
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<tr>
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<td>16.9</td>
<td>3</td>
<td>47.5</td>
<td>11</td>
<td>523.7</td>
<td>8</td>
<td>205.3</td>
<td>23</td>
<td>10</td>
<td>793.4</td>
</tr>
<tr>
<td></td>
<td>37</td>
<td>42.1</td>
<td>37</td>
<td>67.0</td>
<td>67</td>
<td>585.4</td>
<td>80</td>
<td>297.3</td>
<td>221</td>
<td>100</td>
<td>991.8</td>
</tr>
</tbody>
</table>

**Note:** Occasionally the figures in the Bank of England Quarterly Bulletin and those from the raw data cannot be perfectly reconciled; percentages have been rounded and do not add to 100.

#### Table 2.4: Size Distribution of Acquisition Expenditure 1970-73

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>0-</td>
<td>37</td>
<td>7.7</td>
<td>20</td>
<td>4.2</td>
<td>45</td>
<td>9.3</td>
<td>41</td>
<td>8.9</td>
<td>143</td>
<td>40</td>
<td>30.1</td>
</tr>
<tr>
<td>0.5-</td>
<td>13</td>
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<td>11</td>
<td>7.8</td>
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<td>7.7</td>
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<td>45</td>
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<td>30.9</td>
</tr>
<tr>
<td>1.0-</td>
<td>25</td>
<td>48.5</td>
<td>22</td>
<td>58.2</td>
<td>36</td>
<td>80.5</td>
<td>22</td>
<td>49.0</td>
<td>105</td>
<td>30</td>
<td>236.2</td>
</tr>
<tr>
<td>5.0-</td>
<td>6</td>
<td>38.7</td>
<td>8</td>
<td>58.3</td>
<td>11</td>
<td>71.4</td>
<td>5</td>
<td>37.0</td>
<td>30</td>
<td>8</td>
<td>205.4</td>
</tr>
<tr>
<td>10.0-</td>
<td>8</td>
<td>172.6</td>
<td>4</td>
<td>114.3</td>
<td>8</td>
<td>237.2</td>
<td>11</td>
<td>326.1</td>
<td>31</td>
<td>9</td>
<td>850.2</td>
</tr>
<tr>
<td></td>
<td>89</td>
<td>276.0</td>
<td>65</td>
<td>242.8</td>
<td>111</td>
<td>406.1</td>
<td>89</td>
<td>427.9</td>
<td>354</td>
<td>100</td>
<td>1352.8</td>
</tr>
</tbody>
</table>

**Note:** Percentages have been rounded and do not add to 100.
It is clear that throughout the entire period smaller acquisitions have been more numerous. The modal observation of acquisitions occurs in the smallest class for both four-year periods. For 1966-69 52% of acquisitions involved expenditure of less than £½ million; while the largest number of acquisitions also occurred in this class for the second period, the proportion dropped to 40%. This was specifically due to a shift in the distribution with a much less pronounced skew in favour of small acquisitions. In particular this is apparent if one considers the £m 1.0- class, where 30% of acquisitions occurred in the second period compared with 19% during the first four years.

In value terms, the modal observation is at the top rather than the bottom of the range, with acquisitions in the £m 10.0- class accounting for 80% and 63% of total expenditure in the respective periods. The difference between the first and second periods is probably exaggerated by the artificially high value for 1966-69 itself caused by the few unique large mergers in 1968.

Detailed examination of the relationships between each category and the whole is facilitated by Table 2.5 which covers the whole period 1966-73 in percentage form.

The trend reflects a steady increase in the number and importance of acquisitions and mergers valued in excess of £5 million, and a similar decline for those acquisitions under £½ million. The latter accounted for 72% by number and 10% by value of acquisitions in 1966, yet only 46% and 2% respectively in 1973; whereas the former which accounted for 6% and 61% of number and value in 1966 were responsible for 18% and 85% in 1973.

It is also interesting that large mergers were predominant in those years when total expenditure was highest. Hence in 1968, when £585 million was spent, acquisitions in the £m 10.0 class contributed 89% of expenditure. Similarly, in 1973 76% of the total expenditure of £427 million was represented by that category.
Table 2.5: Size Distribution of Acquisition Expenditure 1966-73
Proportions of Totals

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>0-</td>
<td>72</td>
<td>10</td>
<td>59</td>
<td>5</td>
<td>46</td>
<td>1</td>
<td>45</td>
<td>2</td>
<td>42</td>
<td>3</td>
<td>31</td>
<td>2</td>
<td>41</td>
<td>2</td>
<td>46</td>
<td>2</td>
<td>45</td>
<td>2</td>
</tr>
<tr>
<td>0.5-</td>
<td>14</td>
<td>9</td>
<td>16</td>
<td>6</td>
<td>12</td>
<td>1</td>
<td>16</td>
<td>3</td>
<td>15</td>
<td>3</td>
<td>17</td>
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<td>2</td>
</tr>
<tr>
<td>1.0-</td>
<td>8</td>
<td>20</td>
<td>16</td>
<td>18</td>
<td>23</td>
<td>7</td>
<td>23</td>
<td>14</td>
<td>28</td>
<td>17</td>
<td>34</td>
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<td>32</td>
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<td>14</td>
<td>12</td>
<td>24</td>
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<td>10.0-</td>
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<td>40</td>
<td>9</td>
<td>71</td>
<td>16</td>
<td>89</td>
<td>10</td>
<td>69</td>
<td>8</td>
<td>63</td>
<td>6</td>
<td>47</td>
<td>7</td>
<td>59</td>
<td>12</td>
<td>76</td>
<td>9</td>
<td>71</td>
</tr>
<tr>
<td></td>
<td>100</td>
<td>100</td>
<td>100</td>
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<td>100</td>
<td>100</td>
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<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>
In summary, a feature of the all-inclusive data on the size structure of merger activity in the U.K. financial sector is the involvement of very large institutions, for while all sizes of firms were taken over, the firms for which at least £10 million was paid, accounted for some 70% of the total expenditure in the period.

The tendency for acquisitions to become larger which also indicates the participation of large firms in merger activity is reflected as well in the analysis of annual average considerations, contained in Table 2.6.

Table 2.6: Average Consideration paid by Financial Companies 1966-73

<table>
<thead>
<tr>
<th>Year</th>
<th>Average Consideration (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966</td>
<td>1.1</td>
</tr>
<tr>
<td>1967</td>
<td>1.8</td>
</tr>
<tr>
<td>1968</td>
<td>8.7</td>
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<tr>
<td>1969</td>
<td>3.7</td>
</tr>
<tr>
<td>1970</td>
<td>3.0</td>
</tr>
<tr>
<td>1971</td>
<td>3.7</td>
</tr>
<tr>
<td>1972</td>
<td>3.7</td>
</tr>
<tr>
<td>1973</td>
<td>4.8</td>
</tr>
</tbody>
</table>

These trends have not received the attention nor the study that they merit, for economists and legislators have been traditionally concerned with another trend in the economy - that towards increasing seller concentration in one or more markets. As noted earlier, the financial sector has also been relatively neglected. In the context of the generally increasing size of firms and rising aggregate concentration, it is surprising that acquisition behaviour in this sector has apparently gone unnoticed although the trend points towards bigger mergers and the involvement of bigger financial institutions in financial sector merger activity.
2.3.3 Direction of Takeover Activity

Any detailed satisfactory analysis of the nature/direction of financial institutions' acquisitions, and hence analysis of their effects on industrial and market structure confronts us with several problems. Some of these were raised in Chapter 1. Briefly they involve the a priori difficulties of identifying and measuring market boundaries, and problems of definition which impede estimation of the population of firms in a market. Moreover, the relevant Minimum List Headings of the S.I.C. - 860: Other financial institutions - are too broad to be of analytical use.

Thus, although one hesitates to order acquisitions into the traditional categories and does not want to prejudice subsequent analyses, examination and comparison of the leading diagonals in Tables 2.7 and 2.8 is probably sufficiently valid for the purposes of this part of the study and for this stage of the research. Accordingly like other studies which have attempted to determine and examine the changing types of integration chosen by acquiring firms, consideration of Table 2.7 and 2.8 does imply that financial institutions' acquisitions have tended to be increasingly diversificatory. Of 255 acquisitions recorded for 1966-69 costing £1024 million, some 40% by number and 82% by expenditure appear in the leading diagonal; whereas for the second period, of 412 acquisitions (£1378 million) only 27% by number and 33% by expenditure involved firms in the same financial industry.

The apparent move towards diversification is confirmed by examination of the business of acquired firms. The proportion of non-financial firms, for example, in the population of acquired firms shows a significant increase from 34% in period one to 48% in period two. Indeed, particularly in terms of expenditure, these results are substantially confirmed: expenditure on acquiring non-financial companies increased from 6% of all expenditure on acquisitions for 1966-69 to 34% for 1970-73.
Table 2.7: Comparison of type of integration in financial company acquisitions 1966-69

<table>
<thead>
<tr>
<th>Acquiring Cos.</th>
<th>Acquired Cos.</th>
<th>HP</th>
<th>Insurance Companies</th>
<th>Investment Trusts</th>
<th>Unit Trusts</th>
<th>Other Financial Companies</th>
<th>Non Financial Companies</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>412 (9)</td>
<td>- ( - )</td>
<td>13 (5)</td>
<td>13 (4)</td>
<td>- (-)</td>
<td>3 (4)</td>
<td>18 (13)</td>
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<td>146 (25)</td>
<td>- (1)</td>
<td>- (-)</td>
<td>11 (2)</td>
<td>203 (33)</td>
<td></td>
</tr>
<tr>
<td>IT</td>
<td>- ( - )</td>
<td>- ( - )</td>
<td>- (3)</td>
<td>255 (41)</td>
<td>1 (1)</td>
<td>10 (25)</td>
<td>228 (44)</td>
<td></td>
</tr>
<tr>
<td>UT</td>
<td>- ( - )</td>
<td>- ( - )</td>
<td>- ( - )</td>
<td>- ( - )</td>
<td>6 (5)</td>
<td>2 (2)</td>
<td>8 (7)</td>
<td></td>
</tr>
<tr>
<td>Other Fin</td>
<td>- ( - )</td>
<td>9 (4)</td>
<td>- (3)</td>
<td>8 (6)</td>
<td>- (-)</td>
<td>15 (13)</td>
<td>54 (47)</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>64 (16)</td>
<td>159 (36)</td>
<td>276 (52)</td>
<td>7 (6)</td>
<td>42 (49)</td>
<td>64 (87)</td>
<td>1024 (255)</td>
<td></td>
</tr>
</tbody>
</table>

Source: Bank of England data

Table 2.8: Comparison of type of integration in financial company acquisitions 1970-73

<table>
<thead>
<tr>
<th>Acquiring Cos.</th>
<th>Acquired Cos.</th>
<th>HP</th>
<th>Insurance Companies</th>
<th>Investment Trusts</th>
<th>Unit Trusts</th>
<th>Other Financial Companies</th>
<th>Non Financial Companies</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks</td>
<td></td>
<td>39 (4)</td>
<td>7 (3)</td>
<td>10 (5)</td>
<td>- (-)</td>
<td>174 (14)</td>
<td>98 (13)</td>
<td>407 (42)</td>
</tr>
<tr>
<td>HP</td>
<td>- ( - )</td>
<td>17 (7)</td>
<td>- (-)</td>
<td>- (-)</td>
<td>- (-)</td>
<td>- (4)</td>
<td>- (-)</td>
<td>17 (11)</td>
</tr>
<tr>
<td>Ins</td>
<td>28 (1)</td>
<td>1 (1)</td>
<td>105 (28)</td>
<td>49 (3)</td>
<td>- (1)</td>
<td>5 (3)</td>
<td>130 (10)</td>
<td>318 (47)</td>
</tr>
<tr>
<td>IT</td>
<td>- ( - )</td>
<td>1 (1)</td>
<td>- (1)</td>
<td>201 (30)</td>
<td>2 (3)</td>
<td>34 (27)</td>
<td>58 (42)</td>
<td>296 (104)</td>
</tr>
<tr>
<td>UT</td>
<td>- ( - )</td>
<td>- ( - )</td>
<td>- ( - )</td>
<td>- ( - )</td>
<td>- ( - )</td>
<td>- ( - )</td>
<td>- ( - )</td>
<td>- ( - )</td>
</tr>
<tr>
<td>Other Fin</td>
<td>2 (2)</td>
<td>1 (1)</td>
<td>57 (12)</td>
<td>45 (13)</td>
<td>5 (5)</td>
<td>51 (43)</td>
<td>179 (132)</td>
<td>340 (208)</td>
</tr>
<tr>
<td>Total</td>
<td>109 (6)</td>
<td>169 (44)</td>
<td>305 (51)</td>
<td>7 (9)</td>
<td>264 (91)</td>
<td>465 (197)</td>
<td>1378 (412)</td>
<td></td>
</tr>
</tbody>
</table>

Source: Bank of England data
Of particular relevance to those interested in changes in market structure and seller concentration specifically, is the relative concentration of acquisitions of firms in the same industry. This information can be extracted from Table 2.9 which classifies acquisitions involving expenditure of at least £1 million, according to different types of integration.

While other types of integration show no violent fluctuations in year-on-year changes, of £1237.8 million spent on financing acquisitions between firms in the same industry, some 65% took place before 1970. This implies that major consolidations and rationalization and any material increases in seller concentration occurred in a relatively brief period, whereas diversification has been a more gradual process.

Because of the caution expressed above, no definitive conclusions can be drawn at this stage regarding the direction of financial sector merger activity. However, quite clearly cumulative evidence now indicates that financial companies' acquisitions merit more detailed surveillance.
Table 2.9: Aggregate analysis of type of integration in financial company acquisitions, 1966-73

<table>
<thead>
<tr>
<th></th>
<th>Some financial industry</th>
<th>Different financial industry</th>
<th>Non-financial Companies</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No (%</td>
<td>Val (£m</td>
<td>No (%</td>
<td>Val (£m</td>
</tr>
<tr>
<td>1966</td>
<td>4 (80)</td>
<td>29.9 (87)</td>
<td>- (-)</td>
<td>- (-)</td>
</tr>
<tr>
<td>1967</td>
<td>7 (78)</td>
<td>46.7 (78)</td>
<td>1 (11)</td>
<td>11.5 (19)</td>
</tr>
<tr>
<td>1968</td>
<td>20 (71)</td>
<td>542.1 (95)</td>
<td>2 (7)</td>
<td>3.6 (1)</td>
</tr>
<tr>
<td>1969</td>
<td>16 (52)</td>
<td>186.3 (66)</td>
<td>8 (26)</td>
<td>80.5 (29)</td>
</tr>
<tr>
<td>1970</td>
<td>14 (36)</td>
<td>141.2 (54)</td>
<td>13 (33)</td>
<td>83.0 (32)</td>
</tr>
<tr>
<td>1971</td>
<td>13 (38)</td>
<td>111.1 (48)</td>
<td>7 (21)</td>
<td>46.1 (20)</td>
</tr>
<tr>
<td>1972</td>
<td>19 (35)</td>
<td>158.1 (41)</td>
<td>13 (24)</td>
<td>77.1 (20)</td>
</tr>
<tr>
<td>1973</td>
<td>3 (8)</td>
<td>22.4 (5)</td>
<td>16 (53)</td>
<td>218.4 (53)</td>
</tr>
<tr>
<td>Total</td>
<td>96 (40)</td>
<td>1237.8 (55)</td>
<td>60 (25)</td>
<td>520.2 (23)</td>
</tr>
</tbody>
</table>

Source: Bank of England data
2.3.4 Takeover activity - methods of finance

In the past the attention of economists has been focused on how efficiently U.K. capital markets have performed their role of channelling personal savings into industrial investment. The functions of financial institutions in this process have also been the subject of considerable research. In theory, the capital markets should also perform a disciplinary function as a mechanism which punishes poor corporate performance with a low stock value enhancing the probability of takeover. Although there is not a consensus regarding the effectiveness of this discipline, there is wide agreement that a very close relationship exists between merger activity and stock market conditions. It is probable that stock market phenomena are superficial influences affecting the timing of merger activity rather than the basic or underlying causes of mergers.

Even cursory observation of industrial merger trends confirms the importance of the capital market as an important factor in merger movements. The prolonged bull markets of 1968 and 1969 were accompanied by high levels of acquisition activity; similarly the rise in share prices in 1971-1972, when the Financial Times ordinary share index reached an all-time high, signalled an historically unprecedented level of acquisition expenditure.

For financial companies' acquisitions, a similar trend is discernible. A much closer relationship, however, is observed between those acquisitions financed by securities and stock market conditions. Table 2.10 analyses methods of financing acquisitions by financial institutions, and these data are plotted against movements in the F.T. index in Figure 2.5.
Table 2.10: Methods of payment for acquisitions by Financial companies

<table>
<thead>
<tr>
<th></th>
<th>Cash</th>
<th>Securities</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>£m</td>
<td>%</td>
<td>£m</td>
<td>%</td>
</tr>
<tr>
<td>1966</td>
<td>20.8</td>
<td>21.5</td>
<td>42.3</td>
</tr>
<tr>
<td>1967</td>
<td>25.4</td>
<td>41.7</td>
<td>67.1</td>
</tr>
<tr>
<td>1968</td>
<td>31.3</td>
<td>555.1</td>
<td>586.4</td>
</tr>
<tr>
<td>1969</td>
<td>29.4</td>
<td>297.0</td>
<td>326.4</td>
</tr>
<tr>
<td>1970</td>
<td>26.1</td>
<td>254.6</td>
<td>280.7</td>
</tr>
<tr>
<td>1971</td>
<td>30.4</td>
<td>223.1</td>
<td>253.5</td>
</tr>
<tr>
<td>1972</td>
<td>59.6</td>
<td>346.4</td>
<td>406.0</td>
</tr>
<tr>
<td>1973</td>
<td>193.9</td>
<td>244.0</td>
<td>437.9</td>
</tr>
<tr>
<td>416.8</td>
<td>17</td>
<td>1983.4</td>
<td>2400.2</td>
</tr>
</tbody>
</table>

Source: Bank of England data

From Figure 2.5 it can be seen that the fall in share prices after mid-1972 which became pronounced in 1973 was not accompanied by a fall in the level of expenditure on financial sector acquisitions. Indeed this index showed a rise from 1972 to 1973. Those acquisitions financed by securities did however show a corresponding fall. Further, from Table 2.10, this marked a departure from the most usual method of effecting acquisitions in the financial sector - by share exchange, for over the previous five years, at least 85% of all acquisitions by financial institutions were financed by equity or loan stock.

Thus the rise in the level of acquisition expenditure in 1973 may be attributed to 'cash financing'. In fact some 44% of acquisitions effected in that year were financed in this way - a strategy facilitated by the considerable and rapid monetary growth which created excess liquidity amongst the financial intermediaries.
2.3.5 Takeover activity - the active sectors

A further step in the analysis of merger activity in the financial sector is to classify the acquiring firms to the industry or area in which they operate. Problems of definition have been noted above and although banking, for example, now covers a wide range of services, the broad categorization below serves to illustrate the relatively concentrated pattern of acquisitions. Firms are classified by main activity.

Acquisitions and mergers initiated by banks and insurance companies are seen to account for 58% of all financial sector amalgamations by value. By number, however, they represent less than one quarter of the total (23%), indicating the large size of mergers and acquisitions in these sectors.

The validity of the results of the statistical investigation into the acquisitions and mergers of financial intermediaries, however, depends almost entirely on the method of industry classification used - how accurate it is and how realistic it is. Further comment requires a more detailed analysis - one which takes into account the different market structures and competitive environments within the financial sector.
Table 2.11: Acquisitions by financial companies - sectoral analysis by numbers; proportion of total shown in brackets

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks</td>
<td>4</td>
<td>(11)</td>
<td>8</td>
<td>(21)</td>
<td>9</td>
<td>(12)</td>
<td>14</td>
<td>(4)</td>
<td>16</td>
</tr>
<tr>
<td>Insurance</td>
<td>9</td>
<td>(24)</td>
<td>8</td>
<td>(21)</td>
<td>12</td>
<td>(16)</td>
<td>5</td>
<td>(5)</td>
<td>8</td>
</tr>
<tr>
<td>Fin. Hses.</td>
<td>0</td>
<td>(0)</td>
<td>3</td>
<td>(8)</td>
<td>4</td>
<td>(5)</td>
<td>9</td>
<td>(9)</td>
<td>2</td>
</tr>
<tr>
<td>Unit tsts.</td>
<td>2</td>
<td>(5)</td>
<td>2</td>
<td>(5)</td>
<td>1</td>
<td>(1)</td>
<td>3</td>
<td>(3)</td>
<td>0</td>
</tr>
<tr>
<td>Inv. tsts.</td>
<td>17</td>
<td>(44)</td>
<td>13</td>
<td>(34)</td>
<td>33</td>
<td>(45)</td>
<td>44</td>
<td>(45)</td>
<td>43</td>
</tr>
<tr>
<td>Others</td>
<td>6</td>
<td>(16)</td>
<td>4</td>
<td>(11)</td>
<td>14</td>
<td>(19)</td>
<td>23</td>
<td>(23)</td>
<td>31</td>
</tr>
<tr>
<td></td>
<td>38</td>
<td>(100)</td>
<td>38</td>
<td>(100)</td>
<td>73</td>
<td>(100)</td>
<td>98</td>
<td>(100)</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Bank of England data
Table 2.12: Acquisitions by financial companies
sectoral analysis by value;
proportion of total in brackets

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
<td>£m</td>
</tr>
<tr>
<td>Banks</td>
<td>26 (62)</td>
<td>6 (9)</td>
<td>345 (58)</td>
<td>81 (25)</td>
<td>99 (35)</td>
<td>37 (15)</td>
<td>123 (30)</td>
<td>145 (33)</td>
<td>862 (36)</td>
</tr>
<tr>
<td>Insurance</td>
<td>1 (2)</td>
<td>52 (76)</td>
<td>104 (18)</td>
<td>46 (14)</td>
<td>21 (7)</td>
<td>83 (83)</td>
<td>59 (15)</td>
<td>156 (36)</td>
<td>522 (22)</td>
</tr>
<tr>
<td>Fin. Hses.</td>
<td>0 (0)</td>
<td>3 (4)</td>
<td>2 (0)</td>
<td>6 (2)</td>
<td>16 (6)</td>
<td>0 (0)</td>
<td>1 (0)</td>
<td>1 (0)</td>
<td>29 (1)</td>
</tr>
<tr>
<td>Unit tsts.</td>
<td>1 (2)</td>
<td>0 (0)</td>
<td>1 (0)</td>
<td>6 (2)</td>
<td>0 (0)</td>
<td>0 (0)</td>
<td>0 (0)</td>
<td>0 (0)</td>
<td>8 (0)</td>
</tr>
<tr>
<td>Inv. tsts.</td>
<td>12 (29)</td>
<td>4 (6)</td>
<td>121 (21)</td>
<td>156 (48)</td>
<td>110 (39)</td>
<td>68 (27)</td>
<td>10r (26)</td>
<td>18 (4)</td>
<td>593 (25)</td>
</tr>
<tr>
<td>Others</td>
<td>2 (5)</td>
<td>3 (4)</td>
<td>17 (5)</td>
<td>32 (10)</td>
<td>38 (13)</td>
<td>65 (26)</td>
<td>118 (29)</td>
<td>119 (27)</td>
<td>394 (16)</td>
</tr>
<tr>
<td>Totals</td>
<td>42 (100)</td>
<td>68 (100)</td>
<td>590 (100)</td>
<td>327 (100)</td>
<td>284 (100)</td>
<td>253 (100)</td>
<td>405 (100)</td>
<td>439 (100)</td>
<td>2408 (100)</td>
</tr>
</tbody>
</table>

Source: Bank of England data
NOTES


2: i.e. horizontal, vertical and diversified (conglomerate) mergers


PART TWO: THE COMPETITIVE ENVIRONMENT AND MERGER ACTIVITY IN THE FINANCIAL SECTOR
Throughout their history, the financial institutions in the City of London have been shrouded in mystery. This was partly the creation of the institutions which conducted their activities with great secrecy, but also stemmed from a general lack of understanding of their activities and their modus operandi. In the last twenty years much has been done to further understanding of the workings of the financial system. The Report of the Radcliffe Committee in 1959 uncovered some secrets, especially unpublished statistics. Since then various other bodies have investigated the financial markets and monetary system, and different aspects of the role and operation of the financial sector have been studied by individual commentators. Indeed, at the time of writing, the Wilson Committee has barely started its report on the workings of the financial service industries, and the efficiency with which they supply and channel funds into productive investment.

Examination of the reports and texts on the financial sector, reveals continual change in the environments within which financial institutions have competed. In the late 1960s changes began to take place in the structure of banking and other financial markets; in the 1970s the continuation of this process blurred many of the demarcation lines between and within the financial service industries. There has been in particular, an erosion of the cartels and restrictions - both self-imposed and the government-inflicted - which had previously divided the City's institutions into fairly autonomous compartments, separated according to function. New markets have developed and old ones have declined. There has been, moreover, considerable expansion of the ranges of products and services supplied by financial companies and substantial geographical extension of the markets in which they are sold.
Acquisitions and mergers have facilitated an increase in the scale of operations and a diversification of business. The stresses of change and the long and sometimes hesitating process of corporate adaptation should not be confused, however, with a series of relatively isolated occurrences - important as these may have been as symptoms of some aspects of that process. Rather the development and structural change is to be seen in the details of business procedure, organisation and decisions of the companies involved. But these can only be effectively appraised in the context of an industry as a whole: strengths and weaknesses of one firm, or indeed its merger behaviour, are after all only relative matters. Hence a large part of the explanation of the merger activity of banks and other financial companies is concerned with the changing environment within which the firms operate, as well as the firms' strategic responses to it, and the patterns and problems of industrial change and corporate modernisation.
CHAPTER THREE

Acquisitions and Mergers by Banking Institutions

Detailed analysis of the nature and direction of banking institutions' acquisitions can be made by an examination of the leading diagonals of Tables 3.1 and 3.2. These give some indication of the direction of merger activity, and in particular show the extent to which acquisition and mergers were 'horizontal' and diversified.

The reduction in the proportion of 'horizontal' amalgamations between all financial institutions, noted in Chapter Two, is substantially reflected in the banking sector. Of 31 acquisitions initiated by banks during 1966-69, 23% appear in the leading diagonal; whereas, of the 35 acquisitions effected during the second period, only 14% were 'horizontal'. The trend towards increasing diversification becomes more pronounced in terms of acquisition expenditure: expenditure on 'horizontal' acquisitions fell from 80% of total expenditure for the first period, to 14% for the second.

The apparent tendency towards increasingly diversified mergers, identified for the banking sector as a whole, is not however, a common feature of all three groups of indigenous banks.

This description does hold for the clearing banks but, in contrast the acquisitions undertaken by merchant banks were diversified throughout the 8-year period and B.O.Bs expended some 65% of total acquisition expenditure on 'horizontal' integration, in the 1970-73 period.

More pronounced differences in the banks' acquisition behaviour may be discerned by examination of the average size of amalgamations that each undertook: the clearing banks', for example, expended on average £41 million on each acquisition; whereas the B.O.B's average expenditure was £14.9 million, and that of the merchant banks, £4.5 million. These figures, in turn, given an indication of the relative sizes of banks in various sectors of the banking industry.
Table 3.1: Banking Acquisitions and Mergers, 1966-69

(No. acquired in brackets)

<table>
<thead>
<tr>
<th>Acquiring Companies</th>
<th>Clearing Bank</th>
<th>Merchant Bank</th>
<th>British Overseas Bank</th>
<th>H.P.</th>
<th>Insurance</th>
<th>Other Financial</th>
<th>Non-Financial</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clearing Bank</td>
<td>369.9(6)</td>
<td>(-)</td>
<td>8.9(1)</td>
<td>42.0(1)</td>
<td>0.3(1)</td>
<td>(-)</td>
<td>1.2(2)</td>
<td>422.3(11)</td>
</tr>
<tr>
<td>Merchant Bank</td>
<td>(-)</td>
<td>(-)</td>
<td>(-)</td>
<td>13.4(3)</td>
<td>14.4(6)</td>
<td>16.4(10)</td>
<td>(-)</td>
<td>44.2(19)</td>
</tr>
<tr>
<td>British Overseas Bank</td>
<td>(-)</td>
<td>(-)</td>
<td>26.6(1)</td>
<td>(-)</td>
<td>(-)</td>
<td>(-)</td>
<td>(-)</td>
<td>26.6(1)</td>
</tr>
<tr>
<td></td>
<td>369.9(6)</td>
<td>(-)</td>
<td>35.5(2)</td>
<td>42.0(1)</td>
<td>13.7(4)</td>
<td>14.4(6)</td>
<td>17.6(12)</td>
<td>493.1(31)</td>
</tr>
</tbody>
</table>

Table 3.2: Banking Acquisitions and Mergers, 1970-73

<table>
<thead>
<tr>
<th>Acquiring Companies</th>
<th>Clearing Bank</th>
<th>Merchant Bank</th>
<th>British Overseas Bank</th>
<th>H.P.</th>
<th>Insurance</th>
<th>Other Financial</th>
<th>Non-Financial</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clearing Bank</td>
<td>(-)</td>
<td>93.4(1)</td>
<td>(-)</td>
<td>15.0(7)</td>
<td>34.1(11)</td>
<td>71.0(4)</td>
<td>17.6(1)</td>
<td>111.0(2)</td>
</tr>
<tr>
<td>Merchant Bank</td>
<td>(-)</td>
<td>29.7(2)</td>
<td>(-)</td>
<td>(-)</td>
<td>4.8(4)</td>
<td>0.2(1)</td>
<td>122.7(9)</td>
<td>149.8(24)</td>
</tr>
<tr>
<td>British Overseas Bank</td>
<td>(-)</td>
<td>(-)</td>
<td>79.7(3)</td>
<td>38.0(1)</td>
<td>38.9(15)</td>
<td>88.8(6)</td>
<td>383.5(33)</td>
<td>(-)</td>
</tr>
<tr>
<td></td>
<td>(-)</td>
<td>123.1(3)</td>
<td>79.7(3)</td>
<td>38.0(1)</td>
<td>15.0(7)</td>
<td>38.9(15)</td>
<td>(-)</td>
<td>(-)</td>
</tr>
</tbody>
</table>
3.1: Deposit banks' acquisitions 1966-73

The most striking feature of the data reproduced in Tables 3.1 and 3.2 is the high level and concentration of the clearing banks' expenditure on 'horizontal' acquisitions. During the eight-year period, the clearing banks expended a total of £533.3 million on acquisitions. Some 69% of this was recorded in the first period and was represented by the acquisition of other clearing banks. In fact, the banks' 'horizontal' merger activity was even more concentrated. In 1968 alone, three mergers, involving expenditure in excess of £320 million brought about fundamental changes in the structure of the U.K. retail banking market.

3.1.1: Horizontal Integration

3.1.1.1 1968 Bank Mergers

The merger proposals were announced in the first two months of the year; two related to English clearing banks, the third mainly to Scottish banks. The first announcement was the merger of the National Provincial and Westminster Banks, an amalgamation valued at £177 million which resulted in the formation of the National Westminster Bank. The second, amalgamated the Royal Bank of Scotland with the National Commercial Bank of Scotland, creating the National and Commercial Banking Group which also owned the capital of Williams Deacon's, Glyn Mills and National Bank, from which Williams and Glyn's was formed in 1970.

Both mergers appear to have been the product of some months of consideration and deliberation. The same cannot, however, be claimed for the third proposal. Talk of the acquisition of Martins Bank first arose in December 1967 with the bank's announcement that it was studying proposals to merge or associate itself with another bank. An affirmative conclusion, reached in January, led to the Bank of England organizing an 'auction' for Martins.

Following this procedure, Barclays and Lloyds made separate bid proposals, but before either bank had made 'final' revised offers, the National Provincial-Westminster proposal was announced.
The proposed formation of National Westminster created a new situation whereby Barclays would have been displaced as Britain's largest bank, in all aspects except gross deposits, as Table 3.3. reveals:

Table 3.3: National Provincial/Westminster: Barclays Bank
A Comparison, End-1967

<table>
<thead>
<tr>
<th></th>
<th>Barclays</th>
<th>NP/West</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Deposits (£ million)</td>
<td>4049</td>
<td>3447</td>
</tr>
<tr>
<td>Total Branches in British Isles (approx)</td>
<td>2850</td>
<td>3610</td>
</tr>
<tr>
<td>No. of staff (approx)</td>
<td>38000</td>
<td>42500</td>
</tr>
<tr>
<td>No. of current accounts (000s)</td>
<td>3250-3500</td>
<td>4000-4500</td>
</tr>
<tr>
<td>No. of current accounts on computer (000s)</td>
<td>700</td>
<td>2600</td>
</tr>
<tr>
<td>No. of branches on computer</td>
<td>200</td>
<td>918</td>
</tr>
</tbody>
</table>

Source: The Banker

Shortly afterwards, Barclays and Lloyds, the sole bidders for Martins, announced their intention to effect a tripartite merger. The former shared similar approaches to decentralised administration and overseas business, but it was the National Provincial/Westminster announcement that precipitated the Barclays-Lloyds move, as both banks acknowledged.¹

The third merger proposal inevitably provoked considerably more comment than the prior intention of either Barclays of Lloyds to acquire Martins. This would have been regarded as the acquisition by a major clearing bank of the last independent regional bank² - a natural step in the absorption or coalescing of the regional banks. Instead, the creation of a mammoth bank was envisaged whose sheer size alone invoked questions of public concern.³

For example, the group would have handled 48% of total clearing bank deposits and supplied approximately 25% of all call money to the discount market. It represented, moreover, a reduction in the number of independent suppliers of credit and was considered by the Treasury and Bank of England to create pressures that would lead to a duopoly in the provision of retail banking services.⁴
Official concern was reflected in the referral of the proposed merger to the Monopolies Commission which submitted a majority report against the merger.\textsuperscript{5} The Board of Trade accepted the majority recommendation, that the merger would produce a less competitive banking system, and did not allow the merger. No objection was raised, however, to either Barclays or Lloyds acquiring Martins. In the event the former, effected the acquisition by virtue of their higher bid during the Bank of England's auction.\textsuperscript{6}

As a result, by mid-1968 the broad structure of U.K. retail banking was determined. It was dominated by four independent clearing banks - Barclays, National Westminster, Midland and Lloyds.

3.1.1.2: Rationale/Competitive Environment

Several factors influenced the nature and timing of the 1968 mergers. Some were intrinsic to the development of the banking industry and considerably affected the nature and direction of the amalgamations. The concentration of activity in 1968, however, owes more to the official environment within which the banks had operated, in particular, the method by which the Bank of England had exercised its control over the banking sector.

The system, based on suasion rather than statute, has two essential aspects - good communications between the Central Bank and commercial banks, and sanctions which are never actually applied. The Monopolies Commission report exposed serious flaws in the relationship between the authorities and the banks and confirmed that the government itself had been an obstacle to structural development of the banking industry. Indeed for 50 years there had been an almost total absence of acquisitions by clearing banks. This was caused initially by the authorities' acceptance of the doctrines laid down in the Colwyn Committee of 1918.\textsuperscript{7} The report observed that the larger British banks considered it necessary to match each important merger by another, in order to preserve an approximate balance of resources and competitive power. The Committee did not specifically ban amalgamations between banks but recommended that some measure of Government control was essential because of the strategic importance to the
economy of the banking sector. The resort to legislation proved unnecessary, however; instead the banks gave an undertaking that they would submit any merger proposals for official approval.

The procedure whereby the banks would approach the Bank of England, which would consult the Treasury before conveying the authorities' decision, led to the notion, in the absence of a clear policy, that the authorities were opposed in general to further mergers. This view persisted until the enquiry by the Prices and Incomes Board, in 1967, which revealed, for the first time, that the authorities were prepared to question the attitude to bank mergers which underlay the recommendations of the Colwyn Committee:

'Further amalgamations among the banks carried through to the appropriate point, could permit some rationalisation of existing networks. The Bank of England and the Treasury have made it plain to us that they would not obstruct some further amalgamations if the banks were willing to contemplate such a development.'

Notwithstanding this development, the apparent inadequacy of communications between the authorities and the banks, in spite of their close working relationships, fostered considerable misunderstanding in the intervening period. A similar view was expressed by the Monopolies Commission:

'The evidence ... suggested that, over the years those banks which believed mergers would be beneficial to the public interest did not seriously attempt to convert the authorities or public opinion to their point of view.'

In a number of respects then, official attitudes, an important aspect of the banks' competitive environment, influenced their merger activity.

The acceptance by the authorities of the doctrines of the Colwyn Committee and the subsequent informality of communications constrained the clearing banks from effecting major amalgamations. The report of the Prices and Incomes Board, some 50 years later, acted as a catalyst to the spate of 'horizontal' mergers in 1968. Finally, the Government, acting on the Report of the Monopolies Commission has apparently terminated, once again, further links...
between the clearing banks.

It is in the context of changes in other aspects of the banks' competitive environment that those motives, intrinsic to the retail banking market, should be examined. For example, the advent of computer technology and the approach of decimalization, encouraged the banks to plan the installation of computers and ancillary equipment. The banks considered it prudent to carry out some major reorganisations, implied by the proposed mergers, before incurring the costs of investment in mergers - estimated for 1968 at £60 million. The rationale of this argument originates from the belief that there are significant economies of large scale in banking to be gained by increasing the number of accounts handled by one computer. Apart from the expense of the computerisation, this does not by itself establish that merger would reduce the cost per average account appreciably.

A second motive related to the considerable merger activity in manufacturing and other industrial sectors during the twentieth century whilst the growth of banking units, as noted, had been effectively restricted. Thus customers' borrowing requirements, previously small, became large relative to the banks' lending capacities, which were also subject to official control. A prima facie case existed therefore for larger deposit and capital bases for the clearing banks. The difficulty posed by the considerable borrowing requirements of a number of major customers was one of the reasons given by Martins Bank when proposing association/merger with another bank. Similarly, when District Bank was acquired by National Provincial in 1962, 10% of its outstanding advances were to one company, Leyland Motors; and at the time of its merger with Westminster it also had B.P. and Ford among its corporate clients.
A third general rationale for the mergers can be considered under the heading of 'competition'. Indeed the merger proposals were a sequel to the report of the Prices and Incomes Board which recommended more competition among the banks. But they reflected the banks' interpretation of the call for more competition (rather than the P.I.B's suggestion) which stressed the competitive advantages of size in banking. The competitive reasons given for the mergers should not, however, be confused with their competitive effects - these are another complex and contentious issue.

The most notable characteristic of the banks' competitive environment was the absence of direct price competition between the clearing banks. This was the product of two factors: firstly, non-disclosure of profits had prevented 'informed comparison of performance and profitability' that might have stimulated efficiency and competition; secondly, the banks' interest-rate cartel agreement inhibited competition in seeking deposits. Competition between the clearing banks was therefore concentrated on non-price variables, with particular emphasis on 'service'. The costs of rivalry incurred by extensive branch expansion were, however, high. Mergers provided an opportunity for the rationalisation of the structure of the retail banking market by facilitating the elimination of overlapping branch networks. This was envisaged by National Provincial and Westminster, and by 1974 some 400 branches had been closed.14
The operation of a cartel agreement on interest rates which restricted inter-clearing bank competition also encouraged competition for personal banking services from public sector banking intermediaries - notably the Post Office Savings Bank and the Trustee Savings Banks. Moreover, increased competition for retail deposits was threatened by the establishment of a National Giro in 1968. This additional spur of competition apparently encouraged the banks to think in terms of amalgamation. It was considered that a re-grouping of banks into a smaller number of larger banks would be an effective way of meeting this challenge.

A similar rationale was applied to the need for large size in order to compete in the provision of large loans to international customers, in competition with U.S. and Continental banks.

3.1.2: Diversification

3.1.2.1 Expansion into secondary banking markets to 1971

The maintenance of the deposit rate cartel in a period of rising interest rates undoubtedly helped the banks to absorb rising costs by automatically providing increasing revenues. Moreover, as the P.I.B. report argued, the cartel system of bank service pricing was a source of inefficiency which inhibited price competition for personal banking business. The banking industry did not consider this to be the case however. The apparently irreconcilable views on the subject of competition and mergers arise from the failure to recognise that banks are multiproduct firms, marketing a variety of products and services both on the deposit and lending side.

The clearing banks were operating in separate and separable markets, in which they faced competition from different financial institutions. The rapid growth of the secondary banking markets in the 1960s and the relative decline of the clearing banks in relation to the banking system as a whole (illustrated in Table 3.4) suggest that competition from non-clearing bank intermediaries had been successful.
Table 3.4: Banking Institutions - Market Share of Deposits, 1958-1966

<table>
<thead>
<tr>
<th>Deposit Banks</th>
<th>1958</th>
<th>1966</th>
<th>1958</th>
<th>1966</th>
</tr>
</thead>
<tbody>
<tr>
<td>London Clearing Banks</td>
<td>163</td>
<td>148</td>
<td>73.3</td>
<td>53.2</td>
</tr>
<tr>
<td>Scottish Banks</td>
<td>143</td>
<td>222</td>
<td>8.0</td>
<td>5.5</td>
</tr>
<tr>
<td>Northern Ireland Banks</td>
<td>143</td>
<td>222</td>
<td>1.5</td>
<td>1.2</td>
</tr>
<tr>
<td>Other</td>
<td>311</td>
<td>350</td>
<td>3.2</td>
<td>2.0</td>
</tr>
<tr>
<td>Total</td>
<td>2,444</td>
<td>11,055</td>
<td>(86%)</td>
<td>(62%)</td>
</tr>
</tbody>
</table>

Secondary Banks

| Accepting Houses       | 212 | 1,135 | 2.2 | 6.4 |
| British Overseas Banks | 573 | 1,811 | 5.8 | 10.1 |
| American Banks         | 129 | 2,215 | 1.3 | 12.4 |
| Other*                 | 460 | 1,646 | 4.7 | 9.2 |
| Total                  | 1,374 | 6,807 | (14%) | (38%) |

Source: Bank of England Quarterly Bulletin

*Including Clearing Bank subsidiaries

In spite of double-counting faults with the data, especially for the secondary system banks, the table clearly indicates that between 1958 and 1968 the proportion of deposits in the hands of the clearing banks declined significantly. The clearing banks were initially handicapped in their attempts to tap the wholesale deposit market by their reluctance to offer separate rates for wholesale and retail deposits.
The issue of diversification of clearing bank lending was a direct response. Indeed it was recognised as a pre-requisite for the competitive bidding for money market deposits. According to Nevin and Davis:

'Most bankers argue that it would not be feasible for them to offer higher rates for deposits unless they were also able, in turn, to engage in new types of lending at higher rates - for example, hire purchase finance, factoring and so on.'17

As a result, specialist subsidiaries were either acquired or established for the specific purpose of competing in the secondary markets. The subsidiaries afforded the clearing banks the opportunity to channel funds into the profitable instalment credit market and to provide medium-term credit at higher rates. Moreover, these forms of lending were separable from the banks’ primary activities and their subsidiaries, in common with other secondary banks, were outside the Bank of England's prohibitive liquid assets requirement. Thus the clearing banks were able to increase their lending beyond their own restricted limits.

The movement towards participation in the wholesale money markets began in 1958 when the clearers acquired either controlling interests or substantial minority holdings in all but two of the largest finance houses.18 By 1968, the London clearing banks had the following interests in instalment credit companies:
Table 3.5: London Clearing Banks/H.P. Interests

<table>
<thead>
<tr>
<th>Bank</th>
<th>Hire Purchase Company</th>
<th>% of equity held by bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barclays</td>
<td>U.D.T.</td>
<td>28%</td>
</tr>
<tr>
<td>Martins</td>
<td>Mercantile Credit</td>
<td>17(\frac{1}{2})%</td>
</tr>
<tr>
<td>Westminster</td>
<td>Mercantile Credit</td>
<td>17(\frac{1}{2})%</td>
</tr>
<tr>
<td>National Provincial*</td>
<td>North Central Finance</td>
<td>100%</td>
</tr>
<tr>
<td>District</td>
<td>Astley Industrial Trust</td>
<td>33(\frac{1}{3})%</td>
</tr>
<tr>
<td>Midland</td>
<td>Forward Trust</td>
<td>100%</td>
</tr>
<tr>
<td>Lloyds</td>
<td>Bowmaker</td>
<td>25%</td>
</tr>
<tr>
<td></td>
<td>Lloyds and Scottish</td>
<td>50%</td>
</tr>
</tbody>
</table>

*In 1970, National Westminster acquired Lombard Banking which was later merged with North Central Finance to form Lombard North Central.

Growing concern at the 'loss' of deposits to the secondary banks in the 1960s encouraged the clearing banks to re-establish their presence in the secondary markets. The subsidiaries differed considerably in form and range of activities, but concentrated, in general, on instalment credit or international medium-term corporate loans. Many of the subsidiaries were already existing - Barclays Bank (France), Lloyds Bank Europe, the Midland Bank Finance Corporation, International Westminster and County Bank - and were re-designed to bid for wholesale deposits. On the other hand, several institutions were created - Midland and International Banks (M.A.I.B.L.); National Provincial and Rothschilds (International), for example.

In further attempts to compete with the secondary banks and particularly with the accepting houses, which had been especially successful, 19 three of the London clearing banks developed specialised merchant banking subsidiaries. Barclays, for example, extended the activities of its main money market subsidiary, Barclays Bank (London and International) to include corporate advice services, including new issues, underwriting and acquisition advice; 20 in September 1969, National Westminster merged its capital issues department with County Bank, an issuing house which concentrated in providing advisory services, marketing short
and medium term corporate credit, and taking Sterling deposits; in 1967, having formed Midland Bank Finance Corporation to accept deposits and lend at term, Midland acquired a 1/3 interest in Montagu Trust, the owner, inter alia, of Samuel Montagu a long-established merchant bank and member of the Accepting Houses Committee; finally, in 1970, Lloyds Bank formed a sterling money market subsidiary, Lloyds Associated Banking Company (L.A.B.C.O.), with the intention of building a full-scale merchant bank.

In the late 1960s, the clearing banks also diversified into the market for specific investment advice. In 1966, Lloyds Bank Unit Trust Managers was established as a wholly-owned subsidiary of Lloyds Bank. Westminster Bank, in association with Hambros Bank, followed, with the formation of Westminster Hambros Trust Managers, owned 50% by Westminster and 25% each by Hambros and Commercial Union. Similarly Martins Bank acquired a controlling interest in the Unicorn Unit Trust Group which was absorbed by Barclays after the 1968 merger and re-named Barclays Unicorn. Barclays involvement in fund management was extended by its purchase of Southern Cross in 1973.

The diversification of the London clearing banks was not emulated by the Scottish banks, however. During the year 1969-70, the Bank of Scotland merged with the British Linen Bank, reducing the number of Scottish banks to three, and extending the rationalisation, which had begun in 1968. Finally, in 1970, Williams and Glyn's was established as a subsidiary of the National and Commercial Banking Group, in order to incorporate the business of Glyn, Mills, William's Deacons and the National Bank.

To summarise developments until 1970, the clearing banks having effected a series of 'horizontal' mergers, particularly in 1969, began to concentrate on acquisition and establishment of subsidiaries to compete with secondary and 'near' banks in the wholesale money markets. Thus by 1971, the banks were equipped to offer a range of products in the secondary banking markets to complement their main activity of providing retail banking services.
3.1.2.2: Diversification/Competition and Credit Control 1971

In September 1971, the authorities' new policy on credit restriction caused a radical change in the banks' competitive environment. It was introduced at a time when competition for wholesale, sterling and eurocurrency, deposits was steadily increasing and was mainly stimulated by the growth of American banks in the euromarkets and the plethora of indigenous 'fringe' banks. Rivalry for international and domestic banking business had encouraged the clearing banks to devote considerable resources to the formation of money market subsidiaries. The resulting structural changes, noted above, also had their own momentum and encouraged the new generation of fringe and 'near' banks to extend their product range - whether in property financing, consumer finance or stock market operations. The clearing banks remained at a competitive disadvantage, however. The interest rate cartel, described as 'soporific' by the Monopolies Commission, and the quantitative lending ceiling obliged the banks to restrict competition among themselves yet exposed them to competition from non-clearing bank financial intermediaries.\(^{21}\)

Following the publication by the clearing banks of their true profits in February 1970, new measures to control the credit system were introduced in September 1971. They followed discussions based upon the Bank of England's consultative document, issued in May of that year, entitled 'Competition and Credit Control'. The Bank considered:

'\textit{that the impediments to competition arising from the existing liquidity and quantitative credit controls should be replaced by other means of influencing bank and finance house lending in sterling, including the application of a reserve ratio across the whole banking system}'.\(^{22}\)
The emphasis of the new controls was on treating all financial institutions alike. The intention being to create a competitive banking environment, with credit allocated by the price mechanism of interest rates rather than by direct controls on lending. To this end, the quantitative ceiling on lending was removed and the clearing banks were required to abandon their collective agreement on interest rates. From October 1971, the banks were able to lend money in areas which had previously been restricted, notably consumer finance. The Bank of England specifically retained the right to provide the banks with such qualitative guidance as was seen appropriate.

It has been noted that during the late 1960s, the clearing banks came under increasing criticism for alleged lack of competitiveness, because of their interest rate cartel. It was often overlooked that the banks began to compete with other financial institutions through the formation of special subsidiaries which were flexible in their operation and could bid for deposits in competition with other secondary banks. In effect the clearers were operating a divided structure, the main deposit-taking function and relatively traditional forms of lending (for example, overdrafts) being done through the parent institutions, with their widespread branch systems; and the competitive taking of large deposits at higher rates for less orthodox and more varied forms of lending being undertaken by subsidiaries. Thus a varied and diversified banking structure developed and was perpetuated.

In spite of the structural changes, the retention of the interest rate cartel still represented a hindrance to 'free' competition.

Thus it was intended that the discriminatory relationship between the Central Bank, and the clearing banks and discount houses, should be abolished. The new system required all banks to observe, day-by-day, a uniform minimum reserve requirement; similarly all banks were required, if called upon, to place special deposits with the Bank of England.
With the abandonment of the cartel and removal of the quantitative lending ceiling, the justification for separate subsidiaries to operate hire purchase and money market deposit taking and lending ceased. Initially, the clearing banks retained the pre-cartel habit of moving off new and rapidly-growing activities to subsidiaries. During 1972, however, the first steps were taken to merge subsidiaries with the parent banks— or sell them.

In 1973, Lloyds Bank acquired the whole of the equity of Lloyds and Bolsa International, itself formed from the merger of Lloyds Bank Europe and Bank of London and South America in 1971. Similarly, Barclays Bank acquired full control of Barclays DCO, its former Dominion and Commonwealth based bank, which it re-named Barclays Bank International and whose capital it doubled to £10 million. Barclays sold its 28% stake in U.D.T., but retained an 18% holding of the equity of Mercantile Credit which it increased to 100% in 1975. National Westminster effected further product diversification with the purchase of Lombard Banking.24

Midland Bank's further diversification was more extensive. In 1972 it led a consortium in the purchase of Thomas Cook Travel Agents of which it acquired 70%. The majority stake was the first to be taken by a clearing bank in a major organisation whose principal operations were outside banking or finance.25 For Cooks, Midland Bank's branch network and the A.A.'s large membership offered considerable potential. For Midland, though, the motivation was probably linked to potential increases in its travellers cheques business—a highly profitable aspect of a clearing bank's activities. Furthermore, Midland would receive the benefit of deposits made in advance (of the holiday) by Cooks' clients.
In addition, each of the clearing banks extended their product range by acquiring or establishing subsidiaries offering 'near-banking' services. For example, National Westminster founded Credit Factoring in 1970; Midland Bank established 50% ownership of Midland-Citibank Factors in 1970, and acquired a 50% interest in Shield Factors in 1970 which became a wholly-owned subsidiary, Griffin Factors; Barclays established Barclays Export and Finance Company in 1971 to provide, inter alia, a factoring service; Lloyds had an existing interest in International Factors, formed in 1960, through Lloyds and Scottish Finance which owned 75% of the factoring company.

A similar trend is discernible in the provision of leasing services, which are now dominated by the clearing banks. Barclays, through Barclays Export and Finance Company owns the largest leasing company in the U.K.; National Westminster, through the acquisition of Lombard Banking and subsequent formation of Lombard North Central, owns the second largest. Midland Bank's presence is through Forward Leasing, a wholly-owned subsidiary and Midland Montagu Leasing which was a product of the acquisition of Montagu Trust in 1973. Lloyds Bank also has two leasing vehicles. Firstly, Lloyds and Scottish, the fourth largest U.K. leasing company and secondly, Lloyds Leasing Limited, a wholly-owned subsidiary formed in 1973.
3.1.2.3. Diversification and official regulations on banking

mergers and Participations 1972

Even before 1971 the major clearing banks had established or acquired specialised merchant banking subsidiaries. An announcement made by the Bank of England in 1972 clarified its standpoint on links between independent, accepting houses and clearing or foreign banks. In the context of entry into the E.E.C., the Bank announced modifications to existing rules on the acquisition of merchant banks. The measures, which were subject to the provisions of the Monopolies and Mergers Act and Bank of England approval, were in principle that:

1. Clearing Banks were entitled to take participations in accepting houses of more than 25%.

2. E.E.C. banks, though not other foreign banks, were to be treated in the same way as indigenous banks for the purpose of equity participations in British banks; hence, in comparable cases, they were allowed to take participations exceeding 15% in accepting houses as well as in other U.K. merchant banks and in British overseas banks.26

The Bank has followed a pragmatic line by considering, within the above guidelines, all proposals for mergers on their individual merits. Thus mergers, in this context, are interpreted as all participations of more than 15%. The Bank stressed the desirability of amicable agreement between the parties concerned and the importance of tests relating to capital, management, reputation and future intentions. Proposed acquisitions of accepting houses are expected by the Bank to give 'proper weight to the skills and talents on each side'.27
With the announcement, however, it became apparent that the Bank's previously unpublished rules had been honoured in the breach as well as the observance. Midland Bank already held $33\frac{1}{3}\%$ of the share capital of Montagu Trust; Citibank had owned 40% of National and Grindlays since 1969, and Lloyds Banks had a 41% stake in National and Grindlays Holdings which owned the other 60% of the bank - furthermore, Grindlays had acquired $\frac{2}{3}$ of Wm. Brandts in the early 1960s, a merchant bank and member of the Accepting Houses Committee until 1975.

In 1973, however, following the change in the Bank of England rules, Midland Bank acquired the outstanding share capital of Montagu Trust. Although Montagu Trust was a diversified financial company, which held the capital of a merchant bank/accepting house (Samuel Montagu), two international wholesale insurance brokers (E.W. Payne and Bland Welch & Co.) and the international bank (Guyerzeller Zurmont), banking business accounted for 83% of the holding company's assets and 60% of fully-disclosed pre-tax profits. Samuel Montagu, a long-established merchant bank and member of the influential Accepting Houses Committee, thus provided Midland with an immediate and distinguished vehicle for extension of its merchant banking activities.

This diversification was reinforced by the subsequent purchase of the Drayton Group, a "miscellaneous financial company" which in earlier years had specialised in the market for unit trusts, but latterly was developing a fast-growing merchant banking subsidiary, the Drayton Corporation. Both acquisitions therefore, broadened and deepened the range of merchant banking services previously offered by the Midland Bank Group. The acquisition of the Drayton Corporation following that of Samuel Montagu, however, should not be seen as one duplicating an existing range of services.
Rather because of the heterogeneity of merchant banking activities, the amalgamations should be considered as complementary. Samuel Montagu, for example, specialised in offering money trading facilities and was also active in the precious-metal, gold and silver markets. By contrast, the Drayton Corporation, a relatively young organisation, had a developing corporate finance department which was deriving fee income from providing merger and acquisition advice.

In summary, the acquisition activity of the clearing banks in the period 1966-73 appears to have become increasingly diversificatory. Indeed in retrospect, the 1968 horizontal amalgamations seem a single and unique event. The emphasis on diversification coupled with the alternative internal expansion of secondary system subsidiaries resulted in each of the major clearing banks possessing a comprehensive network of wholly-owned and associate companies in the U.K. The most important of these and their main area of operation are illustrated in Figure 3.1
<table>
<thead>
<tr>
<th>Type of Activity/Bank</th>
<th>National Westminster</th>
<th>Midland</th>
<th>Barclays</th>
<th>Lloyds</th>
</tr>
</thead>
<tbody>
<tr>
<td>London clearing bank</td>
<td>N.W. Coutts</td>
<td>Midland</td>
<td>Barclays</td>
<td>Lloyds</td>
</tr>
<tr>
<td>Scottish clearing</td>
<td>-</td>
<td>Clydesdale</td>
<td>Bank of Scotland</td>
<td>National &amp; Commercial</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>(35%)</td>
<td>Banking Group (16.4%)</td>
</tr>
<tr>
<td>Northern Ireland</td>
<td>Ulster</td>
<td>Northern</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other deposit</td>
<td>Yorkshire (40%)</td>
<td>-</td>
<td>Yorkshire (32%)</td>
<td>Yorkshire (20%)</td>
</tr>
<tr>
<td></td>
<td>Isle of Mann</td>
<td></td>
<td></td>
<td>Lewis's</td>
</tr>
<tr>
<td></td>
<td>Coutts Finance Co.</td>
<td>Montagu Trust</td>
<td>International)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>(Samuel Montagu)</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Drayton Group</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(8.7%)</td>
<td>(4.6%)</td>
<td></td>
<td>National &amp; Grindlays</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Guyerzeller Zurmont 3</td>
<td></td>
<td>Holdings (41.4%)</td>
</tr>
<tr>
<td>Finance House/Instalment</td>
<td>Lombard North Central</td>
<td>Forward Trust</td>
<td>-</td>
<td>Lloyds &amp; Scottish (43.2%)</td>
</tr>
<tr>
<td>Credit</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Portfolio Management</td>
<td>N.W. Unit Trust Managers</td>
<td>Forward Trust</td>
<td>Barclays</td>
<td>L.B. Unit Trust Managers</td>
</tr>
<tr>
<td></td>
<td>(75%)</td>
<td></td>
<td>Unicorn</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Pension Fund Inv. Mgt.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Service</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Factoring</td>
<td>Credit Factoring</td>
<td>Griffin Factors</td>
<td>Barclays Export &amp; FinanceIntl. Factors Co.</td>
<td>6</td>
</tr>
<tr>
<td>Leasing</td>
<td>Lombard North Central</td>
<td>Forward Leasing</td>
<td>Barclays Export &amp; Fin. Col. Lloyds Leasing</td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td>N.W. Ins. Services</td>
<td>M.B. Ins. Services</td>
<td>Barclays Ins. Services Co.</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>(Broking)</td>
<td>(Broking)</td>
<td>(Broking)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Bland, Payne</td>
<td></td>
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</tr>
<tr>
<td></td>
<td></td>
<td>(Broking)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Annual Report and Accounts, 1973
NOTES:
1. Drayton Group acquired February 1974
2. Excluding shareholdings in consortium banks
3. Through Montagu Trust
4. Barclays acquired Mercantile Credit in 1975
5. Drayton Montagu Portfolio Management formed 1974
6. Through Lloyds & Scottish
3.2: Merchant banks' acquisitions 1966-73

Unlike the clearing banks, the acquisition and merger activity of merchant banks has been almost entirely concentrated in non-banking sectors. Indeed with the exception of two examples of 'horizontal' integration in the 1970-73 period, all the acquisitions initiated by merchant banks were either of insurance institutions, miscellaneous financial companies or non-financial companies. It is not appropriate therefore to consider their acquisition activity in terms of 'horizontal' and 'diversificatory' integration.

3.2.1: Competitive environment.

The motives for the merchant banks' product extension are largely defensive, stemming from the growing aggressiveness of the big continental and American commercial banks and the competition from the merchant banking subsidiaries of the clearing banks. A further challenge, originating from the growth of the secondary banking system came from a range of new banks, many of which adopted the title 'merchant bank'.

The nature of the merchant banks' competitive environment is dictated by their origins and historical development. Located in London and mainly concerned with financing and advising, firstly international business and secondly the British corporate sector, they existed for many years on a minimal deposit base. In particular, their deposit banking facilities were characterised by dependence upon acceptance credits. Other merchant banking services emphasised the importance of the specialist in advising and arranging finance rather than actually providing the funds. Such services which did not employ the bank's own capital notably included corporate financial advice, including advice on mergers and acquisitions. In addition, they specialised in the management of unit trust and investment trust portfolios.
The growth of secondary money markets encouraged the banks to rely upon wholesale deposits as their major source of funds. In the late 1950s, moreover, a number of events gave an impetus to the development of a vast new international money market concentrated in London. Although dominated by American Banks, Ellis attributes the origin of the eurocurrency markets to the U.K. accepting house, Brown Shipley which enticed the dollar deposits of British insurance companies away from the London clearing banks. U.K. merchant banks, notably Warburgs and Rothschilds, further developed the long-term international bond market. The merchant banks, further encouraged by the convertibility of major currencies, also began to amass foreign currency deposits which were increasing in supply in the international credit markets.

The other main activities of the merchant banks also developed during the late 1950s and throughout the 1960s. There was, in particular, a rapid growth of corporate finance business, as industrial merger activity accelerated. London accepting houses developed or acquired corporate financial expertise, appropriate for the negotiation and arrangement of acquisitions, new issues and flotations, and assumed an almost total monopoly of these lucrative fee-earning activities. In addition, the banks also specialised in the sponsoring of international issues and the management of syndicated euro-currency credits. Finally, they increased their involvement in fund management, gaining shares of the expanding pension funds and raising the volume of unit trusts and investment portfolios under their management.

As the secondary banking system has developed over the last twenty years the functions of the accepting houses have become characterised by the provision of 'tailor-made' services, by utilising expertise in a number of different techniques and through an extensive network of contacts in the City.
In the period 1966-73, however, the merchant banks faced growing competition in different activities, from London clearing banks and international commercial banks. Despite their concentration on wholesale financial business, the merchant banks remained small organisations, particularly in terms of capital resources, which restricted their deposit-taking activities. Competing in the provision of loans with large commercial banks, therefore, produced an impasse. For whereas the latter were able to advance their own resources, the merchant banks' traditional skill had been the mobilisation of other people's funds rather than the use of their own.

3.2.1.1: Foreign Banking Competition

This relative competitive disadvantage is reflected in Table 3.6, which compares the foreign currency business of U.S. and merchant banks. Since 1971, furthermore, with the abandonment of the ceiling on sterling lending, foreign banks began to establish links with indigenous U.K. companies, through aggressive marketing methods, in direct competition with indigenous merchant and deposit banks.

<table>
<thead>
<tr>
<th>Table 3.6: Foreign Currency Deposits and Advances</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966-73</td>
</tr>
<tr>
<td>(£m)</td>
</tr>
<tr>
<td>1966</td>
</tr>
<tr>
<td>-------</td>
</tr>
<tr>
<td>Dep</td>
</tr>
<tr>
<td>Accepting Houses</td>
</tr>
<tr>
<td>U.S. Banks</td>
</tr>
<tr>
<td>Ratio AH:US</td>
</tr>
</tbody>
</table>

Source: Bank of England data

Further competition came from wholly- or majority-owned merchant banking subsidiaries of major U.S. commercial banks. These were established to provide a range of services in which the U.K. merchant banks had specialised: eurocurrency loan syndications, eurobond underwriting, dealing and corporate finance. At the end of 1973, there were eleven such merchant banking subsidiaries in London, nine of which were established from 1970-73 (See Table 3.7)
In addition to the American challenge, the merchant banks also faced competition from a range of commercial and investment banks whose raison d'etre was medium-term eurocurrency transactions. The Continental and Japanese banks particularly expanded their eurocurrency deposits towards the end of the 1966-73 period and several developed expertise in the management of eurobond syndicates. The major German and Swiss banks, Kredietbank of Luxembourg and the U.S. investment banks threatened to relegate the U.K. merchant banks to relatively minor underwriting roles. Similarly, the specialisation of several consortium banks in the provision of investment banking services poses a further threat, which has developed considerably since 1973.37

Table 3.7: U.S. Merchant Banks in London

<table>
<thead>
<tr>
<th>US Merchant Bank</th>
<th>Est.</th>
<th>Parent</th>
</tr>
</thead>
<tbody>
<tr>
<td>First International Bancshares</td>
<td>1973</td>
<td>First International Bancshares</td>
</tr>
<tr>
<td>International Marine Banking Co.</td>
<td>1971</td>
<td>Marine Midland Bank</td>
</tr>
<tr>
<td>Chase Manhattan Ltd.</td>
<td>1973</td>
<td>Chase Manhattan Bank</td>
</tr>
<tr>
<td>Manufacturers Hanover Ltd.</td>
<td>1968</td>
<td>Man. Hanover Trust (75%); NM Rothschild (10%); Riunione Adriatica di Sicurita (10%); Long Term Credit Bank Japan (5%)</td>
</tr>
<tr>
<td>Bank of America International</td>
<td>1971</td>
<td>Bank of America (75%); Kleinwort Benson (25%)</td>
</tr>
<tr>
<td>Wells Fargo Ltd.</td>
<td>1972</td>
<td>Wells Fargo Bank</td>
</tr>
<tr>
<td>Citicorp International Bank Ltd.</td>
<td>1973</td>
<td>First National City Corporation</td>
</tr>
<tr>
<td>Continental Illinois Ltd.</td>
<td>1972</td>
<td>Continental Illinois Corporation</td>
</tr>
<tr>
<td>Bankers Trust International Ltd.</td>
<td>1860</td>
<td>Bankers Trust Co.</td>
</tr>
<tr>
<td>First Chicago Ltd.</td>
<td>1970</td>
<td>First National Bank Chicago</td>
</tr>
<tr>
<td>First National Boston Ltd.</td>
<td>1972</td>
<td>First National Bank Boston</td>
</tr>
</tbody>
</table>
3.2.1.2 : Clearing Bank Competition

The clearing banks' incursion into the market for merchant banking services is a microcosm of the wider topical debate on the virtue of "specialist" and "generalist" banking organisations. The former, traditionally characterised by the independent merchant banks, and important in the development of London as a leading financial centre, has recently been challenged by the clearing banks' merchant banking subsidiaries which have access to the huge resources of their parent clearing banking groups, to support lending activities. The argument is centred on an unresolved question: whether or not the merchant banks' entrepreneurial role can be effectively assumed within the institutionalised framework of a clearing bank. The converse is whether or not independent merchant banks with small capital bases and resources can compete effectively when they are unable to lend directly a large proportion of a particular syndicated credit.

The competition from the clearing banks was relatively undeveloped in 1973. However, in attempts to exploit external economies of scale originating from close contacts established through retail links with corporate customers, the clearing banks had shown signs of encroaching on the domestic activities conducted by the specialist merchant banks.

3.2.2 : Acquisition for Growth

The response to the competitive pressures which developed from 1966-73 highlighted a dichotomy amongst the independent merchant banks. The predominant view was epitomised by Sir Kenneth Keith, chairman of Hill Samuel who consistently and frequently stressed that merchant banks needed to achieve much greater size quickly in order to be able to develop more effective geographic and product coverage. At risk, however, is the loss of flexibility and innovatory style of banking by which the merchant banks have become identified.
The retention of independence by the merchant banks even if they become part of a large financial company was more or less assured by the Bank of England which has continued to take a protective view of the merchant banking sector:

'When, in 1973, it relaxed the rules which had prevented the takeover of top merchant banks by big commercial banks [clearing the way for Midland's full acquisition of Samuel Montagu], it continued, for example, to insist on the independence of merchant banking activities even when accommodated within a big group.'

The acquisition activity of the merchant banks was intended to achieve two aims: first, to increase the size of the capital base, and secondly, to achieve a diversity of financial services within one organisation. A number of 'horizontal' merchant banking mergers occurred before 1966 but, as noted, only two such amalgamations were recorded during the ensuing eight year period. In 1971, Henry Ansbacher was acquired by Robert Fraser, forming Fraser Ansbacher; and in 1972, E.D. Sasoon amalgamated with Wallace Bros. Both appear to have been prompted by the need to increase capital resources.

A similar rationale prompted the ill-fated proposals by Hill Samuel to merge with Metropolitan Estate and Property Company (M.E.P.C.) and then with Slater, Walker Securities, in 1970 and 1973 respectively. Despite Hill Samuel's failure to acquire a property company, expenditure on the acquisition of non-financial companies represents 45% of total merchant bank acquisition expenditure for 1966-73. In the first four-year period apart from Hill Samuel's acquisition of shipping company, Lambert Bros., a series of relatively small, on average £1.6 million, takeovers of non-financial companies were predominant. In the second period, however, the acquisition by Keyser Ullmann of Central and District Properties (62.8 million) accounted for 88% of the expenditure on acquiring 'commercial' companies.
The achievement of a large yet diverse capital base motivated the merger, in 1972, between Guinness Mahon and Lewis & Peat, an old-established commodity merchant. The newly-formed holding company, Guinness Peat, was indeed broadly-based — in merchant banking, insurance broking and merchanting. Sir Charles Villiers, then chairman of the group, displayed the ambivalent attitude of the traditional merchant banker towards growth:

'... the creation of financial conglomerates which are notoriously subject to instability. That is a danger to be watched as banks diversify. The most precious asset of the merchant bank, their nucleus of highly specialised, enterprising staffs, could be diluted if spread too thinly over too wide a business expanse.'

The acquisition and achievement of a multi-product base was also apparent in the series of acquisitions by merchant banks of insurance institutions. Indicative of this trend towards a banking/insurance interface were several takeovers: for example Hill Samuel/Noble Lowndes; Edward Bates/Welfare; Keyser Ullmann/International Life; and Schroder Wagg/Dominion Lincoln.

The acquisition of "miscellaneous" financial companies confirmed the emphasis being placed upon investment management. For instance Keyser Ullmann/Dalton Barton Securities; Keyser Ullmann/Hocroft Trust; Hambros/British Empire Trust; Hambros/Hereditaments and Kleinwort Benson/European Market Investment Trust.

3.3 : British Overseas Banks' Acquisitions 1966-73

The acquisitions and mergers initiated by the British overseas banks (B.O.Bs) were largely 'horizontal'. Of total acquisition expenditure of £150 million in the 1966-73 period, some 71% represented amalgamations between the banks. In the latter half of the period, however, they began to undertake diversifying acquisitions, expenditure on which accounted for 35% of total expenditure in 1970-73. In common with the clearing banks and accepting houses the composition of the B.O.Bs deposit bases was
instrumental in their acquisition strategy. Changes in their international competitive environment particularly influenced the nature of their acquisitions.

3.3.1: Competitive Environment

The deposit banking activities of the B.O.Bs evolved as a result of Britain's imperial traditions. By financing trade and investment in areas of colonial domination and British influence, such as South America, the Middle and Far East, and Africa they were able to establish retail branch services for the countries concerned.

The traditional retail operations of the banks were based on the freedom to move funds around the world. In the 1966-73 period, however, their old-established activities became increasingly circumscribed. Growing nationalism in the countries concerned and the achievement of independence by the old colonial territories brought new pressures on banks operating out of London. In particular they had to face nationalisation of the branch networks which fifteen years ago formed the basis of their business. At the same time, the gradual extension of exchange controls between members of the sterling area, culminating in June 1972 with the floating of the pound and the final end of the sterling area concept, limited their freedom of action.

While in many countries the London overseas banks continued their retail business, they had to treat each area as a separate entity, raising its own deposits and using them for local purposes. In some places, nationalisation resulted in the banks losing their business altogether. In a number of countries the banks were obliged to go into partnership with the Government and sometimes with other local interests; the pattern has tended to be for the banks to retain a large minority interest and, because the banks had the necessary skills to run the local operations, to keep effective management control. The problems were illustrated by the 1973 Franzen Commission Report on the banking system in South Africa, which implied that the South African authorities might insist on foreign holdings in local banks being cut over the long term to just 10%. 44
In the face of mounting pressures to adapt their traditional operations, the banks announced their intention to transform themselves into international banks. In order to survive the vicissitudes of political and economic uncertainties in their traditional spheres of interest the banks have had to diversify both functionally and geographically. Lord Seebohm of Barclays Bank described their changes in policy, in the face of immobility of sterling-based funds:

'One was to become still more international and to extend our operations to anywhere in the world where we could use our banking expertise profitably; and the second was to move deliberately from the system of branch operations to the formation of local companies in order to meet the natural desire of developing countries to have a financial interest in, and greater control over, their banking systems.' 45

The alternative policy adopted by each of the B.O.Bs was participation in the wholesale money markets, and in particular competition for eurocurrency deposits. The eurodollar market, especially, afforded the banks a source of funds that was growing rapidly, in contrast to the localised retail banking deposits which, as noted, were becoming circumscribed. Moreover, wholesale banking business, centred in London, gave the banks a source of income which was independent of the various territories in which they operated.

The growing importance attached to eurocurrency deposits is illustrated in Table 3.8.

Table 3.8: Analysis of Deposits of British Overseas Banks, 1966-73
£m (percentage of total in brackets)

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>Sterling</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966</td>
<td>1,811</td>
<td>1,044 (58%)</td>
<td>767 (40%)</td>
</tr>
<tr>
<td>1970</td>
<td>4,797</td>
<td>1,654 (29%)</td>
<td>4,143 (71%)</td>
</tr>
<tr>
<td>1973</td>
<td>12,766</td>
<td>3,215 (25%)</td>
<td>9,551 (75%)</td>
</tr>
</tbody>
</table>
Furthermore, the profitability of foreign trade and investment financed by eurodollar deposits began to exceed those generated by the traditional mode of business. This was largely because of the banks' dilatoriness in converting their overseas branches to provide the sophisticated wholesale banking services required by international companies. Indicative of this trend is the contribution to total profits, of profits generated in London by National and Grindlays which rose from 35% in 1965 to over 55% in 1971.

These attempts at functional diversification, which reflect the B.O.Bs' efforts to develop international commercial banking services, brought them into competition with established British, U.S. and Continental banks. The B.O.Bs' geographical expansion also proved difficult. Attempts to build up the banking representation in the major financial centres of the world, which is necessary to provide a comprehensive international service have been frustrated by foreign 'nationalism'. The rejection of Barclays Bank's proposed acquisition of Long Island Trust bore witness to the sensitivity with which foreign takeovers could be treated in the U.S. There have nevertheless been successful international acquisitions by the B.O.Bs, which are not recorded in the Bank of England Quarterly Bulletin. Barclays, for example, acquired First Westchester Bank in 1973 providing access to the New York retail banking market; and Lloyds Bank's acquisition of First Western Bank and Trust Company, also in 1973 gave the bank ownership of 95 branches in California.

3.3.2 : Rationale for Acquisition

Notwithstanding the relative increase in diversificatory acquisitions over the 1966-73 period, the majority of merger activity initiated by the B.O.Bs involved 'horizontal' integration, or the forging of closer links with the London clearing banks. Both appear to have been motivated by the forms of expansion the banks were obliged to pursue and the difficulties encountered therein.
The increased dependence on eurocurrency deposits, for example, proved an imperfect substitute for retail deposits collected through branch networks across the world. During the latter part of the eight year period, interest rates rose steadily, but rates paid for eurodollars, for instance, were particularly volatile. Furthermore, in contrast to the widespread system of branches required for a retail banking service, money market banking, centralised in London and other major financial capitals required only a head office. The simultaneous spatial expansion, however, required the obverse. In this respect, organic growth could provide the nucleus for expansion. It was however, a lengthy and expensive way of establishing the base for fulfilling the world-wide role sought by the banks.

In conjunction, these factors required consolidation, widening of asset backing, in particular immediate increases in world coverage, and the recourse if necessary to substantial group funds. The 'horizontal' integration demonstrates this rationale. 46 Australia and New Zealand acquired English Scottish and Australian Bank in 1969 to form the Australian and New Zealand Banking Group; Bank of London and South America (B.O.L.S.A.) acquired Bank of London and Montreal in 1970 and merged with Lloyds Bank Europe the next year. The largest merger between B.O.B's occurred in 1970 when the Standard Bank and Chartered Bank formed the Standard and Chartered Banking Group. The amalgamation, at a time when the clearing banks were beginning to rationalise their overseas subsidiaries, protected both banks against bids from Midland Bank or National Westminster which both maintained shareholdings in this Group. The merger also combined Standard Bank's superior administration and branch network throughout Africa, with Chartered's Middle - and Far-Eastern branches. Integration, however, occurred slowly. In 1973, the banks still operated from separate London offices and retained competing money market departments. Similarly their overseas branches did not reflect the merger, working under their original names. 47
The associations with clearing banks were largely initiated by the latter rather than by the B.O.Bs. Barclays, for instance, had a 56.5% stake in Dominion Colonial and Overseas, which operated independently. In 1971, Barclays acquired the minority interest of the re-titled D.C.O. and then re-named the bank Barclays International. As noted earlier Lloyds Bank has interests in two B.O.B's. In 1971, Lloyds held 55.4% of Lloyds and Bolsa International which provided branch coverage of Europe, Latin America and New York.

In 1973, the parent acquired the remainder of the equity of Lloyds and Bolsa from Mellon Bank and developed the re-named Lloyds Bank International into its principal international banking subsidiary. Lloyds' second substantial connection with overseas banking is through its 41% holding in National & Grindlay Holdings which owns a majority stake in National and Grindlays Bank - which specialises in India and Pakistan.

Standard and Chartered Bank therefore remained the only B.O.B. to be independent of the clearing bank groups. It was also the bank which undertook, in 1966-73, the greatest functional diversification. In 1972 and 1973 it increased its interest in the bullion, other metal and security dealing markets with the acquisition of 90% of the equity of London and Dominion Trust and 55% of Mocatta and Goldsmith, respectively. Also in 1973, the Group acquired the Hodge Group, a diversified financial company, offering services in the consumer finance, leasing and life assurance markets.
NOTES

1: Reported in The Banker, March 1968

2: In 1961, National Provincial had acquired the District Bank

3: The Banker, March 1968, p. 194

4: The Banker, August 1968, p. 665

5: "Barclays Bank Ltd., Lloyds Bank Ltd., and Martins Bank Ltd., - a report on the proposed merger" (H.M.S.O. 1968)


7: Report of the Treasury Committee on Bank Amalgamations, Cmnd. 9042, 1918

8: ibid, para. 8


10: Quoted from The Banker, March 1968, p. 664


12: The Banker, January 1968, p. 5

13: The Banker, September 1962, p. 581

14: Daily Telegraph, Supplement, May 24, 1974

15: Bankers' Magazine, February 1968, p. 104


18: Barclays acquired 25% of U.D.T.; National Provincial and Midland bought the whole of the equity of North Central Wagon and Forward Trust respectively. Martins and Westminster each took 20% in Mercantile Credit; District 331/3% in Astley Industrial Trust; and Lloyds 25% in Bowmaker
19: In 1958, the deposits of the accepting houses were 3% of those held by London clearing banks; in 1966 the corresponding proportion was 12%.

20: It has since been re-named Barclays Merchant Bank.


24: See note to Table 3.5.

25: The remaining shares were held by Trust Houses Forte (23%) and the Automobile Association (7%).


28: The breadth of institutions labelled as 'merchant banks' pose considerable problems of analysis. The scope of this study is restricted to those merchant banks which are members of the Issuing Houses Association. They share a common participation in deposit banking; underwriting/corporate finance; and fund management.

29: In 1948, acceptances represented 59% of accepting houses' total deposits.

30: By 1962, acceptances as a proportion of total deposits had declined to 30%.

31: A full explanation of the origins of the eurocurrency market is given in Chapter 5.


33: See Chapter 6.

34: Banks did not generally accept deposits exceeding twelve times their capital and reserves.


36: See Chapter 5.

38: See for example, interview in *The Banker*, December 1971

39: *Financial Times*, July 22, 1975

40: For example, J. Henry Schroder - Helbert Wegg; S.G. Warburg - Seligman Bros; Kleinwort & Co. - Lonsdale Investment Trust; Philip Hill (-Higgins & Erlangers) - M. Samuel

41: *The Banker*, March, 1972

42: *The Banker*, December 1973

43: *ibid*, p. 1488

44: cf the announcement in 1976 by the Nigerian Government that foreign owned banks would be required to have 60% (previously 40%) Nigerian equity participation.

45: Quoted from the *Financial Times*, 10 June, 1975

46: Australia and New Zealand Bank and the National Bank of New Zealand should be distinguished from other major B.O.Bs. The former are not London-based, and operate their networks in Australasia which has been more politically stable than the colonial territories in which National and Grindlays, Standard Bank, Chartered Bank, Barclays DCO and B.O.L.S.A. were founded.

47: Full integration was achieved in 1975 when the group was re-named Standard Chartered Banking Group

48: National and Grindlays was the product of a merger between the National Bank of India and Grindlays Bank in 1948, subsequently extended by the acquisition of Lloyds Bank Eastern branches in 1961. In 1974 Citibank increased its stake in the bank to 49% thereby reducing the holding company's interest to 51%.

49: National Westminster, Midland and Chase Manhattan each maintained long-standing minority interests in Standard and Chartered. In the year ended March 1975, Standard and Chartered's expansion in California obliged Chase to dispose of its 11.9% interest, which was acquired by Midland, increasing its holding of the Group's equity to 15.9%.
Acquisitions by Other Financial Institutions

4.1: Insurance institutions' acquisitions 1966-73

Following the approach of chapter three, which classified U.K. indigenous banks into three classes, insurance institutions are categorised according to their main function, into two groups: insurance companies and insurance brokers. There is a clear conceptual distinction between the companies, which as 'principals' underwrite risks, and the brokers which perform an 'intermediary' function, providing advice to clients and receiving commission income from the companies.

The inclusion under one head, of underwriting companies is prima facie not satisfactory, however. Although all insurance business consists of a spreading of risks, a dichotomy is apparent between life assurance and general insurance. The former, which is based on actuarial calculations of mortality and provides cover for the eventual death of the policy-holder, also offers a channel for saving which is comparable to the business of a unit trust. It is split into two branches - ordinary and industrial. In contrast, general insurance in which Lloyd's specialises covers a range of insurance risks, the probability of whose occurrence is less certain, and the amount of the eventual claim unknown in advance. For statistical convenience only, grouping usually distinguishes three broad branches of general insurance: fire and accident (non-motor); motor; marine, aviation and transport.

The justification for considering insurance companies as one group lies in the contemporary predominance of composite companies. These write long-term (life) and short- or medium-term (general) business, but tend to specialise in different markets. At the end of 1972, the ten largest insurance companies, measured by premium income, all of which were composite, underwrote 80% of all non-life company business and earned 58% of ordinary life assurance premiums.
The aggregation of life and non-life business, nevertheless, poses problems of analysis. These are circumvented by detailed examination of the companies' competitive environments, in respect of their separate insurance markets.

Comparison of Table 4.1 and 4.2 reveals a number of differences between the acquisition activity of insurance companies and brokers. Taken together, the tendency towards increasing diversification, observed for banks, is confirmed. In 1966-69, 76% of insurance institutions' acquisitions were 'horizontal' and accounted for 71% of total expenditure in that period. During the second period, however, the respective proportions fell to 53% and 27%. Thus from 1970 to 1973, nearly a of all expenditure on acquisitions was represented by mergers which diversified the primum mobile firm's range of activities.

While the acquisitions by insurance companies corresponded to this overall trend, those by brokers did not. Furthermore, their merger behaviour also differed markedly with respect to areas chosen for diversification, and the average size of companies acquired. There were only three mergers between insurance companies and brokers, all initiated by brokers; similarly, insurance companies did not acquire any banks or H.P. finance houses, whereas the 'victim' firms of takeovers effected by insurance brokers were spread across the range of acquired companies.

In the following sections, an explanation of these differences is sought, as part of the wider objective of examining the causes of the merger behaviour of insurance institutions. The analysis is similar to that undertaken in the previous chapter, and considers both general trends and particular acquisitions in the context of the changing conditions within which companies and brokers have competed.
### Table 4.1: Acquisitions and mergers by insurance institutions, 1966-1969

<table>
<thead>
<tr>
<th>(£m)</th>
<th>(No. acquired in brackets)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Co</td>
<td>INSURANCE</td>
</tr>
<tr>
<td></td>
<td>Bkr</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Ins Co</td>
<td>141.9 (12)</td>
</tr>
<tr>
<td>Ins Bkr</td>
<td>0.6 (1)</td>
</tr>
<tr>
<td></td>
<td>142.5 (13)</td>
</tr>
</tbody>
</table>

### Table 4.2: Acquisitions and mergers by insurance institutions, 1970-1973

<table>
<thead>
<tr>
<th>(£m)</th>
<th>(No. acquired in brackets)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Co</td>
<td>INSURANCE</td>
</tr>
<tr>
<td></td>
<td>Bkr</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Ins Co</td>
<td>34.8 (4)</td>
</tr>
<tr>
<td>Ins Bkr</td>
<td>14.7 (2)</td>
</tr>
<tr>
<td></td>
<td>49.5 (6)</td>
</tr>
</tbody>
</table>

* Merchant Bank
4.1.1 : Insurance companies' acquisitions 1966-73

As noted, the direction of insurance companies' acquisitions in the period 1966-73 conformed to the general trend for insurance institutions and all financial intermediaries. Thus in the period to 1969, some 80% of their acquisitions involved 'horizontal' integration, whereas during the second four-year period, only 25% were 'horizontal'. In terms of expenditure, the fall is more pronounced, from 92% to 16%. The increased expenditure on diversificatory acquisitions was in fact heavily concentrated in the acquisition of non-financial companies, or more specifically, property companies; of the seven non-financial companies acquired in the 1970-73 period, all were property companies, and one of the 'miscellaneous financial companies' acquired - Metropolitan Railway Estates - was also concerned with property investment.

Closer examination of the mergers between insurance companies in the first four-year period, reveals a concentration of activity in 1968, when eight 'horizontal' mergers were undertaken.

4.1.1.1 : Acquisitions and the competitive environment (i) : General Insurance

One of the continuing factors which has influenced insurance companies' merger behaviour and which has thoroughly affected their general insurance business, has been the frequency and extent of price and wage change. Indeed, inflation has caused and emphasised several immediate and longer-term problems. These became particularly evident during the period under consideration, in which all three categories of non-life insurance suffered underwriting losses with varying regularity. The experience of insurers in the U.K. motor market illustrates the problems raised by inflation. These occur because the real value of premium rates is eroded by inflation of claims which are often settled several years in the future. For example, between 1963 and 1972, the basic rates for motor cover rose by 114%, while, in the same period, the cost of motor repairs rose by 150%.
Insurance companies have traditionally relied upon investment income to offset underwriting losses, and to produce trading profits. Investment income has not been sufficient, however, to improve the companies' real net worth. The capital adequacy of insurance companies has indeed been crucially affected, in that general companies are legally required to keep a minimum margin between the value of their assets and their liabilities - a margin arithmetically determined by the size of general premium income received. Thus, even where premium income has risen solely because of increases in premium rates, intended to offset expected ex post changes in the cost of claims, it became necessary to attempt to increase proportionately the value of shareholders' funds, that is, the firms' solvency.

Shareholders' funds can be increased in a number of ways; the retention of profits, and the issue of new equity have been methods often favoured by insurance companies. A third, the acquisition of another company, financed by share issue or cash was prominent in the period 1966-73.

To summarise, inflationary pressures have been an important source of insurance companies' demands for increases in own-capital. To an extent, these demands were satisfied by a series of mergers between companies underwriting life and/or general insurance: for example, General Accident/Yorkshire (1967); Commercial Union/Northern & Employers (1968); and Guardian/Royal Exchange (1968). These had been preceded, moreover, by several other horizontal amalgamations, for instance, Royal Exchange/Atlas (1959); Commercial Union/North British & Mercantile (1959); Sun/Alliance (1960); and Royal/London and Lancashire (1962).

The concentration of mergers in 1968 suggests also that there was some 'matching' in the companies' behaviour, reflecting the growth in corporate uncertainty and indicating that problems of size were accentuated by changes in relative positions. The largest composite companies, Commercial Union, Royal and the Prudential had grown quickly, through merger, relative to the Guardian and Royal Exchange, which had previously largely ignored external growth. The quest to maintain relative growth position is therefore demonstrated by the Guardian/R.E.A. merger in 1968.
However, whilst the underwriting capacity of individual firms can and has been increased in this way, any 'horizontal' acquisition is itself unable to extend the overall capacity of the industry; it merely achieves a redistribution of existing capacity. Hence other measures have been adopted. Apart from extensive recourse to the capital market, increases in shareholders' funds have been partly achieved by the acquisition of property companies: for example, Commercial Union/Holloway Sackville (1971); Prudential/Edger Investments (1973); and Legal & General/Cavendish (1973). Indeed one of the arguments used by Eagle Star in their evidence to the Monopolies and Mergers Commission in support of their proposed acquisition of Grovewood Securities and Bernard Sunley Investment Trust, was that the amalgamations would significantly increase its solvency margin, and counteract the effects of inflation. Thus Eagle Star's primary motive was effectively to increase its capital base and hence effectively increase its solvency margin from 35% (1973) to 44% of net premium income following the mergers which would, in turn, support the expansion of its motor and liability business, its fire account and its international position. Eagle Star argued that the prevailing conditions precluded the possibility of a rights issue and that merger was the best means of increasing its capital base.

Inflationary pressures, however, have not been the only reason for general insurance companies to attempt to increase the size of their shareholders' funds. They had also to increase the size of their actual solvency margin in order to be able to meet new and increased demands which have continuously been made on them by those manufacturers seeking to insure their inventions and innovations. The second feature of the environment which has affected insurance companies' behaviour is characterised by uncertainty and technological change. These have led to changes in the demand confronting insurers and have induced them to modify their products.
Indeed, possibly owing to the relatively competitive structure of the various parts of the insurance industry, particularly the relative freedom to enter and exit - underwriters have usually tried to meet manufacturers' demands to insure larger and more costly risks, sometimes irrespective of any knowledge about the inherent risks involved, and often despite the complete absence of dependable ex post information, enabling a probability distribution of expected losses to be estimated. An indication of the uncertainty arising from the newly-created risks of innovation in the shipbuilding and tanker industry, is given by P. Dixey, Chairman of Lloyd's management committee:

"In all previous developments in shipbuilding, and in underwriting, it has been possible to proceed gradually from one design to another slightly larger, but the demands of the oil industry have been so pressing that ships were being built without the builders, the classification societies or the underwriters having gained service experience. And it is the underwriter who pays for everybody else's mistakes or inexperience and he has to fix his rates without any records or previous experience of similar types of ship to guide him." 

Accordingly, new insurance products have been supplied for risky innovations whose sheer size, even possibly in real terms, have been historically unsurpassed. Thus the capital base of the insurance industry has had to be expanded in order to provide new insurance goods such as the underwriting of target risks like massive oil tankers, jumbo jets, North Sea oil rigs, nuclear power stations and complex industrial plants.
Traditionally, insurance companies have met the challenges posed by technological innovation and new risks, by various forms of co-operation. For example, they have established information and research bureaux, created and joined cartels, merged with or acquired other companies with similar interests, and developed an extensive reinsurance network.16

Thus insofar as amalgamations of insurance companies increase a firm's individual capacity to underwrite risks and reduce competition, then acquisitions can be considered as a rational response to technological change and uncertainty.

A third aspect of the companies' environment regarding non-life underwriting, relates to pressures emanating from the geographical diversification of their business and the uncertainty that has resulted. In 1974, 65% of general insurance premiums were earned overseas, 30% of which were in North America.17 Indeed, the U.S. market has been more important than the domestic market for Commercial Union, the Royal, General Accident and Phoenix, and produced, in 1973, approximately 50% and 40% respectively18 of short-term premium income earned by Royal and Commercial Union. Moreover, the assets of U.K. insurers in the U.S. exceed 1/3 of all U.K. investments there, and are valued at fifty times the U.S. insurance companies' investments in Britain.

The problems experienced in the U.S. general insurance market which emphasised the need for larger capital bases were of two types. Firstly, composite companies experienced consistent underwriting losses in the U.S. during the 1966-73 period. Commercial Union, for example, suffered losses averaging £4.6 million for six consecutive years from 1966; similarly, the Royal showed losses in all but two of the eight years, which averaged £3 million.19 For member companies of the B.I.A., underwriting losses totalling £44.6 million were sustained between 1969 and 1973.20
Combined with these recurrent losses, U.K. insurance companies had to reckon with the vagaries of the U.S. courts. Liability Claims in particular resulted in interminable law suits and general settlements, with the result that British insurers became reluctant to undertake liability insurance in the U.S. Furthermore, insurers had to work in a tangled regulatory framework of state and federal laws with premium rates in a large though decreasing number of states actually fixed by law. The main compensation - a generally high level of investment income in the U.S. has already been questioned as a viable cushion for heavy underwriting losses.

The U.S. market was sui generis; its attraction to U.K. insurers lay in its potential profitability, particularly with respect to investment income. Aspirations of profitable investment, reinforced by considerations of prestige, precluded the withdrawal of U.K. insurance companies from the market, but also emphasised the "indispensable strategic advantage of large scale operations".

The acquisition of insurance companies with similar international interests, whilst strengthening the capital base of the primum mobile firm, also enabled a reduction in operating expenses to be made and created the opportunity to achieve a stronger bargaining position vis-a-vis the independent and powerful U.S. agents. This encouraged the Royal Exchange to acquire the Atlas in 1959 - the culmination of co-operation between the companies (and the Sun), whereby all U.S. business was placed under a single manager.

The wave of mergers in 1968, referred to above, similarly demonstrated implicit acknowledgement of changed conditions in the general insurance market, manifest in the requirement of large scale activity.
Life assurance business, in contrast to the unprofitability of general underwriting, was extremely profitable in the period 1966-73. Because the life offices offer an outlet for savings, rather than cover against risks, they suffered none of the underwriting losses of the general insurance companies. Indeed, British life offices derive a substantial proportion of their income from investment of their life funds. For reference, Table 4.3 ranks the ten largest life funds with respect to size, in 1972:

Table 4.3: The 10 Largest Life Funds 1972

<table>
<thead>
<tr>
<th>Company</th>
<th>Size of Fund (£m)</th>
<th>Type of Fund</th>
<th>Type of Office</th>
</tr>
</thead>
<tbody>
<tr>
<td>Prudential</td>
<td>1691.4</td>
<td>Proprietary</td>
<td>Composite</td>
</tr>
<tr>
<td>Legal &amp; General</td>
<td>1299.0</td>
<td>Proprietary</td>
<td>Composite</td>
</tr>
<tr>
<td>Standard Life</td>
<td>1005.3</td>
<td>Mutual</td>
<td>Independent</td>
</tr>
<tr>
<td>Norwich Union</td>
<td>798.7</td>
<td>Mutual</td>
<td>Composite</td>
</tr>
<tr>
<td>Commercial Union</td>
<td>710.8</td>
<td>Proprietary</td>
<td>Composite</td>
</tr>
<tr>
<td>G.R.E.</td>
<td>607.5</td>
<td>Proprietary</td>
<td>Composite</td>
</tr>
<tr>
<td>Eagle Star</td>
<td>514.3</td>
<td>Proprietary</td>
<td>Composite</td>
</tr>
<tr>
<td>Sun Life</td>
<td>483.9</td>
<td>Proprietary</td>
<td>Independent</td>
</tr>
<tr>
<td>Scottish Widows'</td>
<td>477.6</td>
<td>Mutual</td>
<td>Independent</td>
</tr>
<tr>
<td>Royal</td>
<td>382.2</td>
<td>Proprietary</td>
<td>Composite</td>
</tr>
</tbody>
</table>

Source: Life Offices Association

Notes: Mutual companies are those whose capital is supplied by policy-holders, amongst whom profits are shared; c.f. proprietary companies which are joint-stock and owned by shareholders.

The structure of the life assurance market in the period 1966-73 was considerably affected by the high levels of profit of existing firms, and the rapid expansion of the market itself. Thus, distribution to shareholders by ordinary life companies increased by 444% from 1962 to 1968, reaching £17.4 million. With respect to the increase in market extent, from 1956-68, the rates of growth of sums assured - "with profits" and "without profits", were 265% and 469% respectively.

In the period 1970-73, moreover, new sums assured increased 87% to £19.4 billion.
These conditions encouraged a number of new firms to enter the market and compete for the expanding business. Entry was facilitated by the absence of legal barriers and helped by the spread of suburban insurance brokers during the 1960s which afforded new entrants widespread geographical penetration without the expense of establishing branches throughout the U.K.

The successful entry of new firms was mainly threatened by buyer loyalty, enjoyed by long-established companies which offered traditional forms of life assurance, such as industrial life and endowment policies. The advent of new insurance products 'linked' to industrial sectors like property, or to particular indices like unit trusts, provided the opportunity for innovative new companies to transform the market and create a number of new market segments. For example, the expansion of the single-premium market - characterized by a single-premium payment, the promise of large (often guaranteed) yields and surrender values, certain tax advantages and life assurance itself - enabled less conservative companies to meet the needs and aspirations of modern savers who were concerned not merely with death-benefits, but also with the real existing - and future - value of their capital.

An indication of the increased scale of entry into the life assurance market is given in Table 4.4 which shows that more companies entered between 1966 and 1968 than during the previous five years:

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of entrants</th>
<th>Cumulative total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>1962</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td>1963</td>
<td>7</td>
<td>15</td>
</tr>
<tr>
<td>1964</td>
<td>9</td>
<td>24</td>
</tr>
<tr>
<td>1965</td>
<td>9</td>
<td>33</td>
</tr>
<tr>
<td>1966</td>
<td>13</td>
<td>46</td>
</tr>
<tr>
<td>1967</td>
<td>9</td>
<td>55</td>
</tr>
<tr>
<td>1968</td>
<td>12</td>
<td>67</td>
</tr>
</tbody>
</table>

The new insurance products - equity and property - linked, annual and single-premium contracts - enjoyed considerable popularity in the early 1970s. For example, the value of new single premium business (which almost entirely comprises linked-life assurance policies) rose from £55 million in 1970 to £353 million in 1973. The public's receptiveness was largely a function of tax concessions pertaining to the new products and the boom in equities and property in the 1960s.

Those companies specialising in the new policies made their immediate impact in respect of 'new business' figures; this is shown in Table 4.5 which ranks companies according to total premium income and new business premiums.

Rankings according to total premium income contain only two new entrants. With respect to new business, however, and to single-premiums, in particular, considerable penetration by new companies is evident. Abbey Life, gained the largest share of new single premium business and by 1971 was writing more than half of all property-linked and equity-linked life assurance. It was established by Mr. Mark Weinberg and was acquired in 1964 by I.T.T., in conjunction with Georgia International Life Co. Its subsequent growth was based on an annual premium contract (Unit-Linked Planned Investments Endowment), launched in 1963, and two single-premium contracts - Abbey Bonds and Abbey Property Bonds. The former were launched in 1966 and consisted of a life policy linked to an equity fund, managed by Hambros Bank; the latter, which were initiated in 1967 were linked to investments in commercial and industrial property.

Other successful entrants included, International Life, a subsidiary of Investors Overseas Services. Its incursion into the market was mainly achieved through the annual premium equity-linked "Dover" plan. In 1972, following the failure of I.O.S., Keyser Ullmann acquired International Life, and it subsequently became Cannon Insurance.
Table 4.5: Top 10 Groups by constituents of premium income, 1968

<table>
<thead>
<tr>
<th>Total premium income</th>
<th>Premiums excl. annuities</th>
<th>Annuity considerations</th>
<th>New business premiums</th>
<th>Annual Premiums</th>
<th>Single Premiums</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Prudential</td>
<td>Prudential</td>
<td>G.R.E.</td>
<td>*Abbey Life</td>
<td>Legal &amp; General</td>
<td>*Abbey Life</td>
</tr>
<tr>
<td>2. Legal &amp; General</td>
<td>Legal &amp; General</td>
<td>Sun Life</td>
<td>Legal &amp; General</td>
<td>Prudential</td>
<td>Legal &amp; General</td>
</tr>
<tr>
<td>4. Standard Life</td>
<td>*Abbey Life</td>
<td>*Noble Lowndes</td>
<td>Sun Life</td>
<td>*Save and Prosper</td>
<td>*City of Westminster</td>
</tr>
<tr>
<td>5. Commercial Union</td>
<td>Commercial Union</td>
<td>Commercial Union</td>
<td>Commercial Union</td>
<td>Co-operative</td>
<td>Commercial Union</td>
</tr>
<tr>
<td>6. Norwich Union</td>
<td>Norwich Union</td>
<td>Prudential</td>
<td>*Save &amp; Prosper</td>
<td>Eagle Star</td>
<td>*M &amp; G Trust</td>
</tr>
<tr>
<td>7. Sun Life</td>
<td>Sun Life</td>
<td>Scottish Widows</td>
<td>*Int'l Life</td>
<td>*Int'l Life</td>
<td>*Ulster Scottish</td>
</tr>
<tr>
<td>8. *Abbey Life</td>
<td>G.R.E.</td>
<td>Legal &amp; General</td>
<td>Norwich Union</td>
<td>Standard Life</td>
<td>Reliance Mutual</td>
</tr>
<tr>
<td>9. General Accident</td>
<td>Scottish Widows</td>
<td>General Accident</td>
<td>General Accident</td>
<td>*Save and Prosper</td>
<td>Refuge</td>
</tr>
<tr>
<td>10. Scottish Widows</td>
<td>General Accident</td>
<td>Clerical Medical</td>
<td>Standard Life</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: D.T.I. op. cit.

Notes: *

*Annuity considerations are single premiums paid to secure an annual income, and constitute part of new business as well as total premium income

*formed since 1960

*indicates those groups which improved their positions in terms of total premium income and new business premiums since 1960.
The success of Save and Prosper (S & P), an established unit trust group, was based on its unit-linked life assurance policies, and particularly benefited from available tax concessions. The whole of the annual premium paid was eligible for tax relief, in spite of the fact that only a fraction of the premium was used to provide life cover. Thus, unit trusts were effectively being bought at a discount.

In 1968, the Finance Act removed the taxation advantages of single-premium policies, and sales fell in 1969. However, despite the imposition of stricter barriers to entry companies continued to enter the market, as Table 4.6 indicates.

Table 4.6: Number of Authorizations Issued to Conduct Ordinary Long-Term Business 1968-73

<table>
<thead>
<tr>
<th>Year</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>1968</td>
<td>12</td>
</tr>
<tr>
<td>1969</td>
<td>12</td>
</tr>
<tr>
<td>1970</td>
<td>23</td>
</tr>
<tr>
<td>1971</td>
<td>15</td>
</tr>
<tr>
<td>1972</td>
<td>11</td>
</tr>
<tr>
<td>1973</td>
<td>14</td>
</tr>
</tbody>
</table>

Source: D.T.I.: Various 'Insurance Business Annual Reports'

Note: These totals include some companies registered overseas and are not therefore strictly comparable with those in Table 4.4.

In common with new entrants before 1968, those companies successfully entering the market after 1968, owed their positions primarily to single premium business. This is clear from Table 4.7.
### Table 4.7: Top 10 groups by constituents of premium income 1972

<table>
<thead>
<tr>
<th>Total premium income</th>
<th>Premiums excl. annuities</th>
<th>Annuity considerations</th>
<th>New business premiums</th>
<th>Annual premiums</th>
<th>Single premiums</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total PREMIUM INCOME (U.K.)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Prudential*</td>
<td>Prudential</td>
<td>*London Indemnity</td>
<td><em>Hambro Life</em></td>
<td>Prudential</td>
<td>*Hambro Life</td>
</tr>
<tr>
<td>2. Legal &amp; General*</td>
<td>Legal &amp; General</td>
<td>Eagle Star</td>
<td>Eagle Star*</td>
<td>Legal &amp; General</td>
<td>*Abbey Life</td>
</tr>
<tr>
<td>3. Norwich Union*</td>
<td>Norwich Union</td>
<td>Commercial Union</td>
<td><em>London Indemnity</em></td>
<td>Norwich Union</td>
<td>*Property Growth</td>
</tr>
<tr>
<td>4. Eagle Star</td>
<td>*Hambro Life</td>
<td>*Hill Samuel</td>
<td>*Abbey Life</td>
<td>Standard Life</td>
<td>*Save &amp; Prosper</td>
</tr>
<tr>
<td>5. Standard Life</td>
<td>Standard Life</td>
<td>Royal</td>
<td>Prudential</td>
<td>Commercial Union</td>
<td>*Tyndall</td>
</tr>
<tr>
<td>8. Commercial Union</td>
<td>Eagle Star</td>
<td>Scottish Equitable</td>
<td><em>Hill Samuel</em></td>
<td>Phoenix</td>
<td>*Hambro Life</td>
</tr>
<tr>
<td>9. Abbey Life</td>
<td>Sun Life</td>
<td>Prudential</td>
<td><em>Property Growth</em></td>
<td>*Abbey Life</td>
<td>*London Indemnity</td>
</tr>
</tbody>
</table>

Source: Stone & Cox, Ordinary Life and Equity-Linked Life Assurance Tables

Notes: *formed since 1960

* indicates groups which improved their positions in terms of Total premium income and new business premiums since 1968.
Among the most notable entrants was Hambro Life, the most significant in terms of impact on the market. By 1972, having been established only in the previous year, it captured the largest share of the total new business premiums in that year. Hambro Life was created by Weinberg (who left Abbey Life in 1970), as a subsidiary of Hambros Bank. In 1972 its life insurance and annuity fund amounted to £135 million, based mainly on single-premium business (£104 million) and ranked fourth in terms of total premium income less annuities which reached £106 million, compared with the Prudential's £193 million.

The overall effect of this increased competition compounded the problems experienced by composite insurance companies in the general insurance market, and directly challenged the traditional life offices. Thus for different reasons, the conditions in which insurers competed during the period, 1966-73, were characterised by uncertainty. The pressures to increase the capital base of the industry and the solvency margins of particular companies by acquisition and merger, appear to have emanated from the various difficulties experienced in the underwriting of general risks. It is interesting to note, however, that, of a total of 26 insurance company mergers between 1968 and 1973, 17 (65% of the total) were initiated by either specialist life offices or by composite companies whose life fund was among the ten largest as ranked by Table 4.3. Moreover, Table 4.5 shows that only three established companies improved their new business premium rankings since 1968. Two of these, G.R.E. and General Accident had undergone mergers in 1968. The Table also shows that three groups besides Abbey Life improved their total premium income ranking, and in this case, all had undergone acquisitions.
The second aspect of the life assurance market which has influenced the acquisition behaviour of insurance companies relates to their investment policy. Investment income has been a cushion against which general underwriters have offset underwriting losses, and a major source of life assurers' profitability. The structure of the portfolios of insurance companies tends to vary according to the particular underwriting specialization of each company, and is usually differentiated according to the liquidity of the investment assets.

Regardless of the different weights attached to the components of the insurers' funds, composites companies' portfolios share a number of common features, which reflect the multi-product nature of contemporary insurance business. For example, investments are diversified across numerous industrial and public sectors; the widely spread asset base affords a diversification of investment risks and maximizes policyholder and shareholder security. The increasing diversification exhibited by insurance companies in their acquisition policies from 1970-73 is only an extension of the commercial logic underlying insurance companies' operations, achieved by a series of acquisitions of property companies and investment companies in the second four-year period considered.

The reference to the Monopolies and Mergers Commission of Eagle Star's proposed acquisition of Grovewood and Bernard Sunley in 1973 indicates official concern about these developments. Although Eagle Star's principal motive was to increase its capital base and improve its solvency margin, the timing of the proposed merger was apparently influenced by legislation introduced in 1973 which restricted dealings with 'associate' companies. In particular, Section 10 of the 1973 Act provides that the aggregate of certain transactions between a life fund and 'connected persons' should not exceed a level equal to 5% of the total assets of the life fund. A 'connected person' was defined so as to include any company in which the
insurer owns at least 1/3 of the voting shares but excludes a 'subordinate company' in which the life fund holds more than 1/2 of the voting shares. Insurance companies were therefore encouraged to convert associated companies in which they had minority shareholdings, into wholly- or majority-owned subordinates, which were not subject to the controls. Eagle Star owned 33.4% of Bernard Sunley, and 28.6% of Grovewood.

It appears that the Office of Fair Trading had two reservations about the acquisitions which related to the question of an insurance company becoming involved in the management of a wide range of manufacturing interests owned by Grovewood. The Commission's final consideration, and potentially the most important for the incidence of future acquisitions by insurance companies, was:

"... whether the merger might be regarded as a precedent leading to the acquisition by ... insurance companies of other manufacturing or trading companies."

Clearly there was a fear that insurance companies would become more involved with companies which were unconnected with the specialist activities of the insuring of life and general activities. However, the continuous and close relationship between the boards of Eagle Star and Grovewood, and the peculiar nature of Grovewood itself (essentially a 'supervisory firm' of a group of small manufacturing and trading companies, each of which was very small relative to the size of Eagle Star) meant that this reference was unique.

Although many insurance companies own small manufacturing and trading companies, most have been too small to be of any significance. Insurance companies did however hold substantial holdings in finance companies such as United Dominions Trust, the Charterhouse Group and Mercantile Credit which in turn owned manufacturing and trading companies. In none of these cases did insurance company have a controlling interest in the parent company and therefore the acquisition of Grovewood with its wide portfolio of investments was considered to be without precise parallel and so created a precedent. Nevertheless, regarding the proposed merger as the acquisition
by an insurance company of a large number of separate enterprises, which
was more realistic, led the Commission to conclude that the acquisition
by Eagle Star of Grovewood should not be construed as a precedent.

It is more important to consider, though, not whether it should be
construed as a precedent, but whether it will be. Persistent inflation
in particular places a growing strain on insurance companies. Thus an
increasing capital base is necessary, indeed essential, if insurance
business is to be expanded in real terms. Hence a recurring motive to
pursue mergers exists. Insurance companies seem likely to continue to
spread their interests both functionally and geographically, as the
Monopolies Commission admitted:

"... the principle of spreading the risk is cardinal
for successful underwriting and it is natural that
this same philosophy should also inspire insurance
companies' conduct as investors and cause them to
avoid large concentrations of their capital resources."

4.1.2 : Insurance Brokers' acquisitions 1966-73

The nature and direction of insurance brokers' acquisition activity
contrasts with that of insurance companies and other financial institutions.
In the 1966-69 period, 71% of acquisitions by brokers occurred in the leading
diagonal. 'Horizontal' amalgamations, however, accounted for only 6% of
total expenditure on acquisitions. In the second four year period, the
number of 'horizontal' acquisitions as a proportion of total merger activity,
fell to 68% while expenditure on 'horizontal' integration increased to
47% of total acquisition expenditure.

More detailed examination of brokers' merger behaviour reveals that
the average size of 'horizontal' amalgamations was £2 million for the whole
eight year period, compared to £8.3 million for diversificatory acquisitions.
Indeed, estimates of the latter were also influenced by two very large
acquisitions undertaken by C.T. Bowring. In 1969 it acquired Bowmaker,
an instalment credit finance house for £44.9 million; and in 1971 it
acquired the merchant bank Singer and Friedlander at a cost of £27.7 million.
Similarly the mean size of 'horizontal' mergers was artificially high, owing to the amalgamation of Sedgwick Collins and Price Forbes, creating Sedgwick Forbes and costing £36.9 million.

4.1.2.1: Competitive environment/Rationale for acquisition

In common with insurance companies, insurance brokers have competed within rapidly-changing environments. The factors which appear to have affected their merger behaviour can be considered under two heads.

As intermediaries in the market, brokers were subjected to the same inflationary pressures which caused problems for general underwriters. The losses experienced by general companies which led them to seek acquisitions in order to expand their capital bases, also encouraged them to attempt to achieve administrative and operating economies. Inevitably, the companies sought to reduce the real and absolute value of commission payments made to brokers. Thus they attempted to restrict an additional source of brokers' income - derived by investing premiums, collected from clients, before they were required to remit them to the underwriter - by pressurising the broker to shorten this intervening period.

In particular, a policy of direct billing developed as competition in the marketing of insurance products intensified. Thus in the late 1960s, Commercial Union instituted a policy of direct selling, by encouraging its industrial clients to dispense with a broking service, by buying 'direct.' In ordinary life assurance, broking mushroomed during the period in which the various investment packages, referred to above, enjoyed sudden rises in popularity. However, the tightening of tax legislation and new commission structures served to reduce the profitability of life broking towards the end of the period.
The cumulative effects of these developments encouraged brokers to seek profits from sources, other than insurance broking, and induced diversificatory acquisitions such as those undertaken by C.T. Bowring. Bowring's acquisition strategy also included the purchase of three smaller broking firms and a unit trust. As a result, by 1973, the parent derived less than half its profits from traditional insurance broking business.

The other large brokers diversified in general to a lesser extent. Indeed, notwithstanding the pressures to extend their range of activities, insurance broking remained an important part of the insurance industry. For example, insurance may still be placed at Lloyd's only through the medium of some 250 firms of Lloyd's brokers. In addition, according to a report by the Economist Intelligence Unit in the early 1970s, brokers sold 90% of all marine business (owing to their connections with Lloyd's), 90% of all U.K. pension business, and 74% of all commercial and industrial insurance. 42

The high number of small 'horizontal' amalgamations were indicative of the structure of the broking market, which apart from seven dominant firms of Lloyd's brokers - C.T. Bowring; Willis, Faber & Dumas; C.E. Heath; Bland Payne; Bray Gibb Wrightson; Bogg Robinson & Gardner Mountain; and Sedgwick Forbes - mainly consisted of relatively small firms. The amalgamation of broking firms was encouraged by a defensive rationale caused by the incursion of banks into the market for insurance broking services. The clearing banks, in particular extended their range of services relating to insurance advice. By 1973, such was the extent of their rationalization of insurance advisory services that, collectively, they represented a considerable if largely potential threat to traditional brokers.

Even before the rationalization of the 1960s, branch managers, following the lead of the Westminster Bank, had already established the basis for personal insurance services. This entailed the further development of the traditional customer relationships which arose through routine banking business. By utilising the marketing potential of their branch networks, the rationalization of the banks' insurance broking
interests represents a logical 'spilling over' into a complementary
financial advisory activity.

Up to 1973, the banks' impact was confined to the personal sector; their incursion into the market segment for corporate clients was negligible. Nevertheless, the diversification of banks into insurance broking provoked much debate within the insurance industry and gave rise to considerable criticism from traditional insurance brokers. The latter apparently feared the banks' unparalleled advantages of access to customers and their facilities for marketing of insurance services. In particular, the potential capacity of the banks to extend services to small- and medium-sized commercial companies caused uncertainty. This was emphasised by Midland Bank's acquisition of Montagu Trust which brought a leading Lloyd's broker, Bland Payne into the clearing bank group. At the end of 1973, the other clearing banks relied upon 'in house' broking departments and subsidiaries, as follows:

National Westminster - National Westminster Insurance Services
Barclays - Barclays Insurance Services Company
Lloyds - Insurance Division of the Executor and Trustee Department

Each of these competed especially for advisory business pertaining to personal life assurance.

The result of this expansion was evident in the increased concern of established broking firms and exemplified by Mr. E. Orbell, a director of Leslie & Godwin (Holdings), who forecast the implications of the banks' incursion into the broking market as:

"... vicious competition which can only have the effect ultimately of removing from the business of insurance the intermediary as we know it today."
As noted, this produced a spate of 'horizontal' acquisitions. For example, Leslie & Godwin, among the larger brokers undertook several amalgamations with other brokers, as did Fenchurch Insurance Holdings, Staplegreen Insurance Holdings, and Stenhouse Holdings.

4.2 : Investment Trust and Portfolio Management

Investment trust companies, unit trusts and other similar bodies have portfolios which consist very largely of ordinary shares. They are means whereby investors can obtain a share in a portfolio very much larger and more diversified than their individual portfolios could be. They represent, therefore, the pooling of a number of different economic units, which enables holdings to be diversified, risks to be spread and professional management to be secured. They are distinguished from other financial institutions - which differentiate between the nature of the claims issued and the assets they hold - because the major type of financial claim which they issue is formally almost identical with the major assets which they hold.

Under the laws of the UK the only two forms which a pooled portfolio can take are the investment trust company and the unit trust. An investment trust company is an investment-holding company, incorporated under the Companies Acts and having the same type of capital structure as an industrial or commercial company. Thus it is an entity which is separate from its shareholders, who have no direct legal or beneficial interest in the assets of the company. In contrast, the holders of units of a unit trust are, collectively, the beneficial owners of the deposited property: a unit trust is a trust at law.
The rationale for mergers between trust management companies appears to centre on the expected benefits to be accrued from large-scale operations. Because the costs of buying securities, decline with the size of the purchase, it is possible for a large portfolio to have a much wider spread of assets than a small one. Diversification of assets, moreover, enables and facilitates diversification of risks. In addition, professional management of individual portfolios can be secured by using the services of a stockbroker or portfolio management company, although it is not considered economic to provide individual attention to portfolios of less than £50,000.

The data provided by the Bank of England and analysed in Chapter 2, supports this contention. A total of 218 acquisitions by investment and unit trusts were recorded by the Bank in the period 1966-73, involving the expenditure of £601 million; the average of £2.8 million, is relatively low in comparison with all financial institutions' acquisitions. Further examination of mergers and acquisitions initiated by investment companies confirms that amalgamations were undertaken in order to achieve growth and portfolio diversification. Thus, many of the larger mergers were between trusts in the same group; for example, the £23 million amalgamation of the 2nd Scottish Northern and 3rd Scottish Northern Investment Trusts (1968); the acquisition by First Scottish American Investment Trust of the 2nd and 3rd Scottish American Investment Trusts, involving £18.7 million (1970); and the largest merger, between London Scottish American and 2nd London Scottish American in 1972 which was valued at £52.5 million. Furthermore, as Revell has noted:

"... some investment trusts have used mergers to augment their portfolios in certain directions, notably to acquire dollar portfolios by the issue of sterling securities to finance the merger ..."
This section is not, however, primarily concerned with the acquisition behaviour of investment trusts or unit trusts. Rather its purpose is to concentrate on the role of banks and other financial institutions as portfolio managers. This is one aspect of the banks' recent diversification and is a potential source of power, for it affords them control over a proportion of the country's investment resources.

The management functions of companies which administer investment and unit trusts are slightly different but involve similar duties and skills:

**Investment Trust Companies : Management Functions**

To take the investment decisions; to buy and sell securities; to register the holders of the shares and debentures of the company and the payment of dividends and interest; to carry out the duties of company secretary.

Many investment trust companies are under common management; the whole management is often contracted out to a single management company;

**Unit Trusts : Management Functions**

To initiate the unit trust; to conduct day-to-day business connected with administration, including the investment decisions.

Some functions can be contracted out to other bodies; many of the management companies are under common management.

The most easily recognisable investment trust management companies are the merchant banks. Indeed, the origins of the investment trust company are closely connected with Robert Fleming which founded several of the first sixteen trusts in the 1870s, in Scotland. Flemings, which has since become a merchant bank, has maintained a specialisation in portfolio and investment management. Of the investment trusts covered by L. Messel & Co in 1975, 29% by number and 22.5% by value of assets were managed by 20 merchant banks, either independently or in conjunction with one another; for example Drayton Montagu and Schroder Wagg jointly managed the City and Commercial Investment Trust.
These figures understate the true merchant bank involvement in fund management, however. Baring Bros. owns 26% of the Save & Prosper Group which administers a large number of unit trusts and manages the Save-and-Prosper Linked Investment Trust; similarly Kleinwort Benson, through its interest in M & G Securities, one of the largest UK unit trust groups, is involved in the three investment trusts run by M & G, as well as its direct presence as a manager for eight investment trusts together valued at £87.7 million in 1974.

The movement of banks into unit trust management has been more pronounced. Merchant banks, clearing banks and insurance companies are now in competition in this market. The various types of financial institution were attracted for several reasons - the deposit banks because of their extensive retail branch networks; the merchant banks because of their previous specialization in portfolio management; and the insurance companies owing to the growth in assurance-linked units.

For largely historical reasons, clearing bank involvement in unit trust management did not begin until late 1966. For many years before that it was the recognised function of the banks to act as trustee for all kinds of trust funds. On the other hand, they were content until the mid-sixties, to act as an agent and intermediary, obtaining information and giving advice when required to help their customers, and carrying out transactions on their instructions. When therefore, the first unit trusts were set up in the early 1930s and trustees were required to safeguard the interests of unit holders, it was natural that the banks should assume the role.

In 1969, it was reported that the clearing banks still acted as trustee of more that ¾ of all authorised unit trusts.\(49\)
The importance of the clearing banks' diversification into unit trust management, described in Chapter three, lay in its principal aim: to meet the demand of private customers of moderate means whose individual portfolios were too small for the merchant banks. To provide effective management for the small sums involved proportionately high charges. Thus the small investor with perhaps £2,500 to invest fell into an unserviced category. It was largely to provide a convenient service for potential equity investors in this bracket that Lloyds Bank formed its own unit trust. It was anticipated that customers of the bank would welcome the opportunity to invest in a trust actually managed by the bank.

The significance of clearing bank expansion into this area may be seen from the nature of unit trusts as an investment medium - they represent one of the first attempts by the banks to provide a savings service for medium- and long-term money. The importance also arises from the links formed between the banks and insurance companies in stressing the savings aspect of life policies. The most popular medium (because of tax reliefs) was the unit linked life assurance policy and schemes were set up by Lloyds with Royal Assurance, and by Westminster Hambro with Commercial Union. When Midland entered the market in 1976, it announced that it was launching a joint operation with the Prudential in the unit-linked field. The Prudential was to form a wholly-owned subsidiary to market life policies linked to one or more of the Midland Drayton unit trusts. Midland undertook to sell these policies across-the-counter of its UK branches. The early success achieved by the bank/insurance links is evident from data presented in Table 4.8.
Table 4.8: Bank Unit-Linked Assurance Policies: Early Years

<table>
<thead>
<tr>
<th></th>
<th>No. of Pols.</th>
<th>Anl. Prms.</th>
<th>Sums Assured</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>end '67</td>
<td>end '68</td>
<td>end '67 ('£000)</td>
</tr>
<tr>
<td><strong>Martins Unicorn/Griffin Assurance</strong></td>
<td>2598</td>
<td>5493</td>
<td>208</td>
</tr>
<tr>
<td><strong>Lloyds/Royal</strong></td>
<td>-</td>
<td>2655</td>
<td>-</td>
</tr>
<tr>
<td><strong>commenced Apr. '68</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Westminster-Hambro/C.U.</strong></td>
<td>403</td>
<td>1306</td>
<td>45</td>
</tr>
<tr>
<td><strong>- commenced July '67</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Growth (%)</strong></td>
<td></td>
<td>215</td>
<td>217</td>
</tr>
<tr>
<td><strong>Source:</strong> The Banker</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Note:</strong> Martins Unicorn is now Barclays Unicorn</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Although the banks are now concerned with the management of unit trusts, they still continue to perform their function as trustee for the majority of other trusts. The likelihood of conflict of interest therefore arises, for the Department of Trade maintains that the manager and trustee should be independent. When the regulations requiring an independent trustee were first framed by the Board of Trade it was probably not envisaged that trust corporations themselves would take over the role of fund managers. Suggestions that acting in both capacities might cause a conflict of interests have since been voiced, but such problems do not appear to have arisen in practice. Indeed Midland's venture some nine years after the first clearing bank moves, shows that separation of potentially-conflicting interest areas can be avoided. Drayton Montagu Portfolio Management continued to manage the investment portfolios of the new trusts to dispel fears of the trustee/manager relationship. However, a potentially greater conflict was threatened by the link with Prudential Assurance. Firstly, the assurance company already
had a life subsidiary, marketing unit-linked policies - Vanburgh Life (formerly Vavasseur Life). However, this company was broker-orientated so that the sales outlet of the two companies was not expected to overlap. Secondly, Midland already had a 50% interest in a linked-life company - Individual Life (through the Drayton Group). But rather than being involved in the management and underwriting of a life company, Midland preferred to join force with an established life company and Individual Life was sold to Schroder Wagg. Finally the fear that the combination of principal and broking function might prove tenuous was dismissed by the manager of the Midland Bank Insurance Service, the Group's insurance broking arm, in the following statement:

"... the Midland Bank trusts and the linked life policies will be treated as any other product and will not be recommended to clients if there is a better contract on the market".

Apart from a very few obvious exceptions - Hill Samuel, Slater, Walker and Hambros - merchant banks have not been a powerful force in unit trust ownership. Their specialisation has been in managing funds for clients rather than operating their own portfolios.

At the end of 1973 Hambros controlled some £212 million, Hill Samuel - £73 million, Schroder Wagg - £60 million, and Slater Walker - £53 million. Together with Barclays - £268 million, these banks accounted for almost 95% of those unit trust funds which are owned and managed by merchant banks. In total some £700 million, or the equivalent of 28% of the unit trust industry, is managed by banks; although the exclusion of Barclays reduces this share to 17%.

Merchant banking influence is more extensive than these observations suggest, however. The largest unit trust management group, Save & Prosper, with funds of over £700 million (1973), employs Robert Fleming (also a shareholder) to manage most of its trusts, in conjunction with Ivory & Sime. Moreover Baring Bros. which manages the Stratton Trust also owns 26% of Save & Prosper. Another example of indirect presence is that of
Kleinwort Benson which owns 33% of White Drummond, the parent company of M & G Securities which controlled funds valued at £220 million, at the end of 1973.

The strategy of merchant banking participation reflects, at least in part, the changes in the savings market in the years preceding 1973. One of the fundamental moves was the emphasis placed on insurance packages, mentioned earlier. Hill Samuel, recognising the attraction of unit trusts for the 'wealthier' investor, launched personal portfolio trusts (Personal Finance Service) aimed at clients with a minimum of £20,000 to invest. Such private portfolios are geared for the clients of Noble Lowndes, the insurance broking subsidiary of the Hill Samuel Group. To overcome the major problem facing merchant banks - their lack of retail outlets - Hill Samuel formed Hill Samuel Professional Adviser Services to cater for the needs of advisers such as accountants, solicitors, stockbrokers, insurance brokers and bank managers who, in turn, advise the public.

Moreover, and in response to the popularity of unit-linked life assurance packages, several merchant banks established or acquired existing insurance companies, and therefore became able to offer a range of new insurance products - managed bonds, property bonds and guaranteed income bonds. Thus acquisitions were undertaken by Hill Samuel (Noble Lowndes); Schroder Wagg (Dominion Lincoln); Keyser Ullmann (International Life which became Cannon Assurance); Samuel Montagu (Stronghold Insurance) and Edward Bates (Welfare). In addition, Hambros established Hambro Life, and Warburgs held a minority interest in Tyndall. Examination of Tables 4.5 and 4.7 in the previous section of this chapter shows that several of these subsidiaries were initially among the most successful entrants to the life assurance market from 1966-73.
The emphasis placed on 'management' rather than 'ownership' of unit trusts, is clearly revealed if the proportion of all funds invested in unit trusts managed by large groups is examined. Recent figures indicate that the five largest groups, Save & Prosper (£755 million), M & G (£300 million), Barclays Unicorn (£258 million), Slater Walker (£175 million) and Allied Hambro (£175 million), controlled 65% of all funds invested in unit trusts in 1975.53

Some of the larger groups have also figured in the limited merger activity in this sector. Hambros acquired Hereditaments in 1969; Save and Prosper took over Ebor Securities also in 1969; in 1972, Dawnay Day acquired Target (the eighth largest group in 1975); in 1973 Barclays acquisition of Southern Cross brought nine authorized unit trusts under the bank's control and represented a complement to the Unicorn funds as well as providing an entree into international markets; and Slater, Walker acquired Jessel and National and Oceanic in 1974 and 1975 respectively.

4.3 : Financial Multiproduct Companies

The preceding discussion suggests that the financial system will become increasingly dominated by companies whose products and services are sold in a wide range of markets. The process towards all-purpose financial companies has encouraged commentators and journalists, in particular, to christen contemporary financial institutions as 'financial conglomerates'. The term has no precise definition, however, and lends itself to wide interpretation. Its use has tended to arouse official interest because it is immediately associated with 'massive financial power and influence'.54

The purpose of this section is three-fold; first, to review the implications of financial conglomerates; secondly, to discuss the various forms which conglomerates can take; and thirdly, to assess the role of diversificatory acquisitions in the process towards multiproduct financial organisations.
4.3.1 : Meaning of financial conglomerate/constraints

The 'pure' financial conglomerate is perhaps best explained as a limiting case at one end of a spectrum, represented by a holding company with a number of 'principal' and 'intermediary' functions under its control. It would own, therefore, the equity of: a major retail banking function, a wholesale banking function, an insurance operation (either broking or principal), money transmission and investment services and a hire-purchase function. In addition it might include a stock broking or jobbing function, operate subsidiaries in different industrial areas and would probably contain a property company. Thus the component parts would operate in all the major areas associated with financial sector activities in short, medium and long-term markets, in the corporate and personal sector.

It is not envisaged that such specialist functions as building societies and discount houses, would operate under the umbrella.

There are no financial institutions which at present approximate to that description and specification, although some go part of the way. The eventual attainment of a structure such as this requires a breakdown of traditional demarcation lines and perhaps more importantly, a favourable attitude from official bodies, such as the Treasury, the Bank of England, the Department of Trade and the Monopolies Commission. Nevertheless progress towards the provision of a multitude of services by one institution had been made by December, 1973. Banks had become increasingly involved in the insurance broking market, insurance companies and brokers had acquired shares in banks and both traditionally owned stakes in hire-purchase finance houses; furthermore links had been established between banks and insurance companies in the unit trust industry.
An assessment of the financial services industries should recognise, at the outset that financial companies sell widely differentiated products, including corporate and personal advice. Moreover, they may embrace a complicated concept such as insurance-linked unit trust investment and may therefore be difficult to describe and understand. Not only are funds heterogeneous, and differentiated with respect to source, term and uses, but the other products of financial institutions, notably financial advice are often tailored to a specific situation or client.

Partly because of the non-standard and technical nature of these products and services, emphasis may not be on the sellers' integrity, but on the buyers' confidence in the sellers' recommendation (although the two will possibly be related). Despite criticisms of a lack of competition among financial intermediaries in well-demarcated markets, the non-standard nature of products, reinforced by the ability of certain financial institutions to make undisclosed allocations to inner reserves, makes comparison between competitors very difficult. In the market for retail banking services, there is a low propensity to 'shop-around' and a high degree of buyer loyalty. The same used to be the case for the merchant banks' corporate clients. However, as wholesale banking business has become more price-elastic and competitive, corporations have become more discerning. Thus it is now quite usual for industrial clients to select a merchant bank on an ad hoc basis depending on their particular requirement.

Thus, in spite of the diversification of financial institutions across industry and market boundaries, which might suggest a breakdown of entry barriers, there are few signs of the markets themselves overlapping. In other words, assuming the facilities to be available and subject to legal constraints, clients appear to differentiate between the insurance products offered by a composite insurer and a clearing bank, and between the banking services offered by the same institutions.
The dichotomy between the main activities of insurers and banks which is well illustrated by early, mainly historical and descriptive texts and studies, is indicated by the nature and role of different financial intermediaries. These in turn emphasise that each has its own special function to perform in the financial system.

Evolutionary pressures have, nevertheless, resulted in financial institutions aspiring to a greater degree of expertise in a wider variety of markets, and they have therefore crossed the traditional demarcations between activities. The juxtaposition of financial sectors provides a framework within which attention can be focused on the behaviour of intermediaries and, in particular, on the relationships between companies in different parts of the financial system.

The diversification undertaken by banks and insurance companies has two important implications. First, the behaviour of institutions whose main activity is in different markets, cannot be examined in isolation. Secondly, changes in one part of the system have repercussions in other parts. They should be considered as influences affecting the interrelationships between financial companies and causing disequilibria throughout the financial system. Development, therefore, whether for a single institution or for a financial industry such as banking or insurance, or for the financial sector as a whole, should be considered in the round. As changes occur they spill over into each of the other areas. Because changes in different sectors occur for a number of reasons they do so at different times and at different rates - hence motion throughout the system as a whole is virtually continual. At the same time the 'aggregate' environment is changing: in particular, the market for funds, the employment situation, the state of technology and the framework of technology; as noted the changing environment creates the opportunity or imposes the need for further change.
4.3.2: Vehicles for all-purpose financial companies

The process towards financial conglomeracy has created a number of different forms of diversified financial company. The first to be considered, however, is yet to appear in the U.K:

Financial Supermarkets

The setting up of financial centres where banks, insurance companies, building societies, finance houses and others would have their counters, and in this way retain their own identities.

In contrast, many financial institutions are organised on the basis of a multiproduct financial company or a financial holding company. The former is most readily identifiable with a group, whose parent is well-established in a particular market and whose wholly- or majority-owned subsidiaries operate in a range of different and/or overlapping markets. Diversification of the parent, after whom the group is named (and sometimes the subsidiaries as well), is usually achieved by the acquisition of going-concerns in those aspects of the financial system selected for expansion. The clearing banks, in particular, adopt this form of organisation.

Financial holding companies are typically associated with the term 'financial conglomerate'. It comprises a holding company, owning the equity of a major bank, an insurance institution and various other financial intermediaries. This one group comprises companies which are well-established in their own particular market each of which retains their own independent identity. The various arms of the company are therefore capable of supplying a range of financial services. Examples of this form of organisation are C.T. Bowring, which includes a major insurance broker, a member of the Accepting Houses Committee, and a leading finance house; and Guinness Peat, which owns an accepting house, a commodity broker and various insurance broking interests.
4.3.3: Financial services: Competitive or complementary?

In 1959, the Radcliffe Committee's report on the working of the Monetary System, considered the following institutions in the private sector:

London clearing banks; Scottish banks; Overseas and Foreign banks; Finance houses; Discount houses; Accepting houses; Issuing houses; Insurance companies; Pension funds; Investment trusts; Unit trusts; Building societies.

The Committee said:

"We have included all these groups of institutions in one chapter, despite the great differences in the activities which they undertake and the type of credit they offer, because we have been impressed in hearing evidence not by differences but by the fact that the market is a single market. Though each type of institution has its special type of business and may, by tradition or as a matter of commercial arrangement, state a preference for one form of lending rather than another, it does not seem that any hard and fast lines are drawn, for instance between the supply of short finance and the supply of long finance; borrowers seem to be ready to switch to some extent from one to another if difficulties are put in the way of their obtaining finance from the source upon which they are accustomed to draw."

The importance of this pronouncement lies in its consideration of financial institutions as competitive, not complementary intermediaries.

The following analysis examines this hypothesis by considering the competitive and complementary aspects of the inter-relationships between financial companies and, in particular, the interface between banks and insurance institutions which is widely recognised as being the initial stage in the process towards multiproduct financial intermediaries. 56

Historically, there has been a natural affinity between the banking and insurance industries, which were considered as complementary businesses. Banks were primarily concerned with the taking of deposits, lending of their own funds and the provision of a money transfer service. The basic business of insurers was that of providing cover against a variety of risks. Various aspects of the banking-insurance interface can be examined in respect of the sources of their funds and the destination of their investment.
Sources of Funds: Savings

Banks and insurance companies, in common with other financial institutions, seek to attract the savings of their respective clients. They then perform an intermediary function - channeling these savings into investment. With respect to the source of their funds, however, banks are accustomed to accepting deposits on demand, whereas insurers attract premiums for a potentially longer term, from their policyholders. Both are therefore in competition with building societies and other savings media in the market for the savings of the personal sector.

However, savings must be grouped into various categories according to their maturity, because investors have varying requirements - the most obvious distinction being between short-term savings (probably invested for emergencies or income purposes) and those invested for a longer period, possibly for capital growth. Funds accruing to banks from the personal sector are generally of a short-term nature and take the form of current and deposit accounts. On the other hand, funds accruing to insurance companies in the form of premiums are generally the longer term contractual savings of investors designed to be of much longer maturity.

The managing director of National Westminster Insurance Services attributed the insurance sector's success in attracting savings largely to environmental conditions, reinforced by innovations in respect of new products designed to take advantage of tax concessions. The banks, in contrast, suffered because of the rise in interest rates in 1973, after which the Bank of England imposed restrictions on rates payable for deposits under £10,000 to 9¾%.

These contrasting, yet simultaneous, fortunes suggest that the market for funds is extremely diverse, and that participants have not competed on equal terms. Banks and insurance companies, in particular, operate in different segments of the market which indicates that they should not be considered as savings vehicles which are perfect substitutes.
Application of funds: Investment

An examination of banks' and insurers' respective investment portfolios, reveals a difference in emphasis which is determined by the nature of their liabilities. Banks, for example, have traditionally put an emphasis on liquidity which has encouraged short-term advances. They have, moreover been subject to restrictive official requirements such as special deposits and reserve asset ratios.

In contrast, insurance companies have tended to employ funds of longer maturities. Revell has estimated that in 1970, some 31% of insurance companies' investments was in the form of U.K. equities. Rather than competing, therefore, insurers and banks - which have occupied the position of secured creditor - have provided complementary forms of finance.

This distinction became blurred during the early 1970s when the banks began to offer medium-term credit facilities and to compete in the money markets for deposits over longer-terms, they have not, however, except in a few instances, provided equity capital.

4.3.4: The process towards financial 'conglomeracy'

These comments are, furthermore, abstractions from the factual basis of the banking-insurance interface and the other inter-relationships which are evident within the financial system. Structural and operational changes have created financial groups which are capable of providing services for a diversity of financial interests. The banking industry, in particular, has undergone a transition in which the traditional 'specialist' banking institutions have been superseded by banks of a 'generalist' nature. The latter are characterised by organisations providing products and services in a wide range of markets, including corporate financial and investment management advice.
The initiative for this diversification has mainly come clearing banks which have competed effectively in the markets for wholesale deposits, whilst maintaining their traditional and reliable source of short-term, comparatively-cheap, retail deposits. Their widespread branch networks have proved an effective barrier to the entry of secondary banks to retail markets. All categories of bank, however, have ventured into the market for insurance broking services, and to an extent, that for life underwriting.

There are occasional instances where insurance institutions have extended their interests to include the provision of banking services, either by way of trade investments, or as a suitable method of employing their premium income. In 1972, for example, Norwich Union established Norwich General Trust to provide corporate credit through the group's branch network; and Commercial Union owned 25% of Mercantile Credit until its acquisition by Barclays in 1975.

The innovation in the development of the insurance-banking interface and in the process towards multiproduct financial institutions, has demonstrably come from the banking sector. Indeed, the process might be considered as a spilling-over of banking into insurance. The acquisition behaviour of banks and insurers into the respective industries confirms this:
Table 4.9: Mergers between banks and insurance institutions, 1966-73

<table>
<thead>
<tr>
<th>Year</th>
<th>Bank</th>
<th>Insurance Institution</th>
<th>% Holding</th>
</tr>
</thead>
<tbody>
<tr>
<td>1967</td>
<td>Martins Bank</td>
<td>Unicorn Securities</td>
<td>75</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Dillow Walker and Co</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Ditto</td>
<td>E.E. Golding &amp; Co.</td>
<td>n.a.</td>
</tr>
<tr>
<td>1969</td>
<td>Hill Samuel Group</td>
<td>Noble Lowndes Securities</td>
<td>n.a.</td>
</tr>
<tr>
<td>1970</td>
<td>Samuel Montagu</td>
<td>Stronghold Insurance Co.</td>
<td>n.a.</td>
</tr>
<tr>
<td>1972</td>
<td>Keyser Ullmann Holdings</td>
<td>International Life Ins. Co.</td>
<td>n.a.</td>
</tr>
<tr>
<td>1973</td>
<td>Antony Gibbs &amp; Sons Ltd.</td>
<td>Mothercare Ins. Co.</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>Edward Bates &amp; Sons Ltd.</td>
<td>Welfare Insurance Co.</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>Arbuthnot Latham Holdings</td>
<td>A.J. Collins &amp; Co.</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>Schroders Ltd.</td>
<td>Dominion Lincoln Assurance</td>
<td>100</td>
</tr>
</tbody>
</table>

INSURANCE BANK MERGERS

1966-1973

<table>
<thead>
<tr>
<th>Year</th>
<th>Insurance Institution</th>
<th>Bank</th>
<th>% Holding</th>
</tr>
</thead>
</table>
Adaptation to innovation and change has also been evident in the U.K. securities industry. Since the war, there has been a trend towards larger units; relatively few stock brokers and jobbers continue to operate successfully on a small scale. In response to changing demands, moreover, many London firms have installed computers, extended their free advisory services to clients, and improved the range of statistical and economic information produced in their research departments.

These and other changes have taken place against a background of a shift in share ownership in favour of the institutional investor and declines in the membership of the Stock Exchange and in the population of stock broking firms. In the period from 1966 to 1972, 79 firms left the industry thereby reducing the population by approximately one-third. Table 4.10 shows the extent of firm disappearance and accounts for the reasons for exit.

Table 4.10 : The number of causes of disappearances from the U.K. stockbroking industry 1966-1974

<table>
<thead>
<tr>
<th>Year end Totals</th>
<th>Number of firms</th>
<th>Number and cases of disappearance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Total</td>
</tr>
<tr>
<td>25.3.1966</td>
<td>248</td>
<td>17</td>
</tr>
<tr>
<td>1966</td>
<td>231</td>
<td></td>
</tr>
<tr>
<td>1967</td>
<td>199</td>
<td>32</td>
</tr>
<tr>
<td>1968</td>
<td>196</td>
<td>3</td>
</tr>
<tr>
<td>1969</td>
<td>192</td>
<td>4</td>
</tr>
<tr>
<td>1970</td>
<td>177</td>
<td>15</td>
</tr>
<tr>
<td>1971</td>
<td>167</td>
<td>10</td>
</tr>
<tr>
<td>1972</td>
<td>168</td>
<td></td>
</tr>
<tr>
<td>25.3.1973</td>
<td>372</td>
<td>15</td>
</tr>
<tr>
<td>1973</td>
<td>360</td>
<td>69</td>
</tr>
<tr>
<td>1974</td>
<td>297</td>
<td></td>
</tr>
<tr>
<td></td>
<td>165</td>
<td>91</td>
</tr>
</tbody>
</table>

Source: Stock Exchange data.


(2) Discrepancies between changes in year end totals and the number of disappearances are caused by firms entering the market.
Notes continued: (3) The change in population in March 1973 reflects the amalgamation of the various stock exchanges into one body; up to March 25, 1973, figures relate to the London stock exchange only.

The predominant cause of exit, throughout the period, was merger or acquisition which accounted for 55% of all firm disappearances; 38% of brokers 'ceased trading', and 7% defaulted and were "hammered".

Closer examination of the data reveals two interesting features. The first concerns changes in the incidence of merger and acquisition. In 1966 and 1967, amalgamations accounted for 65% of disappearance from the industry; whereas, in the next seven years, only 51% of firms disappeared as a result of acquisition.

The second feature is the very close inverse relationship between the rate of disappearance and stock market conditions which is portrayed in Figure 4.1.

Figure 4.1: The rate of disappearance from the U.K. stock broking industry 1966-1974
Notes:  ñ = F.T. ordinary share index

= Rate of disappearance; calculated as follows:

\[
\frac{\text{Number of disappearances 'year } x'}{\text{Total number of firms at end of 'year } x-1'} \times 100
\]

= Movements in the F.T. ordinary share index are closely related to changes in the volume of business transacted (see Appendix 7).

The inverse relationship suggests that exits from the broking industry, and hence mergers between stock brokers, tend to be more numerous when stock market conditions are depressed. This pattern of behaviour which is in sharp contrast to that of other financial institutions, is particularly noticeable after 1967. Before then mergers and acquisitions were not only more numerous but also occurred in spite of the 'bull' market which began in 1967. Thus an explanation of merger activity in this sector must account for two periods in which the nature of acquisitions differed markedly.

The spate of mergers in 1966 and 1967 was a response to pressures which obliged stock broking firms to operate in larger units. These pressures, in turn, arose due to several factors. The growing complexity and widening scope of industry required much greater research effort on the part of stock brokers in order to provide the comprehensive investment advice which managers of institutional funds required. Thus, brokers were obliged to expand their specialist staffs which added to their overhead costs. These were already rising due to firms' attempts to modernise systems by investing in computers, and due to increases in rents.

Internal growth was constrained, furthermore, by a shortage of skilled manpower and the 1967 Companies Act which imposed a statutory maximum of 20 partners on the size of stock exchange firms. Thus mergers in 1966 and 1967 were the result of attempts by firms to increase the scale of their operations.
In the period since 1967, the pattern of firm disappearance has followed inversely fluctuations in the F.T. ordinary share index. Thus acquisitions have been particularly pronounced in periods of falling share prices, and less pronounced during 'bull' markets. The extremes of this pattern of behaviour occurred in 1972 and 1974. There were no disappearances during 1972 - the year in which the F.T. index peaked at an all-time high of 543.6; whereas, during the severe 'bear' market of 1973-1974, 69 firms were either acquired or 'ceased operations'.

In depressed market conditions, stock brokers have found it necessary to effect cost reduction programmes. These have inevitably been aimed at the major components of the brokers' costs - salaries and rent. Mergers have proved to be one method of achieving both objectives. In the period from 1968 to 1974, mergers accounted for approximately one-half of firm disappearances. This suggests that many were undertaken for defensive reasons in order to avoid being forced out of business. As a result of the extensive merger activity, the securities market is now serviced by a smaller, more streamlined broking industry in which larger firms are predominant.
NOTES

1: Practical evidence of this separation of activities is provided by the existence of independent trade associations, such as the Industrial Life Offices Association, the Life Offices Association, the Fire Offices Committee, the Accident Offices Association, the Motor Insurers Conference and the Institute of London Underwriters.

2: The origins of the composite insurance companies lay in a series of mergers in the early 1900s. These were of several different types, for example: between large fire offices - Atlas/Manchester (1904), Law, Fire/County Fire (1906); between fire and accident offices - of the 24 largest accident offices in 1899, 15 were acquired by fire or fire and life offices by 1914; between diversified insurance companies and specialist marine companies - of 16 marine insurers in 1899, 8 had been absorbed into composites by 1914; and finally, between general and life insurers - of 29 specialist proprietary life companies in 1899, 16 had been acquired before 1919.


Composite insurance companies were also predominant amongst acquiring insurers in 1966-73

3: For example, Prudential specialises in ordinary and industrial life assurance; General Accident is the U.K's largest motor insurer; and Sun Alliance specialises in household insurance

4: Specialists are more important in the life market. Indeed, in 1972, three of the largest life offices were specialist companies - Standard Life, Sun Life and Scottish Widows.


6: Drivers with full no-claims bonus (two-thirds of all British motorists) experienced a real increase of under 50%.

7: This has recently proved an unsuccessful strategy - in 1973-74 simultaneous falls in the value of property and securities caused a fall in asset values and brought pressure on solvency margins

8: For companies writing general insurance with premium income in excess of £2.5m, the statutory minimum solvency margin is presently the aggregate of £0.5m + (Premium Income - £2.5m)

Solvency in life assurance is actuarially based, the actuary stating after his triennial valuation of assets and liabilities whether or not the life company's liabilities exceed the amount shown in the balance sheet. See Scott Report, Linked Life Assurance : Report of the Committee on Property Bonds and Equity Linked Policies in the Life Assurance Industry, Cmd. 5281, (H.M.S.O., 1973); Insurance Companies Act, 1974.

9: Under the Counter Inflation Act, 1973, these have been controlled by the Secretary of State for Trade

10: Profits on underwriting general insurance are notoriously volatile: worldwide motor insurance made a loss in each of the years 1969-1974; fire and accident insurance for the same period made a small profit of £90 million; see British Insurance Association, Facts and Figures, 1974.
11: In 1975, of the 20 largest rights issues, 6 were made by insurance companies. *The Banker*, February 1976, p. 159


13: ibid, para. 37


15: Quoted from H. McRae & F. Cairncross, *Capital City*, (Eyre Methuen, 1974), pp 158-159

16: See G. Clayton, *British Insurance*, (Elek, 1971); NB also the extensive reinsurance network in London, see F.T. *Survey, Reinsurance*, June 10 1975


19: Ibid.


21: Commercial Union, for example, generated greater investment income from the U.S. than from the U.K. in every year from 1966-73, except 1973. Moreover, throughout the period, U.S. investment income exceeded that derived from the rest of C.U's world markets taken together. For the Royal, US investment income was approximately twice that earned in the U.K. from 1966-73. Sources: Annual Reports and Accounts, op. cit.

22: Cf. Supple, op. cit., p. 534

23: Ibid.

24: Several other acquisitions were apparently also motivated partly by this rationale, for example, Guardian/Licenses & General (1956); Caledonian (1957) and Commercial Union/North British & Mercantile (1959).


26: *Annual Abstract of Statistics*


28: Ibid., p.7

29: Until the 1968 Finance Act, single as well as annual premium bondholders could escape surtax on the proceeds of their investments, as well as obtaining tax relief on the premiums.
30: In its evidence to the Scott Committee, op. cit., the Law Society argued that single-premium bonds should be treated as investment rather than insurances and thus be subject to the same controls as unit trusts; see also K. Richards & D. Colenutt, "Concentration in the U.K. Ordinary Life Assurance Market", J.I.E., December 1975


32: The reaction of traditional life assurers was varied: London & Manchester, for example, acquired Welfare, which had gained initial successes in the marketing of single-premium policies; for other reactions, see Richards & Colenutt (1975), op. cit., pp. 175-177

33: See P.J. Franklin, "Insurance into property", The Banker, October 1976

34: Insurance Companies Amendment Act, 1973

35: Monopolies and Mergers Commission, Cmnd. 5641, op. cit., para. 232

36: For example, Eagle Star owned 10% of U.D.T. at December, 31, 1973 and Commercial Union had a 24% holding in Mercantile Credit until the Barclays acquisition of the finance house in 1975

37: Monopolies and Mergers Commission, Cmnd. 5641, para 236

38: Where it expands insurance business in money terms, without a corresponding increase in the money value of the capital base that is available as reserve backing for that business

39: Monopolies and Mergers Commission, Cmnd. 5641, para 236

40: Commercial Union subsequently reversed its policy when direct selling was not commonly applied by other large underwriters

41: In industrial life assurance, premiums are payable at intervals of less than two months and are collected by agents who call at the home of the policyholders

42: Conducted on behalf of the Corporation of Insurance Brokers


44: The distinction between investment trust company and miscellaneous financial company is often a fine one, and has caused some confusion in the Bank of England's classification of acquiring and acquired financial companies

45: Further distinctions are made by J.R.S. Revell, The British Financial System, (Macmillan, 1973), pp. 444-446; and M. Day & P. Harris, Unit Trusts - the law and practice, (Oyez, 1974), ch. 2

46: Revell, op. cit., p. 449 and pp. 451-459
47: L. Messel & Co., Investment Companies, September 1975

48: Of 255 investment trusts covered in L. Messel & Co's annual booklet (September, 1975), with total value of £4037.4 million, 74 (£907 million) involved merchant banks

49: The Banker, April 1969

50: According to the Unit Trust Year Book, (1972), deposit banks were trustees for 85% of all unit trusts, and insurance companies for 11%

51: For example, in The Banker, April 1969

52: Financial Times, September 20, 1975

53: See The Observer, November, 17, 1975

54: The Times, April 5, 1972


56: See J. Maycock, "Banking and Insurance - The Interface", Institute of European Finance, U.C. of North Wales, 1975


58: Revell, op. cit., p. 346, Table 15.9

59: See Appendices 3 and 4
'It could be said that banking has always been an international business. And in the sense that it has always been concerned with trade and payments, and that the banks themselves have long shown a disposition to follow their customers to the back of beyond, that would be true. It is also true that some of the recent moves are no more than a continuation of that trend. However, there is more to it. Banking has become international in the further senses that there are international corporations for the banks to serve and there are international money markets for them to operate in.'

(The Economist, November 15, 1969, p. 14)

5.1 : Introduction

The aims of this chapter are to analyse the causes and nature of U.K. banks' international expansion. An analysis of geographical diversification must take into account foreign banks and foreign banking systems; to circumvent problems of definition and classification, and legal restrictions, the examination is focused on the market.

Several commentators have attached considerable importance to U.K. entry to the E.E.C. The Treaty of Rome envisaged the complete freedom for the establishment of banks and the provision of services throughout Europe. It also foresaw the liberalization of capital movements and the harmonization of national banking regulations. On these grounds there have been optimistic forecasts of larger banking markets, culminating in a single European market. National sovereignty, and economic and monetary crises have so far prevented the achievement of this ideal. Indeed, at present, European banking systems tend to be non-integrated and characterised by different forms of regulation, different types of bank and varying degrees of state intervention.
The fact that, in spite of numerous obstacles, considerable internationalization has been achieved, owes much to the banks themselves. For the U.K., entry to the E.E.C. came too late to affect this analysis. Thus, although it remains potentially an important influence it is not analysed in detail. Instead, the stimuli to U.K. banks' international growth are considered with respect to the competition they have faced in wholesale banking business.

5.2 : International competitive environment

5.2.1 : Foreign banks in London

5.2.1.1 Quantitative Impact

The Bank of England classifies foreign banks in London into three groups: American banks; Foreign banks and affiliates (mainly European) and Other foreign banks. The extent and growth of their entry to London is shown in Table 5.1.

Table 5.1 : Foreign Banks in London 1966-1974

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>U.S.</th>
<th>Jap.</th>
<th>Eur.</th>
<th>Other For.</th>
<th>Total Deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966</td>
<td>103</td>
<td>14</td>
<td>12</td>
<td>34</td>
<td>43</td>
<td>3,503</td>
</tr>
<tr>
<td>1967</td>
<td>109</td>
<td>15</td>
<td>12</td>
<td>37</td>
<td>45</td>
<td>4,955</td>
</tr>
<tr>
<td>1968</td>
<td>125</td>
<td>23</td>
<td>12</td>
<td>39</td>
<td>51</td>
<td>7,426</td>
</tr>
<tr>
<td>1969</td>
<td>144</td>
<td>32</td>
<td>12</td>
<td>45</td>
<td>55</td>
<td>12,508</td>
</tr>
<tr>
<td>1970</td>
<td>159</td>
<td>37</td>
<td>13</td>
<td>50</td>
<td>59</td>
<td>15,145</td>
</tr>
<tr>
<td>1971</td>
<td>172</td>
<td>40</td>
<td>15</td>
<td>53</td>
<td>64</td>
<td>17,904</td>
</tr>
<tr>
<td>1972</td>
<td>202</td>
<td>50</td>
<td>19</td>
<td>60</td>
<td>73</td>
<td>25,429</td>
</tr>
<tr>
<td>1973</td>
<td>226</td>
<td>53</td>
<td>21</td>
<td>76</td>
<td>76</td>
<td>40,863</td>
</tr>
<tr>
<td>1974</td>
<td>248</td>
<td>61</td>
<td>23</td>
<td>84</td>
<td>80</td>
<td>49,257</td>
</tr>
</tbody>
</table>

Source: The Banker
The draw of London to those banks arriving before the abolition of ceiling controls in 1971, lay in its pre-eminence as a financial centre. The City remains the focus of the world's major banking (and other financial) markets, whether measured by volume of financing or by the extent of foreign bank representation. The assets and liabilities of U.S. banks' foreign branches in London exceed those of U.S. banks in the rest of Europe, in Latin America and in Asia and Africa taken together. Moreover in 1975, there were 449 branches, representative offices, subsidiaries or affiliates of foreign banks in London, compared with 179 in New York and 149 in Hong Kong. In 1977 only seven of the world's largest 100 banks had no direct or indirect representation in the City.

London's reputation owes much to the traditional competitive environment characterised by a relative freedom from regulation which is encouraged by the Bank of England. Flexibility and the development of specialist skills still remain a priority with the Bank of England. At a seminar of the Institute of European Finance in March 1976, Mr. Galpin, Deputy Chief Cashier of the Bank, insisted that flexibility was still an important factor in the regulation of banks operating in Britain. A letter from the Director of the Committee on Invisible Exports to an American journalist, of which the following is an extract, summarises London's strategic importance:

'The City has foreign exchange earnings which have doubled in the last five years and are bigger than New York's. It is the centre of the world's euro-dollar market, has the largest international insurance markets, the largest international commodity market, the world's leading bullion centre, the biggest shipping and air freight market and boasts more international security quotations than any other centre. It also has more American banks than New York.'
Apart from its highly developed financial infrastructure and its supremacy as a financial centre, the main attraction of London to foreign banks has been the growth of the euromarkets which decisively consolidated the position of London as an international centre of finance. As noted, this was further enhanced by the liberal establishment provisions and the fact that the markets have been largely free of restrictions.

The importance of the foreign banks is shown not only by their ever-growing number, but also by their rapidly expanding volume of business. At this aggregate level, the various categories of foreign banks are considered collectively. The business activity of the foreign banks in London is oriented primarily towards euromarket business, but also towards the financing of trade and investment, and the performance of related financial services. They take little part in transferring payments from one person or organisation to another, which is the main function of deposit banks. Instead they concentrate on the financial intermediary function of banks, acting as takers of deposits and givers of loans.

In the U.K., deposit banking is overwhelmingly domestic in character and conducted in sterling; more than one half of all deposits is on current account and the greater part of the advances is in the form of overdrafts. By contrast, more than one half of the business of the wholesale (secondary) banking system is with overseas residents, and more than one half is expressed in currencies other than sterling. In 1973, 86% of foreign bank loans were to overseas residents (85% of the total in foreign currency); for acceptance houses and British overseas banks, corresponding figures were 71% and 69% respectively; nearly all the deposits bear interest and the typical loan is for a fixed term.
The activity of foreign banks is therefore almost exclusively wholesale and their impact is best measured and assessed in comparison with the wholesale banking activities of competing indigenous banks. Before 1971, comparison is restricted to the secondary banks (accepting houses etc.,); after C.C.C. in 1971, Bank of England statistics were published in a uniform manner covering the main assets and liabilities of all banks subject to reserve ratios. Previously, statistics for the London and Scottish banks and the Northern Ireland banks were arranged differently from those of other banks. The reason for this was partly historical in that the clearing banks' figures were based on monthly balance sheet statements published by the banks themselves, while the other banks' figures were derived from specially compiled statistical returns. The distinction also recognised the operational differences between the two types of bank, largely due to the clearing banks' concentration on domestic branch banking. The introduction of a minimum reserve ratio for all banks in 1971 made this distinction less relevant. Moreover, the clearing banks, in their own name, began to transact business which had previously been left to their secondary subsidiaries.

Thus, since 1971, it has been legitimate to consider the foreign banks as being in competition with the clearing banks, if not for current account deposits, then for wholesale loan business and for inter-bank money market deposits. In the analysis, comparison is made with the London clearing banks alone - the other deposit banks are excluded, as are 'other UK banks', an extremely varied selection of banks from overseas and the UK, including consortia, first listed in the Bank's Quarterly Bulletin, December 1973, p. 540.
The impact of foreign banks on domestic banking institutions can be measured in a number of ways. Firstly, one may record the continuing upsurge in the number of foreign banks' branches in London (Table 5.1). Indeed, this has been well-documented and receives regular attention. This, however, gives no indication of their importance, which may be obtained instead, by examining the rapid expansion in their volume of business transacted. In this respect, both the total deposits and advances of foreign banks have shown large increases, especially since 1971. It has to be taken into account that the bulk of deposits and advances are in foreign currencies, reflecting the share these banks enjoy in eurocurrency business. Since 1971, foreign currency lending to U.K. residents has constantly exceeded that by London clearing banks and accepting houses taken together. In 1973, the relative figures were:

- Clearing banks + Accepting Houses: £735 million
- Foreign banks: £1748 million

Of more significance, the foreign banks have expanded their sterling advances to indigenous British customers. From 1971 to 1973, the level of this category of advance increased 1½ times to £2125 million. In general, the foreign banks as a group have concentrated their sterling business in a combination of pure money market activity, advances to U.K. subsidiaries and affiliates of home office customers and in financing the movement of goods, principally between the scheduled territories and the home country of the bank concerned. Following sterling devaluation in 1967 and the ensuing period of credit restraint, more and more of this financing came to be denominated in dollars or other foreign currencies. Hence the growth in sterling lending to U.K. residents from the end of 1966 to the end of 1970 was less than 50%; for the corresponding period, foreign currency advances to U.K. and overseas residents increased by more than 370%. The abolition of ceiling controls in September 1971 released a large quantity of resources for domestic lending and the result has been a particularly marked increase in sterling advances vis-à-vis foreign currency loans. From the end of
1970 to the end of 1973, the former increased nearly three-fold and the latter by just 1½ times.

The most important indication of the impact of foreign banks is a comparison of certain of their business activities with the corresponding growth in British indigenous banks' activity. An increased share in deposits or advances would indicate a threat to domestic banks.

Relative growth rates have not been used as an indicator or 'relative shares'. Instead a series of ratios has been chosen as the most appropriate measure. They are not exhaustive, but they do provide evidence that the relative positions of foreign banks vis-à-vis domestic banks have changed, and particularly since 1971, in favour of the former, which have made continued inroads into areas of banking business once dominated by U.K. institutions.

These measures will be considered in 3 groups:

1. Foreign banks' share in the total credit volume of business;
2. The emphasis placed by foreign banks on domestic U.K. business;
3. Ratios of foreign banks to indigenous banks in terms of shares of business.

The data were collated from various issues of the Bank of England Quarterly Bulletin; they are presented in Appendix 1.

a) Foreign banks' shares in the total credit volume of business

Table 5.2 shows details of the relative shares enjoyed by various categories of wholesale bank (i); this is supplemented by part (ii) which gives a wider comparison for October 1971-1973, by including London clearing banks.
Table 5.2: Relative Shares of Credit Business (Advances)

5.2 (ii) : All Banks 1971-1973

<table>
<thead>
<tr>
<th>Category</th>
<th>1966</th>
<th>Oct 1971</th>
<th>1973</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>a. All Business (%)</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign banks</td>
<td>63</td>
<td>63</td>
<td>62</td>
</tr>
<tr>
<td>Accepting houses</td>
<td>13</td>
<td>9</td>
<td>7</td>
</tr>
<tr>
<td>B.O. banks</td>
<td>20</td>
<td>17</td>
<td>17</td>
</tr>
<tr>
<td>Other banks</td>
<td>5</td>
<td>10</td>
<td>15</td>
</tr>
<tr>
<td><strong>b. Loans to UK Residents</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(all currencies)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign banks</td>
<td>42</td>
<td>36</td>
<td>36</td>
</tr>
<tr>
<td>Accepting houses</td>
<td>22</td>
<td>18</td>
<td>12</td>
</tr>
<tr>
<td>B.O. banks</td>
<td>24</td>
<td>27</td>
<td>16</td>
</tr>
<tr>
<td>Other banks</td>
<td>13</td>
<td>19</td>
<td>35</td>
</tr>
<tr>
<td><strong>c. Loans to UK Residents</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(sterling)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign banks</td>
<td>40</td>
<td>38</td>
<td>30</td>
</tr>
<tr>
<td>Accepting houses</td>
<td>23</td>
<td>20</td>
<td>12</td>
</tr>
<tr>
<td>B.O. banks</td>
<td>23</td>
<td>20</td>
<td>10</td>
</tr>
<tr>
<td>Other banks</td>
<td>14</td>
<td>22</td>
<td>48</td>
</tr>
</tbody>
</table>

Note: These figures are for advances; deposits show identical trends. The appropriate statistics are available from the author.

5.2 (ii) does not include Scottish and Northern Ireland banks.
The overwhelming conclusion with respect to all categories of business is the continuing dominance of the foreign banks. They have accounted for over 60% of all loans made by wholesale banks since 1966 and even including the London clearing banks increased their share to 47% in 1973 (1972: 46%).

b) Foreign Bank Incursion into Traditional Domestic Bank Business

As noted, most of the City's apprehension has been caused by the increased penetration by foreign banks of the UK market. Deposit figures tend to overstate the importance of foreign banks, and in particular those from the US. Over 85% of foreign bank deposits are expressed in currencies other than sterling. By contrast, however, they understate the impact that the foreign banks have made on UK corporate business. Like the merchant banks, foreign banks are engaged in wholesale banking and do not have the catchment area of a network of branches which characterises the retail emphasis of the clearing banks. For this reason comparisons are made on the basis of advances (assets). A first indication of foreign bank interest in domestic banking is derived from Table 5.2 (ii) b, which shows a rise in the foreign banks' share of UK loan business at the expense of the three British categories. 'Other Banks' also increased their share, and foreign banks are well represented in that category as well. If sterling lending is isolated (Table 5.2 (ii) c.) the increased importance of foreign banks is confirmed.

The inference is that foreign banks, either as branches, merchant banking subsidiaries or shareholders in consortia, have had a considerable impact on the credit business transacted in London. A majority of their activities is connected with multinational corporations whose multiplicity of banking requirements have provided a potentially profitable yet very highly competitive outlet for, and source of, bank funds. The traditional British banking attitude of allowing the customer to come to the bank showed signs of breaking up in 1958, when world currencies became externally
convertible. From then on, banks have increasingly come to accept the idea that they can satisfy the needs of the multinationals, and they can, indeed must, compete for business by offering their customers a well-planned and comprehensive package of services. 7

The results lead to the conclusion that the British banks did not meet with the success of the foreign banks. Before 1967, the main contenders for multinational banking business were the US and other foreign banks. Since then British banks begun to look beyond the simple provision of domestic banking services, utilising eurodollar finance and increasingly providing medium-term credit; they are therefore better placed to compete with their foreign counterparts. However, it remains clear that foreign banks are still a significant force. Indeed the twin concepts of the multinational corporation and bank servicing on an international scale originated in the US - the broadening of traditional banking methods was an inevitable consequence, but it did not augur well for British banks, as the manager of the Bank of Credit and Commerce indicated:

"A considerable section of American industry is now multinational - as, indeed are her banks - and the panoply of services being offered by American banks to the multinationals all over the world has made any British infiltration a formidable task" 8

This sentiment is supported by the following ratios of foreign bank : British bank lending, which substantiate the claims made earlier in the chapter. First, foreign banks have progressively increased their loans to UK residents as a proportion of total advances since September 1971, thus:

Oct 1971 : UK resident loans as % total loans : 9%
End 1971 : " " " " : 11%
End 1973 : " " " " : 14%

The proportion of loans in sterling to the total also increased from 6% to 7% to 8% at the end of 1973. This increased emphasis brought considerable success, as Table 5.3 shows:
Table 5.3: Loans to U.K. Residents, Foreign Banks and British Banks, Ratios, 1971-73

<table>
<thead>
<tr>
<th></th>
<th>Oct. 1971</th>
<th>End 1973</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign banks as % London clearing banks</td>
<td>21</td>
<td>33</td>
</tr>
<tr>
<td>Accepting houses as % foreign banks</td>
<td>49</td>
<td>33</td>
</tr>
<tr>
<td>British wholesale banks as % foreign banks</td>
<td>125</td>
<td>78</td>
</tr>
</tbody>
</table>

5.3 (ii): Sterling only

<table>
<thead>
<tr>
<th></th>
<th>Oct. 1971</th>
<th>End 1973</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign banks as % London clearing banks</td>
<td>13</td>
<td>20</td>
</tr>
<tr>
<td>Accepting houses as % foreign banks</td>
<td>53</td>
<td>40</td>
</tr>
<tr>
<td>British wholesale banks as % foreign banks</td>
<td>111</td>
<td>71</td>
</tr>
</tbody>
</table>

Note: British wholesale banks = Accepting houses + British overseas banks (B.O. banks)

Whether gauged by loans in currencies of all denominations or by loans in sterling alone, the foreign banks have increased their share of the UK credit market at the expense of indigenous British banks in the period October 1971 to the end of 1973. Further proof comes from consideration of foreign banks' lending to UK residents, as a proportion of British banks' total advances (in sterling and other currencies) to the UK sector.

Table 5.4: Foreign Banks' Sterling Loans to UK Residents as a proportion of British Banks' Total Loans, 1971-1973

<table>
<thead>
<tr>
<th></th>
<th>Oct. 1971</th>
<th>End 1973</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign banks as % London clearing banks</td>
<td>13</td>
<td>18</td>
</tr>
<tr>
<td>Foreign banks as % London clearing banks + British wholesale banks</td>
<td>10</td>
<td>14½</td>
</tr>
</tbody>
</table>

Once again the data confirm the considerable impact of the foreign banks. In October 1971, the clearing banks' sterling advances to UK residents were eight times greater than those of the foreign banks; at the end of 1973 the margin had been cut to five times; in October 1971, the foreign banks advanced less than twice as much in sterling as the accepting houses; by the end of 1973, they were lending 2½ times as much; finally
in October 1971, loans in sterling to UK residents from wholesale British banks exceeded those from the foreign banks; at the end of 1973, the foreign banks loaned 1½ times as much as the accepting houses and overseas banks together.

5.2.1.2 : Qualitative Impact

What has emerged clearly from the preceding analysis is the concentration of foreign banks on the wholesale banking markets and their relative success in them. The major growth area of foreign banks' resources has been foreign currencies, which accords with their professed traditional purpose of corporate business related to their country of origin. More recent attempts to secure sterling deposits may be seen as a reflection of these banks' attempts to increase their ability to meet the needs of their customers. Hence, it is not inconceivable that the major growth in foreign banks' resources should be in foreign currencies, while their impact has been most significant in the capture of larger shares of U.K. domestic markets.

The attempts to achieve this followed their arrival in London as the banks sought access to the wide range of facilities that the City offered. The spread of foreign bank services is explained by Pringle:

"... nowadays, perhaps their biggest role is to act as full international bankers to companies, and individuals - an activity involving a range of services which might be organised and co-ordinated from London rather than from the head office of the bank concerned." 10

These services (finance for, and advice on, international operations; economic and market research; establishment of contacts, etc.) which were primarily for a bank's existing clients, have also appealed to UK corporations, as the increase in sterling business indicates.
Any assessment of the relative importance of the foreign banks in London and their British-owned competitors must of necessity be crude. This is mainly because the only way of comparing the size of an changes in banking business ignores other aspects of banking activity. Without wishing to underestimate or understate the many activities of other foreign banks' in London, it is reasonable, simply from the point of view of volume to concentrate on the activities and impact of the US banks in London.

US banks represent the largest single contingent of foreign banks in London, accounting for nearly 2/3 of deposits and advances of these groups. The majority of the banks arrived as a result of the meteoric growth of US international banking in which lending from foreign offices funded with eurocurrencies replaced lending from head offices with 'on shore' funds. During this period of mushroom growth, the number of American participants in international banking rose sharply, expanding both geographically and functionally. The extent of this growth is worth stressing:

<table>
<thead>
<tr>
<th>Year</th>
<th>No. US banks with for. offices</th>
<th>No. for. branches</th>
<th>Assets $bn</th>
</tr>
</thead>
<tbody>
<tr>
<td>1964</td>
<td>11</td>
<td>181</td>
<td>8.9</td>
</tr>
<tr>
<td>1974</td>
<td>125</td>
<td>700</td>
<td>152</td>
</tr>
</tbody>
</table>

Source: The Banker

The strategy of expansion has depended upon the size of the bank in question. For long-established banks, the opening of the London branch was a function of various factors which collectively brought about migration abroad. For the newer arrivals, and indeed for the majority of other foreign banks, presence in the City was perhaps due to its eminence as a financial centre and its position as the centre of the eurocurrency markets.
The period since the end of World War II has seen a resurgence of international trade and business and in particular the extension of US overseas investment. During the 1960s, the business environment became dominated by the growth of the multinational corporation, the majority of which were of American origin.

Initially, only the largest US banks ventured abroad, encouraged by the level of overseas investment by native US companies and thus strengthened the close associations between bank and customer. The rationale of following one's client was reinforced by the persistent balance of payments deficits experienced since 1960 in the US. These deficits were financed by the issue of more dollars and an increase in short-term liquid liabilities with foreigners. Simultaneously, US foreign economic policy was aimed at alleviating the deficits, and measures were implemented to restrict money and capital market flows. The Interest Equalization Tax (1963-1974) taxed portfolios of foreign investment by Americans; the voluntary foreign credit restraint programme (VFCR) of 1965 and the mandatory controls programme decreed by executive order in 1968, limited direct foreign investment in most areas of the world and precluded new capital flows for such investments in Western Europe. The VFCR was the most specific government programme affecting the international operations of US banks. By limiting the flow of funds from the banks directly to their customers, the programme forced these banks to establish branches overseas.

At the end of the decade, US monetary policy (aimed at stemming inflation) placed a severe liquidity squeeze on American banks. The interest rate ceiling imposed by Regulation Q in particular made bank deposits and CDs in America unattractive as savings media. This resulted in the steady outflow of domestic funds from the banking system, forcing US banks to rely on their overseas branches' eurodollar deposits to make good their liquidity loss. Consequently the late 1960s saw US banks flocking overseas, partly due to the expansion in international trade.
and partly as a consequence of domestic regulations.

Several factors explain the incursion of migrant US banks into London. The initial arrivals were a reflection of the large share of US direct overseas investment which had come to Britain. Indeed it was estimated by Revell in 1968 that 75% of the sterling business of the London branches of US banks was accounted for by subsidiaries of US companies. 11

A second important influence was the degree of international competition and lack of restriction encouraged by the Bank of England. The flexibility of the Bank stood in contrast to the legalistic and bureaucratic approach to banking shown on the continent. The General Manager of Bankers Trust Company UK saw London's importance in the following way:

'... there is a large supply of highly skilled technical specialists and administrative staff who speak the world's main business language ...' 12

a) Eurocurrency Markets 13

The development of London as a centre for euromarket transactions has been well documented. However, it has a special relevance for the subject of this chapter for the rapid expansion of the euromarkets, more than anything else, has attracted foreign banks to London and encouraged the co-operation and joint-ventures to be discussed later.

While there is no universal agreement as to why this pool of funds developed, most experts trace its origin to a culmination of factors, particularly the substantial US balance of payments deficits during the 1960s, the interest rate premium over US-held dollars which eurodollars have offered to depositors and the US exchange control regulations. It is certain, however, that the first influx of American banks were instrumental in the growth of the markets and especially the eurodollar market. 14 London branches were initially required to borrow eurodollars on a substantial scale to supplement loanable funds
at home. Thus rather than relying on head office for resources, they were forced into aggressively tapping the eurodollar market and effectively transferred domestic banking competition into the international arena where US banks were not bound by restrictions or constraints on the rate of interest payable and the period for which funds could be advanced. The real onslaught began in 1968 with the credit squeeze in the US economy and, due largely to the investment made by the US banks, the eurocurrency pool more than tripled in the next four years.

Table 5.5: Estimated size of the eurocurrency market and number of authorised non-sterling banks in the UK, 1966-72

<table>
<thead>
<tr>
<th>Year</th>
<th>Size ($bn)</th>
<th>No. banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning 1966</td>
<td>17</td>
<td>157</td>
</tr>
<tr>
<td>&quot; 1967</td>
<td>22</td>
<td>168</td>
</tr>
<tr>
<td>&quot; 1968</td>
<td>31</td>
<td>177</td>
</tr>
<tr>
<td>&quot; 1969</td>
<td>44</td>
<td>187</td>
</tr>
<tr>
<td>&quot; 1970</td>
<td>57</td>
<td>193</td>
</tr>
<tr>
<td>&quot; 1971</td>
<td>71</td>
<td>204</td>
</tr>
<tr>
<td>&quot; 1972</td>
<td>95</td>
<td>213</td>
</tr>
</tbody>
</table>

Source: B. I. S. and Bankers Trust Co.

Note: Throughout the period, eurodollars accounted for approximately 75% of the total eurocurrency pool.

The US balance of payments programme caused US companies to turn to European markets to finance their development abroad while the same measures effectively cut off New York as a capital market for foreign borrowers who also turned to London for short-, medium-, and long-term credits. This further stimulated the demand for eurodollars. In 1970 official statistics for overseas spending by US-affiliated companies showed a 20% rise during 1969 to $12.7 billion. To avoid a steep increase in eurodollar rates, US monetary strategists eased domestic credit restrictions (the restraint on foreign investment outflows meant that, inevitably, a large proportion of these funds were being...
raised outside the US) and thus the Euromdollar activities of overseas banks assumed the prime objective of lending to US overseas corporate affiliates direct, in order to finance their operations which, it will be remembered were still expanding.

London, as the world's major eurocurrency centre therefore became a necessary link in the development of US banks' overseas business. The continuing upsurge in the extent of foreign bank presence placed the City in a 'feed-back' situation where its eminence attracted more banks, which in turn added to its eminence. Thus whereas in the past only the larger US banks had moved overseas, during the late 1960s US banks arrived in London at an increasing rate, as international business expanded and as the penalty for not being there increased.

The primary reason was the expanding needs of corporate customers. The growing diversity and complexity of multinational operations demanded local expertise and in turn local representation. The choice of London has also had a secondary origin however, for the requirements of servicing international corporations demands a presence in London if only for access to the euromarkets. The scale of corporate borrowing had become such that no domestic market would have been capable of providing the funds. This rationale for US bank expansion is described by Baker and Bradford:

"Since the Eurocurrency and Eurobond markets were centred in Europe, American banks found it necessary to expand branching and subsidiary operations in that area in order to participate in this form of financing if they were to retain their international firm customers."
The eurocurrency markets then, provided the funds which could be repatriated to supplement on-shore loanable funds or could be loaned direct to companies which had come to London to raise finance, an aspect which has become increasingly important. Although not widely published, one expects that the dealing operations of foreign banks, especially in the inter-bank and foreign exchange markets provided a profitable justification in themselves.

In summary, the expansion of banks' foreign operations was a function of the growth of world trade and investment and was facilitated by the development of an efficient market mechanism which put at the disposal of borrowers the pool of funds resulting from persistent payments deficits in the US. London became the centre of the eurocurrency markets partly because of the liberal attitude of the Bank of England and partly because of its highly-developed inter-organisational communications network. The dollar-based US banks became the predominant force in euromarket business, and in turn the lure of the markets and prestige of being represented in London attracted smaller US banks and gave an impetus to the migration plans of other foreign banks, notably those from Japan and the EEC. The attraction of the eurodollar market to a commercial bank lay in the opportunities through participation in syndicated loans of building an international loan portfolio with the added advantage of a guaranteed fixed interest spread.
b) **Intensity of US Bank Entry to London**

It was remarked earlier that the US banks have concentrated on the wholesale banking markets. The first challenge therefore, to British banks comes in the provision of finance and service to international corporate customers. The mass of eurodollar repatriations obviously overstates the impact of US banks, but they tend to understate their impact in UK corporate business. The type of business transacted and accordingly the impact varies from bank to bank.

The function of a representative office, for example, is to attract potential customers and generate business for the parent bank. On the other hand, bank branches are primarily geared towards international money market operations. The aggressive move towards international banking which was characteristic of the US banks in recent years has brought about a more competitive operating environment for international banks. One response has been to search for additional types of business to supplement their earlier reliance on money market operations.

Although the early US arrivals confined themselves to servicing US companies, and their associates and subsidiaries in Britain and Europe, it was to be expected that in time they would make inroads into the traditional business of British banks. Until 1971, their impact was cushioned by two restraints:

1. The official lending ceiling which blocked the growth of sterling loans for recent arrivals;

2. The concentration of most foreign banks on the eurocurrency markets.

In 1971 the demand for eurodollars fell and foreign banks began to look for new lines of business; this coincided with the new freedom to lend introduced by Competition and Credit Control. In the fourth quarter of 1971, there was a sudden upturn in sterling deposits and advances by foreign banks. However, foreign bank competition became serious only when British banks' liquidity came under pressure in June 1972. The liquidity squeeze was accompanied by a slowly changing
attitude in Britain that loyalty to banks was perhaps not essential. American banks could not offer the advantages of a big branch network but they could offer cut rates on both domestic and foreign business. As a result, many companies formerly wedded to one British bank also employed a foreign bank, as R. Fry of The Banker has explained:

"... big companies sometimes need more credit than any one clearing bank or even two of them combined can provide; some companies find it convenient to use a foreign bank with a strong overseas network for their international business." 19

The prime target for US banks became the external business of British international companies offering a package of financial services—the plan being to use eurocurrency financing as a way of introduction to the companies and participate in sterling financing where margins were still wider than in the eurodollar market. It was stressed nevertheless that foreign exchange dealing would still have a valuable function, providing the resource base for wholesale lending activities which were to be the extension of connections made and cemented through euromarket dealings. 20 To an extent the US challenge in this area has been helped by British banking attitudes and relative lack of development. Since 1971, the active solicitation of business among medium-sized customers, including British companies, by aggressive marketing methods, has brought a great deal of sterling business to US banks. This was reinforced by borrowers beginning to look beyond the overdraft facilities traditionally offered by clearing banks to term loans which the secondary banks, including the clearing banks' subsidiaries were advancing. Fry again summarises this point:
"Although the British clearing banks have developed their international resources, ... their experience, in most cases, is still rather recent. The American banks, as well as ... other foreign banks, are making much of their special skill in offering an all-round financial service overseas." \(^{21}\)

This relative lack of expertise was coupled with the traditional tacit agreement among British banks that direct solicitation was to be avoided; hence, despite the clearing and merchant banks' 'domination' of the British financial scene, the early 1970s saw the 'middle ground' falling to the more forceful US banks.

The form of the American challenge has varied widely. After 1970, the most notable changes in entry strategy were moves to take interests in British financial institutions and multinational consortia. Moreover, those banks already in London, increased their presence by taking shareholdings in a similar way; Bankers Trust, for example acquired Rodo International and re-named it Bankers Trust International.

Table 5.6 shows those minority interest held by foreign banks in UK banks, the majority of whose capital is British-owned. \(^{22}\)

Table 5.6: US Banks' Minority Interests in UK Banks, 1973

<table>
<thead>
<tr>
<th>Shareholding</th>
<th>Date Taken</th>
<th>Bank</th>
<th>Other main Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chase Manhattan</td>
<td>12</td>
<td>1965</td>
<td>Standard Chartered</td>
</tr>
<tr>
<td>Citibank</td>
<td>40</td>
<td>1969</td>
<td>National &amp; Grindlay</td>
</tr>
<tr>
<td>F.N.B. Chicago</td>
<td>20</td>
<td>1972</td>
<td>Commercial Bank of Wales</td>
</tr>
<tr>
<td>F.N.B. Maryland</td>
<td>25</td>
<td>1970</td>
<td>1st Maryland</td>
</tr>
<tr>
<td>Franklin Nat Bank*</td>
<td>7</td>
<td>1970</td>
<td>Sterling Indl. Securities</td>
</tr>
<tr>
<td>J.P. Morgan</td>
<td>32</td>
<td>1936</td>
<td>Morgan Grenfell</td>
</tr>
<tr>
<td>Philadelphia National Bank</td>
<td>8</td>
<td>1965</td>
<td>Arbuthnot Latham</td>
</tr>
<tr>
<td>Texas Commerce Bank</td>
<td>35</td>
<td>1968</td>
<td>Burston &amp; Texas Commercial Bk</td>
</tr>
</tbody>
</table>

*In liquidation

Source: The Banker
c) Breadth of US Bank Entry to London

The recent attempts by US banks to expand their services in Europe and particularly in the UK by establishing subsidiaries and affiliates have sometimes, but not always, interlocked with their commercial branch banking base. Most of the early consortia set up with US participation have since been superseded by the setting up of US merchant bank subsidiaries. Thus the growth of US international banking has manifested itself in more than the mere geographical expansion of branch and subsidiary networks. A concomitant of the increased size of international company activities is the demand for more complex requirements and larger financial packages. Apart from the formation of specific consortia, US banks have become established through subsidiaries in merchant banking and near-banking activities.

The setting-up of subsidiaries has its origin in the strict limitations on the scope of branching activities and types of business which banks can practice in the US. The most important restraints are those imposed by the Edge Act which permits bank branches abroad to carry on only those activities they could in the US; hence the original concentration on domestic commercial banking activities, and recent diversification achieved by subsidiary or joint-venture operations.

It is also important to distinguish between investment and commercial banking, as it is perceived in America. Most of the activities referred to so far have been in the commercial banking sphere; investment banking on the other hand, may be loosely described as 'merchant banking'; its most important activity is the underwriting of (euro) bond issues, which US commercial banks are forbidden to do by law. Thus to an extent, the wholly owned merchant banking subsidiaries are a vehicle for US commercial banks to participate in investment banking operations.
Merchant Banking

Since their inception, US merchant bank subsidiaries have stressed the international aspects of merchant banking. They have specialised in both primary (issuing and underwriting) and secondary (dealing) eurobond business; the granting of higher risk medium-term credits in several forms and in various currencies; and project financing. Perhaps more than any other area, these vaguely defined international merchant banking services offer scope for competition. Of particular relevance to British banks is the fact that these activities were being carried out mainly by the UK accepting houses before the US incursion. The sophisticated techniques, flexibility as autonomous specialist subsidiaries and world-wide links of their parents, have increasingly favoured the US merchant banks. To date, however the traditional London merchant banks have maintained their 'monopoly' in domestic corporate finance, which, in view of the dearth of new issues and takeover bids since 1974 has been critical to their existence.  

Near Banking

The breadth of US banking expansion also includes an attempt to break into the provision of such near-banking activities as factoring, leasing, instalment credit, insurance broking and money shops. The extent of this challenge is recorded in Table 5.7. Quite frequently these ventures have been in conjunction with British financial intermediaries: for example, the link between F.N.B. of Boston and Lloyds and Scottish to provide a factoring service.
<table>
<thead>
<tr>
<th>Shareholding</th>
<th>Date Taken</th>
<th>Financial Institution</th>
<th>Business Description</th>
<th>Other Main Partners</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Express</td>
<td>25</td>
<td>1968</td>
<td>Crusader Insurance</td>
<td>Insurance</td>
<td>C.T. Bowring (75)</td>
</tr>
<tr>
<td>American Express</td>
<td>50</td>
<td>1971</td>
<td>LB/AMEX Agency*</td>
<td>Agency*</td>
<td>Lazards (50)</td>
</tr>
<tr>
<td>Bank of America</td>
<td>51</td>
<td>1971</td>
<td>B. of A/Wm. Factoring Glyn's Fact.</td>
<td>Factoring</td>
<td>Wm &amp; Glyn's (31)</td>
</tr>
<tr>
<td>Chase Manhattan</td>
<td>42</td>
<td>1967</td>
<td>Equipment Leasing</td>
<td>Leasing</td>
<td>Hambros (29)</td>
</tr>
<tr>
<td>Chemical Bank</td>
<td>100</td>
<td>1973</td>
<td>Chemco Fin. Leasing Services</td>
<td>Leasing</td>
<td>-</td>
</tr>
<tr>
<td>Continental Illinois</td>
<td>10</td>
<td>1964</td>
<td>H &amp; H Factors Factoring</td>
<td>Factoring</td>
<td>Hambros (25)</td>
</tr>
<tr>
<td>P.N.B. Boston</td>
<td>25</td>
<td>1961</td>
<td>Intl Factors Factoring</td>
<td>Factoring</td>
<td>Lloyds &amp; Scottish (75)</td>
</tr>
<tr>
<td>F.N.B. Boston</td>
<td>100</td>
<td>1972</td>
<td>Boston Tst &amp; Savings Finance</td>
<td>Finance</td>
<td>-</td>
</tr>
<tr>
<td>Citibank</td>
<td>100</td>
<td>1970</td>
<td>Citibank Fin. Tst.</td>
<td>Consumer Finance</td>
<td>-</td>
</tr>
<tr>
<td>Citibank</td>
<td>100</td>
<td>1970</td>
<td>Citicorp Leasing</td>
<td>Leasing</td>
<td>-</td>
</tr>
<tr>
<td>Grand Trust</td>
<td>100</td>
<td>1971</td>
<td>Penn Invs. Holding Co.</td>
<td>Holding Co.</td>
<td>-</td>
</tr>
<tr>
<td>Manuf. Hanover</td>
<td>100</td>
<td>1963-1970</td>
<td>Commercial Expt. Credit</td>
<td>Export Expt. Credit</td>
<td>-</td>
</tr>
<tr>
<td>Manuf. Hanover</td>
<td>100</td>
<td>1973</td>
<td>Ocean Acceptances</td>
<td>H.P.</td>
<td>-</td>
</tr>
<tr>
<td>J.P. Morgan</td>
<td>25</td>
<td>1973</td>
<td>HFC Trust Consumer Finance</td>
<td>Household Fin. Corp</td>
<td>(75)</td>
</tr>
<tr>
<td>J.P. Morgan</td>
<td>100</td>
<td>1974</td>
<td>Morgan Gnty Inv. Inv. Services Management</td>
<td>Management</td>
<td>-</td>
</tr>
<tr>
<td>N. Carolina N. Bank</td>
<td>85</td>
<td>1974</td>
<td>Carolina Leasing</td>
<td>Leasing</td>
<td>-</td>
</tr>
<tr>
<td>Philadelphia N. Bank</td>
<td>78</td>
<td>1972</td>
<td>Phil. Credit Holdings Company</td>
<td>Finance Company</td>
<td>Arbuthnot Latham (22)</td>
</tr>
<tr>
<td>Union Bank of California</td>
<td>-</td>
<td>1971</td>
<td>Unionamerica Insurance</td>
<td>Reinsurance</td>
<td>-</td>
</tr>
</tbody>
</table>

*Set up to co-ordinate the activities of these two banks in eurocurrency loan transactions*

Source: The Banker
The penetration of British domestic business has also been achieved by the provision of consumer credit. Citibank, for example, bought an existing finance house, Campbell Discount and planned to sell the service through its money shops. The latter were an attempt to capture some of the 55% of the UK working population without a banking account. These moves marked a departure from the US banks' concentration on wholesale banking activities and within two years of the establishment of the first money shop (by Citibank in 1970) there was speculation about a major threat to traditional retail banking. The speculation was given some support by the fact that 40-50% of new customers already had clearing bank accounts.

The money shop movement involved the leading US banks: notably, Citibank, Chase Manhattan and F.N.B. Boston (through Boston Trust and Savings). Since 1973, however the expansion has tailed off owing largely to the straitened economic circumstances.

Banking Techniques

Inevitably the US banks have imported a number of banking techniques from their domestic markets. Some of the new ideas have been adopted by British banks. For example, negotiable CDs and, more importantly, term loans and project financing. The profound influence of the growth of foreign banks in London has been partly reflected in the techniques adopted by City banks - and because medium term eurocurrency lending is an aspect of international corporate banking, it is associated with the 'internationalisation' of British banking. Beyond this, the growth of foreign banks is one facet of the transformation of the structure of London's banking business in the 1960s, especially with respect to servicing large international corporations. However, new techniques are only one side of the foreign banking influence. The other side is the weight these banks have had in shaping the direction of British banking development.
A tentative conclusion at this stage would be that while US banks have had little impact on domestic retail banking (witness the limited effect of money shops) which is relatively over-banked, their position in the City's wholesale and international markets has been formidable. Since competition and credit control in 1971, they have also gained a sizeable portion of UK domestic business. As UK corporations began to expand internationally through the 1960s and early 1970s, a situation threatened where foreign banks would be preferred for international banking requirements. Thus US banks found that by concentrating their activities in this area they could develop a large portion of business controlled from London. Herein lies the importance for indigenous banks, of the loss of domestic business to the Americans.

The phenomenal growth of the eurodollar market brought to the City a new era of international prestige and renewed competition, in the merchant banking sector, for the business of large international corporations. It also had a considerable impact on the City's traditional institutions giving a new impetus to the British merchant banks and providing the key attraction to the host of foreign banks which came to London. During the 1960s the foreign banks, and to a lesser extent the accepting houses, began to cross the demarcation lines which the clearing banks had created for themselves. This dispelled the clearers' complacency and perhaps invoked a positive response by inducing the acceptance of US banking techniques including aggressive marketing policies and the competitive bidding for commercial wholesale business. The salutary lesson went further, however; the breadth of foreign bank entry, especially the strength of the trend towards expanding international merchant banking activity stressed the profit opportunities and impression that retail banking was full to capacity. In addition the diversity may have impressed the need for universal banking structures as a precursor to international expansion, in order to compete with the one-stop banking services offered by, for
example, the German banks.

5.3: U.K. banks' response

The creation of such institutions as the IMF, GATT and the World Bank, while indicating the misalignment of political and economic power throughout the world, also demonstrates the growing emphasis on certain types of international co-operation alongside the re-emergence of nationalism. The principal emerging trend in the international financial environment has been the multinational company. Its emergence has been described as:

"... the most important institutional change in international business during the next quarter century ... the international production of goods and services, rather than traditional export/import trade, will be the main focus of these world businesses." 26

U.K. banks' internationalization has taken many varied forms. Barclays Bank's network, for example, is multinational in the sense that its branches are far-flung; the same may be said of the British overseas banks whose rationale was originally wide-spread retail coverage. In orientation the British accepting houses may make similar claims. The Earl of Cromer, in his foreword to the most recent book on merchant banking, characterizes the members of the Accepting Houses Committee, as follows:

"... the international experience, the international expertise and the international approach are of particular importance. These houses have experience in trade and investment throughout the world in all the varying political, economic and market conditions that have occurred since the beginning of the last century and the clients that they have served have included the governments of probably every country in the world." 27
while possessing the reputation of the archetypal English institution, paradoxically, nearly all the originators were foreigners. The Rothschilds came from Frankfurt; the Barings from Bremen; the Warburgs, and the Schroders from Hamburg; the Lazard from Alsace and the Brandts from St. Petersburg. 28

The discussion of the previous section has highlighted four main causes for the internationalisation of world banking; a fifth one applies to British banks, in particular:

1. The growing financial requirements and diversity of services demanded by industrial corporations which have outrun conventional banking sources;

2. The development of the multinational corporation;

3. The rapid growth of the eurodollar market, followed by the establishment and subsequent growth of the eurobond market;

4. In a European context, the prospect of an 'integrated' economic and political unit, embracing most of Western Europe;

5. The increase in competition for wholesale banking business experienced since the end of 1971 in both domestic and eurocurrency markets, in London.

Internationalisation has been accompanied and influenced by merger and diversification. Functional expansion and the assumption of multi-product status achieved by a majority of British banks may be seen as a prelude to international expansion. Here, various degrees of co-operation have been the rule rather than the exception in achieving some form of geographical expansion. Three ways can be discerned in which a bank can develop its international business:
1. Independent action - acquisition of subsidiaries or extension of branch networks; extension of international banking operations, including corporate advice;

2. Co-operation to varying degrees with foreign banks. This can be institutional, involving common participations in each other's capital, or the establishment of a subsidiary in which a number of banks have shareholdings (consortia); or, operational, which includes temporary ad hoc groupings for particular international financings, involving syndicates or agreements. Evidence of the widespread participation in syndications is seen from 'tombstone' advertisements in the financial press;

3. Transnational merger - this option has not yet been taken up. Some of the more formal relationships concluded in recent years have advanced towards full amalgamations, but, further links are likely to be dependent on progress in harmonization and integration in the EEC, more especially in the fiscal company law field.

5.3.1: Independent Action

5.3.1.1: Breaking with Tradition

The growth attained and sustained by British clearing banks through their overseas bank subsidiaries acquired for British banks a considerable world standing, as Nevin & Davis remark:

"For nearly a generation British joint-stock banks remained in terms of deposits, the largest in the world, and the international network of their subsidiaries dominated finance in many areas, especially in the British Dominions and Colonies." 30

In the 1960s however, British banks lagged behind their US counterparts in organising operations on a world-wide scale. This was for a number of reasons. First, they had been operating in a controlled domestic environment. Secondly, they had not developed the same aggressive approach to seeking out new business. Thirdly, at the start of the 1960s most British banks were relatively small and not until 1968, did banks emerge that were capable of competing internationally. Fourth, the clients of European banks had expanded abroad less than US firms. Finally the overseas banking experience of British banks was limited to retail operations in colonial and ex-colonial territories and had tended to be kept quite separate from domestic activities.
With the growth of international trade after the second world war, the traditional reliance on correspondent relationships, which had been the main way of servicing international commercial requirements, began to prove inadequate. The advent of international investment brought forth an unprecedented growth of multinational companies and with it a new era of international banking, centred on the eurocurrency markets. New competitors began to compete for the custom of European corporate business. In the 1960s the largest US banks, restrained from widespread branch expansion at home, emerged as active competitors in many overseas territories (including Britain) where the subsidiaries and affiliates of the British clearing banks had long enjoyed a privileged position. Perhaps the magnitude of the threat was emphasised by the stakes taken in the British overseas banks by the Americans: for example, Citibank's 40% holding in National & Grindlays, and Chase Manhattan's 14% interest in Standard Chartered. The reality of the challenge was manifest in the US banks' achievements in the sterling money markets, especially since the loss of the clearers' competitive advantage (cheap deposits) after the mid-1972 credit crisis and the rapid rise in interest rates in the preceding year. Moreover, the challenge extended beyond wholesale deposit taking; in the retail market they set up money shops and, of more significance, the establishment of US merchant bank subsidiaries threatened the dominance of London merchant banks in the arrangement of corporate financial services.
This section will consider the British banks' independent response. In an international context, the 1968 bank mergers may be seen as an essential pre-requisite for independent geographical expansion. Two factors crucially affect the success of directly extending a wholesale branch network, without recourse to consortia or groupings. First, size, often cited as a reason for linking with other banks in eurocurrency operations; second, a world-wide branch network. The links effected in 1968 were the realisation that, despite their dominance in the domestic retail markets, the clearing banks' international aspirations were inhibited by their relatively small size. Similar moves by many merchant and British overseas banks also indicate that size had become a valuable asset. In terms of assets and deposits the clearing banks remain the strongest contenders; this is also true on the second point - mainly through their subsidiaries, the clearing banks had achieved world-wide representation, as indeed the British overseas banks had done. However, the location of their branches in the Commonwealth and Colonies, and their emphasis on retail banking which had suited the traditional needs of trade finance were quickly becoming anachronistic. As international business grew in size, its complexity also increased and while local expertise remained essential and therefore local representation desirable, the need was to concentrate on the provision of wholesale services. Requirements were two-fold: firstly, a positive break with the geographical legacies of the past, with a new focus on America/Japan/Europe; secondly, a shift in the mix of business - a decline in retail banking (transferring traditional activities to local institutions) and a new accent on activities associated with international commercial and investment banking. This would represent therefore recognition of the prime objective of increasing their international coverage and service to customers for whom retail services were already adequately provided.
The need for rationalization became apparent with the growth of the European multinational corporation which by the end of the 1960s was challenging the dominant Americans in world foreign investment. Given the existing US banking networks, the wider operating scale and growing demands for a broad banking service that characterised the expansion of European business, meant that if facilities were not forthcoming from their domestic banks, they would turn to the Americans, and once the connection had been made it might be extended.

Thus one motive for British and European banks to expand abroad was defensive - to forestall their clients turning to their international and particularly U.S. competitors. Moreover, the Monopolies Commission report of 1968 effectively erected a barrier against further inter-clearing bank mergers; the expansion and progressive breaking down of institutional demarcations improved competitive capabilities by providing the base from which to offer a comprehensive range of services. In addition as banks reached their national growth limits, a natural response was to turn abroad. Nevertheless, the incursion of foreign banks into their own territory was probably the catalyst, for without an active extension of their international activities, the threat remained that the City of London would become increasingly dominated by foreign-owned institutions, remitting their profits overseas.

Thus one would expect direct participation in international banking activities to be centred around wholesale aspects (due to the importance of large companies) which reflected the foreign bank activities in London and the need to exploit international capabilities. The requirements of sophisticated advice on international finance and exchange controls, also stressed the significance of expertise and experience. In this respect, the UK accepting houses were well-placed, but lacked the resources to develop an extensive branch network since their business focus did not require a widespread deposit-taking capability. In terms of size and branch networks,
the clearing banks were the only British institutions which, acting independently, could challenge the dominance of the US banks and the impending threat of the Japanese.

5.3.1.2: Clearing Banking/British Overseas Banking

The experience of commercial banks in international wholesale banking markets has emphasised the importance of large size - both in terms of a substantial capital base and a large deposit base. With respect to the U.K., this premium on size immediately focuses attention on the deposit banks, and in particular, the 'Big Four'.

Without acting in concert, smaller banks have been virtually precluded from direct participation (on a large scale) in the new era of international banking competition. The immense sums required for project financing (for example, North Sea oil exploration) tend to be beyond even the largest banks' capacity. More than one bank, then, may be approached. This is unavoidable and is dictated by circumstances. The danger facing the clearing banks, however has been that while they may remain a company's 'domestic banker', a foreign bank, probably from the US, with a wide-spread branch network would be chosen as the 'international banker'. Both the clearing banks and overseas banks have developed the capacity and expertise backed by research in attempts to retain and/or improve their opportunities.34 Beyond doubt British banking mentality has been stimulated by the efforts of the foreign banks operating in London, and one reaction has been to adopt some of the techniques introduced by the US banks such as medium-term eurocurrency lending and the issue of certificates of deposit.
The traditional demarcation in the British financial sector, with intermediaries anchored in particular markets would have hindered development. The provision of international wholesale services by a clearing bank which had domestic retail banking experience but limited knowledge of merchant banking and a tenuous link with an overseas bank would clearly be untenable. Moreover, even with the rationalization of structure, the integration of a far-flung overseas network, still left the problem of transforming correspondent relationships, designed to accommodate retail demand, to comply with the growing demand from international companies for eurocurrency finance on an international scale.

The debate has centred around the most appropriate methods of extending international coverage and adapting inherited structures in order to reflect the predominant feature - the growth in international wholesale banking business. In this section the analysis is confined to direct representation and will attempt to answer two main questions:

1. Should international representation be restricted to an extensive coverage of wholesale banking activities, indicating the most important services provided for multinational companies, or should it include the retention (or creation) of retail business, if only to provide a stable deposit base in foreign currencies?

2. Should development abroad be approached by building a new operation, or acquiring an existing one?

a) Clearing Bank experience

It is accepted that comprehensive direct representation is the preserve of the largest banks, but there is little consensus on the methods employed nor on how merchant banking capabilities should be accommodated within a large group, and whether or not international services should be supplied by departments, branches or integrated subsidiaries under the control of the group's central management. The clearing and overseas banks are considered jointly, for, they share to some extent the problems noted above and are quite different in orientation from the UK merchant banks. Moreover, where a clearing bank has opted for independent action a significant proportion of its overseas development has been through its overseas banking subsidiary.
The extent to which direct action, as opposed to some form of co-operation has figured in a bank's strategy, has quite clearly been a legacy of their evolution. Barclays and Lloyds had the most extensive overseas banking links, and they have been most dependent on an extended and rationalized branch coverage. National Westminster which lacked a constituent overseas bank concentrated on establishing a representation in the world's major financial centres. In contrast, Midland has concentrated on co-operation with its European partners in EBIC. This is a path which only Lloyds has rejected.

**Barclays**

Barclays can boast the largest geographical representation of any of the 4 clearing banks. At 30 September, 1973, the offices of Barclays International and its subsidiaries numbered 1650 in 50 countries. The spread of branches reflecting the bank's extensive retail network was largely concentrated in France, South Africa and California. Over 870 offices in the Republic of South Africa and South-West Africa produced 27% of total deposits and 43% of deposits from outside the UK. The retail network in France involved 22 offices and yielded 18% of total international deposits. Both these networks were long-standing but the more recent development in the US is a reflection of contemporary pressures to expand. Barclays Bank of California was established with 29 branches in 1973 and an existing business was acquired and re-named Barclays Bank of New York. The full network of branches is reproduced in Appendix 8.
To signify the end of colonial banking and dawning of international banking, Barclays integrated DCO with the parent, merging the foreign business of the domestic bank into the wholly-owned subsidiary. The result, Barclays International, has since become the vehicle for international expansion, opening new offices throughout the Far East and in Europe; Frankfurt (1971); Milan (1972); Amsterdam (1972); and Brussels (1972). Although B.B.I. still carried on domestic retail banking business in several traditional territories, the new branches and offices were for wholesale business.

**Lloyds**

Lloyd's approach has understandably centred around the rationalization of the extensive overseas branch network of its subsidiaries. It has pursued a policy of direct expansion by merger, takeover and new branch formation. The base was provided by the long-standing expertise of B.O.L.S.A., with experience in the eurocurrency and eurobond markets and well-established connections in Latin America. In 1971, Lloyds Bank Europe, a retail deposit bank, was merged into B.O.L.S.A. forming Lloyds and BOLSA International. Full ownership was acquired in 1973, and the wholly-owned subsidiary was re-named Lloyds Bank International in April 1974. The combined group's strength involved 43 banking offices in Europe, 123 in Latin America and representative offices in Caracas, Hongkong, Mexico City, Singapore, Sydney and Tokyo. The gap in North America was filled by the acquisition of First Western Bank and Trust Company which had 95 branches in California. In September 1974, the bank was re-named Lloyds Bank California. Its presence in the US was recently increased by the purchase of the failed First State Bank of Northern California. In addition Lloyds' acquisition of the National Bank of New Zealand in 1966 provided the parent with 204 offices in New Zealand.
National Westminster

The creation of National Westminster brought together constituents with a limited overseas presence. National Provincial's nominal foreign involvement was through a link with Rothschild (the forerunner to Rothschild Intercontinental Bank) and Westminster Foreign Bank which engaged in money market operations. From this base the bank has made strenuous efforts to expand its international network. Its main operating subsidiary is International Westminster which has become a force in the eurocurrency markets and has branches in France (6), Belgium (3), Germany (1) and the Bahamas (1).

Its independent strategy has been the most varied of the clearing banks. Firstly, it gained quotes on the bourses of Paris, Amsterdam and West Germany. Secondly, it has concentrated on extending representation by creating its own representative offices and branches and also by the acquisition of local interests. By 1974, branches were established in Greece, Japan, Singapore and the US; representative offices in Australia, Bahrain, Canada, Hongkong, Spain and the USSR; and an agency in San Francisco.

In 1973 acquisitions figured predominantly and reflected a European bias. Apart from a 31% holding in Banca Milanese di Credito, re-styled Creditwest SpA, the bank owned 25% of RoyWest Banking based in Nassau. During that year National Westminster acquired 25% of the holding company which controls the Dutch banking firm of F van Lanschot, the seventh largest commercial bank in Holland. In France, agreement was reached with Banque de Paris et des Pays-Bas (Paribas) where National Westminster acquired 20% of the share capital of Union Bancaire which itself virtually controlled the two leading private sector French banks of Credit de Nord et de L'Union Parisienne.37
The result of the European expansion prompted the following comment in the 1974 Annual Report and Accounts:

"These investments, together with the Group's existing branches in Belgium, France and Germany, provide the most comprehensive branch and service coverage in Western Europe of any financial institution, and give the Group very substantial financial strength."

Despite the European coverage, the clearing bank lacks a substantial presence in North America, where it has so far concentrated on carrying out mainly wholesale banking business through a limited number of branches.

Two interesting features appear from the three clearing banks' independent expansion overseas. First, the retention of a global retail deposit base which emphasises the need for a stable source of funds in foreign currencies. Secondly, the creation of deposit bases in countries where customers operated. These factors were summarised by the then chief executive of Orion Multinational Services in 1971:

"The backbone of financing in any given country is obviously going to be in the currency of the country itself. Eurocurrencies present an important alternative, certainly. But they are no substitute."
Finally, as an indication of the importance of international banking to the clearing banks - an analysis of trading profits (before tax and exceptional items) is as follows:

<table>
<thead>
<tr>
<th></th>
<th>1973</th>
<th>1974</th>
</tr>
</thead>
<tbody>
<tr>
<td>total</td>
<td>£184.5</td>
<td>£120.3</td>
</tr>
<tr>
<td>Nat. West.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>international</td>
<td>13.1</td>
<td>21.7</td>
</tr>
<tr>
<td>% international</td>
<td>7%</td>
<td>18%</td>
</tr>
<tr>
<td>total</td>
<td>£173.0</td>
<td>£158.1</td>
</tr>
<tr>
<td>Barclays</td>
<td></td>
<td></td>
</tr>
<tr>
<td>international</td>
<td>46.4</td>
<td>58.2</td>
</tr>
<tr>
<td>% international</td>
<td>27%</td>
<td>37%</td>
</tr>
</tbody>
</table>

Source: Annual Reports and Accounts

Note: Lloyds do not give a breakdown

b) **British Overseas Bank experience**

The geographical and functional focus of the independent overseas banks has undergone an perhaps even more fundamental change. Some of the moves were forced by the political vagaries of the third world, but the most significant changes have been deliberate acts of policy. The most important development has been the move towards international eurocurrency and merchant banking. The growth in currency deposits with overseas banks from 1966-73 was such that they were second only to the US banks in the eurocurrency markets. From 1966 to 1971, National and Grindlays reported that 57% of its group profits and over ¾ of total deposits were derived from London operations. The growing weight of London activities reflected that international wholesale banking did not require widespread profit centres.
A decision to tap European markets followed the mergers and re-organisations in this sector discussed in Chapter three. National and Grindlays, for example, acquired the European branches of the Ottoman Bank; and Standard Chartered chose branch formation to give "a wider base for their increasingly important European operations." The links with US commercial banks on the other hand, gave an impetus to expansion into the US: B.O.L.S.A's link with Mellon Bank which was taken over by Lloyds Bank in 1973; Citibank's stake in National and Grindlays; and Chase's holding of 11.9% of Standard Chartered's equity (disposed of in 1974/75) are all examples.

In addition to their own concentration on merchant banking, National and Grindlays now has full ownership of Wm. Brandts, while Standard Chartered has a 9% trade investment in Arbuthnot Latham, owns 49% of Tozer Standard and Chartered and has merchant banking interests in Africa and the Far East.
5.3.1.3: Merchant Banking

In parallel with the growth of commercial banking business - centred on the eurocurrency credit markets - there has been an expansion of other banking services, equally geared to the multinational corporation and foreign provincial and national governments. These services, collectively known as investment or merchant banking, are founded on a bank's expertise and the reputation which it has earned in the market, rather than financial muscle. They include the issue and trading of bonds, private placements and other corporate financial advice, particularly in connection with mergers and acquisitions. Indigenous merchant banks have traditionally dominated the domestic markets for merchant banking services, but the internationalisation of banking has brought U.K. accepting houses into competition with foreign investment banking houses, notably those from the U.S., West Germany and Switzerland, and more recently with certain consortium banks. Few U.K. merchant banks retained their position as leading 'new issue' banks, and with the notable exception of Warburgs, the lead management of international capital debt became dominated by Deutsche Bank, Credit Suisse White Weld (CSWW), Morgan Stanley, Wood Grundy and Westdeutsche Landesbank among other American and European banks.

The growth strategy of U.K. merchant banks in face of such competition has been inhibited by the small size of their deposit and capital bases. Their contribution to international banking has nonetheless been significant. It has emanated from the management of investment banking business, notably eurobond issues and corporate advice. Their international orientation, has also resulted in representation and acquisitions throughout Europe; this is reproduced in tabular form in Appendix 9.
One can also discern less tangible signs. In December, 1971, Singer & Friedlander, using the experience of the UK companies register it had operated since 1968, joined with a number of European and US companies to set up a similar register on an international scale. Its main aim was to arrange mergers between medium-sized companies in different countries in Europe and North America, and advise on other joint business ventures and licensing arrangements.

A more significant event followed the Bank of England's relaxation in November, 1972 of rules governing the acquisition of accepting houses. In March 1973, a close relationship was established between Warburgs and Paribas. The latter took a 25% stake in Warburgs and, in exchange, Warburgs acquired 50% of a new company, Paribas-Warburgs SA which was formed and jointly owned by Warburgs and Compagnie Financiere de Paris et des Pays Bas. The new bank owns 25% of Banque de Paris et des Pays Bas SA in France, and 20% each of the bank's branches (under the same name) in the Netherlands, Belgium and Switzerland. In the US, the business of SG Warburg Inc and Paribas Corporation were combined as Warburg-Paribas Inc (equally owned by the parents). A further merger was also agreed with AG Becker, another US investment bank.

Two more recent moves confirm the contemporary importance of international banking to the UK merchant banks. In June 1976 it was announced that N.M. Rothschild were examining the possibilities of forging closer links with the Continental Rothschilds. The planned moves may be interpreted as a means to expand international activity. Secondly, the list of appointments to senior positions in Guinness Mahon, after the departure of Sir Charles Villiers, were also reported as having an 'international flavour'; Mr. Donald Robson from International Commercial Bank was brought in as chairman and a French executive from Lloyds Bank International joined the board.
The moves described above, in common with the activities of the clearing and overseas banks, have involved independent initiative, in the sense that they have excluded participations in formal groupings or consortia. The amalgam of retail deposits and money market deposits for wholesale banking remains a necessity for the overseas banks; for the clearing banks, the acquisition of existing banks with developed branch networks appears to have been the most convenient way of extending coverage; as expected, the merchant banks have displayed a variety of strategies.

5.3.2 Co-operation (I) Banking Clubs

If the independent action of British banks began to assume a European slant, the advent of alliances between banks has involved European banks exclusively. The timing of the establishment of the European Banking Clubs indicates that the EEC, and in particular British entry, prompted their formation, and UK bank participation.42

There are four such banking groups, three of which involve U.K. deposit banks. They are listed in Table 5.8.
Table 5.8: European Banking Clubs

**EBIC (1971)**

<table>
<thead>
<tr>
<th>Participants</th>
<th>Country</th>
<th>Nat Posn.</th>
<th>World Posn.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amro Bank</td>
<td>Neth.</td>
<td>3</td>
<td>48</td>
</tr>
<tr>
<td>Banca Commerciale Ital.</td>
<td>It.</td>
<td>2</td>
<td>24</td>
</tr>
<tr>
<td>Creditanstalt Bankverein</td>
<td>Aus.</td>
<td>1</td>
<td>109</td>
</tr>
<tr>
<td>Deutsche Bank</td>
<td>WG</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>Midland Bank</td>
<td>UK</td>
<td>3</td>
<td>27</td>
</tr>
<tr>
<td>Societe Generale</td>
<td>Fr.</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td>Societe General de Banque</td>
<td>Bel.</td>
<td>1</td>
<td>67</td>
</tr>
</tbody>
</table>

**ABECOR (1971)**

<table>
<thead>
<tr>
<th>Participants</th>
<th>Country</th>
<th>Nat Posn.</th>
<th>World Posn.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algemeene Bank Nederland</td>
<td>Neth.</td>
<td>1</td>
<td>42</td>
</tr>
<tr>
<td>Banca Naz. del Lavoro</td>
<td>It.</td>
<td>1</td>
<td>20</td>
</tr>
<tr>
<td>Banque de Bruxelles</td>
<td>Bel.</td>
<td>3</td>
<td>81</td>
</tr>
<tr>
<td>Banque Nationale de Paris</td>
<td>Fr.</td>
<td>2</td>
<td>5</td>
</tr>
<tr>
<td>Bayerische Hypo-und Wechsel</td>
<td>WG</td>
<td>7</td>
<td>51</td>
</tr>
<tr>
<td>Dresdner Bank</td>
<td>WG</td>
<td>2</td>
<td>14</td>
</tr>
<tr>
<td>Barclays Bank</td>
<td>UK</td>
<td>1</td>
<td>9</td>
</tr>
</tbody>
</table>

**INTER-ALPHA (1972)**

<table>
<thead>
<tr>
<th>Participants</th>
<th>Country</th>
<th>Nat Posn.</th>
<th>World Posn.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banco Ambrosiano</td>
<td>It.</td>
<td>18</td>
<td>200</td>
</tr>
<tr>
<td>Berliner Handel-Frankfurter</td>
<td>WG</td>
<td>28</td>
<td>273</td>
</tr>
<tr>
<td>Credit Commercial de France</td>
<td>Fr.</td>
<td>7</td>
<td>122</td>
</tr>
<tr>
<td>Kredietbank</td>
<td>Bel.</td>
<td>4</td>
<td>91</td>
</tr>
<tr>
<td>Nederlande Middenstandbank</td>
<td>Neth.</td>
<td>4</td>
<td>104</td>
</tr>
<tr>
<td>Privatbanken A/S</td>
<td>Den.</td>
<td>3</td>
<td>254</td>
</tr>
<tr>
<td>Williams &amp; Glyn's*</td>
<td>UK</td>
<td>7</td>
<td>102</td>
</tr>
</tbody>
</table>

*(part of National & Commercial Banking Group)*

**EUROPARTNERS (1970) also called CCB**

<table>
<thead>
<tr>
<th>Participants</th>
<th>Country</th>
<th>Nat Posn.</th>
<th>World Posn.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banco di Roma</td>
<td>It.</td>
<td>3</td>
<td>40</td>
</tr>
<tr>
<td>Credit Lyonnais</td>
<td>Fr.</td>
<td>3</td>
<td>7</td>
</tr>
<tr>
<td>Commerzbank</td>
<td>WG</td>
<td>4</td>
<td>26</td>
</tr>
</tbody>
</table>

Note: National and world rankings are from *The Banker*, June 1976
Group banking dates back to the early 1960s when NM Rothschild developed a close relationship with other European banks in the so-called Five Arrows Group (joining merchant banks and banques d'affaires, comprising Banque Lambert-Belgium-, Banque Privee-Switzerland-, PHP-Holland-, Banque Rothschild-France-, and the English Rothschilds). It was from this group that Rothschild Inter-continental Bank (R.I.B.) evolved.

It is evident that British bankers saw not only the need for a wider spread of banking facilities for international business; they also saw the difficulties inherent in independent geographical expansion. As a result, external expansion was favoured by some British banks and to ameliorate the problems posed by financial and managerial requirements, they often chose to pool resources through the setting-up of joint operations.

With hindsight, one can now distinguish between the different kinds of cross-frontier banking co-operation. In the course of the present and next section it should become apparent that the emergence of co-operation, formal and informal, has been the most recent and important feature of international banking development. The distinction between these groupings and the specialist consortia (5.33) can best be seen by comparing the rationale of their establishment and their mode of operation.

5.3.2.1: Rationale and Motivation

The original motivation behind the international banking groups was basically defensive and intended to counter the challenge of the rapid overseas expansion of the US banks. The club concept is very much a European one, and has attracted eight of Europe's largest banks, and the largest banks from Austria, West Germany, the UK, Holland, Italy and Belgium. However, the appeal has been specialised involving, with a few exceptions, those banks lacking substantive overseas representation. Thus, while Lloyds concentrated on rationalizing and integrating its overseas organisation, Midland (with virtually no overseas branch network) was attracted by the alternative of transnational European groupings. It did not involve the considerable expenditure and time associated with the independent
acquisition or organic expansion of a branch network, yet it assured access to local deposits and economised on staff and capital costs. Similar considerations applied to the three members of Europartners (the so-called 'quasi-merger') and to the seven smaller banks which formed Inter-Alpha.

Because this European creation is a recent phenomenon, all four clubs have been formed since 1970, and is considered to be "a continuing feature of international group banking", an objective judgement of progress to 1973, is not feasible. One is limited to assessing their place in the developing structure of international banking and to analyse some of their claimed qualities.

While the original motivation was perhaps defensive, this force seems to have affected timing rather than intention. Barclays' recent involvement in the expansion and reconstitution of ABECOR, marked a change in their approach to international banking. One suspects that this was solely for the EEC group of countries having taken the view that co-operation with local banks is essential to achieve effective penetration in the demarcated national banking markets of Europe. In this respect it parallels the approach adopted by Midland.

The objective of the groups has been to develop co-operation within Europe with a steering committee and a common secretariat to guide future plans. In this, they are contrasted with the very often specific aims of the consortium bank. Beyond such intangibles, an indication of 'success' would be the generation of more business for each other than other, less formal, bank relationships would have produced. The announcement that both EBIC and CCB were introducing systems to facilitate the supply of funds for corporate customers, from partner banks in their countries of operation, for example, EBICREDIT was not as novel as might be expected. The international connections of UK merchant banks have in the past provided an equivalent service. Moreover, the relationships developing between shareholder banks of consortia add a further question mark to the club concept. In retrospect,
perhaps the competitive disadvantage of the participating banks was the main cause of their involvement. The advantages of wide membership and extensive geographical coverage may be moderated by accentuated problems of cohesion and control. In the long-term, success, as measured by the generation of new business, will hinge on efficient integration of the banks' international departments. CCB has perhaps achieved the greatest progress in this respect. In contrast, structural problems have prevented Midland and its co-members from unification. Ironically the most visible forms of co-operation to the outside observer, are the joint-ventures which are off-shoots of the clubs. Arrangements made for mutual participation in the capital of finance companies and financing institutions have frequently assumed the guise of consortium banks - with which the clubs were earlier contrasted.

5.3.2.2 : European Banking Clubs

The rationale, progress and problems mentioned above are illustrated in the following sketches of the four clubs. Less attention is devoted to CCB because it contains no British participation.

**EBIC**

The group involving Midland Bank had its origins in the agreement between Midland, Amsterdamsche Bank (now Amro), Societe Generale de Belgique and Deutsche Bank. In 1963 they set up the European Advisory Committee, whose aim was to hold regular consultations and to create a joint basis for particular business projects especially large scale international financing. The European Banks International Company (EBIC) subsequently evolved, the four member banks being joined by Creditanstalt Bankverein and Societe Generale, and in 1973, by Banca Commerciale Italiana.
For several of the participants, EBIC represents the only means of transacting foreign business. Furthermore, in the attempt to promote international business, it has established banking enterprises in overseas territories: for example, European Asian Bank, Euro-Pacific Finance Corporation and European Arab Bank. Perhaps the most notable of EBIC's joint ventures are European-American Bank (ranking among the largest 25 banks in the US), Banque Europeene de Credit a Moyen Terme (BEC) which is based in Brussels and provides, as the name implies, medium term lending facilities for European customers. More recently, European Banking Company (EBC) has been established in London operating in the field of international merchant and investment banking.

This represents, on the surface, an extensive and complementary system of international coverage. However, when examining these developments in context, a number of anomalies appear. For instance, the EBIC partners channel their commercial banking business in the US through European-American Bank, but with regard to investment banking there is a split:

**INVESTMENT BANK**

- Societe Generale de Banque
- Amro Bank
- Deutsche Bank
- Sogen Swiss International
- Union Bank of Switzerland

Second, Midland Bank's domestic acquisitions of merchant banks, Samuel Montagu and Drayton Corporation paralleled the formation of EBC in London. The increasing emphasis on international merchant banking has meant that to some extent Midland would be competing with a new joint venture with which it was also involved. The complicated web of inter-relationships may militate against the complementary operation of the two subsidiaries. In principle, the organisation would be:
Montagu-Drayton

- sterling domestic merchant banking - bullion, foreign exchange

through Guyerzeller Zurmont, international representation (in Zurich)

EBG

- international operation in eurocurrency markets

- international merchant banking

- capital issues; medium-term lending; international mergers

Thirdly, the attempt to adhere to a code of club conduct has tended to break down. Member banks were not expected to establish direct representation in their co-partners' country of origin. However, Societe Generale de Banque's subsidiary, Banque Belge, and Societe Generale's (Paris) merchant bank Societe Generale (France) are both in London and also overlap with Samuel Montagu. In 1975, Deutsche Bank announced its intention to open a branch in the City of London, and has now achieved a listing on the London Stock Exchange. Similarly, Midland, despite its very limited presence abroad has representative offices in Brussels and Frankfurt.

Fourthly, a perhaps unforeseen and temporary problem, arose following Midland's takeover of the Drayton Group. Drayton had been involved with Banque de Bruxelles in a consortium - Banque de Bruxelles Drayton. The liaison thus connected Midland with a member of the ABECOR group.

ABECOR

Associated Banks of Europe Corporation, is an example of a banking club developing from a consortium. It was started initially by four shareholders of Societe Financier Europeene (SFE), Dresdner Bank, Algemene Bank Nederland, Banque de Bruxelles and Bayerische Hypotheken-und Wechsel Bank. A close relationship was maintained between ABECOR and a number of other SFE shareholders, notably Barlcays, BNP and Banca Nazionale del Lavoro, and in April 1974 they were also admitted to the club together with two associated members, Banque Internationale a Luxembourg and Oesterreichische Landesbank. Two of the new members, Barclays and BNP had already made attempts to build up their own branch networks; their decision to join ABECOR provides some confirmation that overseas branches are not an
adequate means of affording a full banking service, and that European coverage might be best achieved through co-operation among existing national banks. Barclays' involvement, in particular, was a clear departure from their previous strategy of professed independence and was to mark the first of several moves to co-operate with other banks.

With the entry of the new members, a perceptible change in ABECOR's objectives occurred; orientation became to a far greater extent European. However, the 'loose' co-operation between the members permitted only general forms of agreement rather than specific joint banking ventures and has included syndicated loans and international cash management. Again, the greatest potential appears to lie with the SFE link. As individuals, the ABECOR partners control some 75% of the consortium (Bank of America and Sumitomo Bank own 12.6% each) and reports suggested that a closer link will be emphasised.

**INTER-ALPHA**

The rationale underlying the third European banking group is more straightforward and derives its strength from the lack of the members' overseas networks. Subsidiaries also form an important part of strategy: for example, Inter-Alpha Asia (a Luxembourg subsidiary) was formed with the intention of opening a branch in Hongkong; the members also currently own 40% of the London-based consortium bank, Brown Harriman and International Banks, which specialises in international corporate finance and eurobond underwriting. In addition Privatbanken and William & Glyn's still control 20% of a competing consortium bank, United International Bank, which also emphasises corporate finance and eurobond activities among its objectives.
Perhaps the most cohesive grouping remains the only one without British participation. Described as a 'quasi-merger' it has advertised its joint image extensively. A reciprocal credit facility has been developed and a 'co-operation passport' enables personal customers to withdraw money when abroad, beyond the limits imposed by the 'eurocheque' system. Of more significance, considerable co-operation has been achieved by the three banks in the area of bond issues. By mid-1973, CCB had managed or co-managed 35 bond issues. Similarly, in the field of medium-term credit syndications, the close ties were demonstrated in a $300 million loan to Denmark, in September 1974 when Commerzbank and Banco di Roma each subscribed $50 million and Credit Lyonnais $72 million.

However, in line with other groupings, there has been a need to establish subsidiary operations. A joint Dutch bank was opened in Amsterdam at the end of 1973 (the majority being owned by Commerzbank); and the following year saw the merger of the French and German banks' operations in the Saar into Commerz-Kredit-Bank. Their links with consortia remain restricted to a joint 34% interest in International Commercial Bank which leaves no well-established investment bank under their control.

One can see from Table 5.8 that the majority of Europe's largest commercial banks are involved in banking clubs. The fact that the establishment of the clubs was concentrated in a few years suggests a defensive rationale. They had the specific aims of protecting members against exchange rate upheavals and of overcoming the costs of retail banking abroad. They were designed, moreover to counter the influence of the U.S. banks in Europe. The groups now all offer reciprocal credit facilities and ways of harmonizing and speeding transfers between banks, but their joint ventures and subsidiaries, perhaps indicate the need for an integrated unit to organise operations in the eurocurrency credit and bond markets. This focuses attention on the consortium bank and international wholesale operations.
On the retail and commercial side, parallel developments have already made obsolete the co-operation achieved. The eurocheque system and, in the field of money transfer, the Society for World Wide Interbank Financial Telecommunication (SWIFT) which was due to start in 1976, are wider in scope and potentially more significant.

Finally, if these clubs are a preparation for full banking mergers, is Europe any nearer to reaching that stage? There has been little progress towards financial harmonization which leaves gulfs between national legal and fiscal structures. Clearly such a development must await the further harmonization of banking rules, if not the convergence of national operating policies. The growth of the euromarkets questions the necessity of full mergers. The establishment of consortia, arguably the most significant development achieved to date, is a clear realisation of the importance of euromarket banking. While bank syndicates continue to co-operate across national frontiers in international money markets, it seems unlikely that there will be pressures towards full-scale banking mergers. The closer business relationships which have developed between the shareholders of consortium banks despite the lack of formal institutionalisation challenges still further the need for formal links.

5.3.3 : Co-operation (II) Consortium Banks

5.3.3.1 : Growth/Rationale/Operation

The developments noted above were principally a response to the needs of large multinational companies and occurred in anticipation of UK entry into the EEC. Although not in complete contrast, the advent of the consortium bank is directly linked to the growth of the eurocurrency markets in the 1960s and the subsequent expansion of the eurobond capital market. Consortia share a common attribute with other forms of international banking organisations in that they were originally established to service the needs of the multinational companies which have been noted earlier. Where they differ is partly in the source of their funds and partly in their motivation.
Unlike the defensive motives attributed to banking clubs and to independent external growth, consortium banks represent a positive approach to banking opportunities - they were aimed at building up new business, rather than defending established positions. Indeed while they have been a response to the US banks' dominance in the London eurocurrency markets, they have also been the method adopted by many US banks to gain entry to London. Consortia depend almost exclusively on the inter-bank market and wholesale eurocurrency markets for their funds. It is essential to comprehend the difference in kind as well as in degree, between eurocurrency financing and national currency operations. This difference is perhaps best understood by comparing the sophistication of the borrowing and lending machinery and the organisation of intermediaries of the eurocurrency era, and the lack thereof in the provision of sterling at its peak.

The precedent set by the exponential growth of the money markets to 1973, was paralleled by the exceptional importance in terms of size, power and influence of the multinational corporation. The latter indirectly gave rise to an ever-increasing demand for capital; more recent political and economic events have emphasised these requirements, for example, project financing and North Sea oil development. These demands for capital investment funds exceeded the capacity of a single bank. The inability of individual banks to concentrate large proportions of their resources, and the availability of a huge supply of funds, emphasised the need for size, and, of more relevance, encouraged co-operation, merger and consortia. The eurocurrency markets operate across frontiers and this gave a further impetus to multinational co-operation. In essence then, the capital requirements of large international borrowers such as corporations and governments were the main stimuli to the growth of consortia which was accentuated by the ability to tap the expanding eurocurrency markets. Furthermore a consortium's ability to seek international sources of funds was enhanced by the wide geographical base of its shareholders.
The consortia are the most important phenomenon in contemporary international banking. Indeed their success is essential for the future development of multinational banking because the consortia popularized the idea of permanent syndicates and thus obviated the need for a lead bank seeking out participants for an ad hoc syndicate. The consortium's shareholders, it is claimed, provide a ready-made syndicate:

The ideas noted above were summarised in an Investors Chronicle Supplement in 1973:

"In order to appreciate the real value of the consortium bank to potential large-scale borrowers, who require finance of such complexity that they can only be served by an international finance group, it must first be realised that a basic reason for the creation of a consortium bank is its ability to tap a sufficiently large source of funds in international centres to be able to satisfy the financial requirements of the potential borrower."

The Bank of England now defines a consortium bank as one owned by other banks but in which no one bank has more than 50% ownership, and in which at least one shareholder is an overseas bank. A number of consortium banks offer both commercial and investment banking services. The best-documented is the commercial banking side, involving medium-term eurocurrency lending; the second involves various aspects of investment banking notably eurobond business in the primary and secondary markets; international merger and acquisition negotiations; and project financing. The latter was mainly connected originally with the US banks' merchant banking subsidiaries which increasingly became a feature of US banking in London. The majority of these merchant banks are now wholly-owned by their US parents and do not therefore comply with the Bank's definition; they have in the past, however involved UK merchant banks: Bank of America achieved 100% ownership of its hitherto majority owned subsidiary, Bank of America International Limited, with the purchase in 1975, from Kleinwort Benson and Paribas, of their 22.5% stake.
N.M. Rothschild retained its 10% holding in Manufacturers Hanover Ltd., but lost its interest in R.I.B., when the consortium was taken over and re-styled as Amex Bank, the merchant banking arm of American Express.

The main raison d'être of the original consortia was the syndication of medium-term loans. In the first four years of this decade their growth rate matched the expansion in the eurocurrency markets.

Table 5.9 : The Growth of London-based Consortium Banking 1966-74

<table>
<thead>
<tr>
<th>Year</th>
<th>Existing</th>
<th>New</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>1967</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>1968</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>1969</td>
<td>6</td>
<td>2</td>
</tr>
<tr>
<td>1970</td>
<td>8</td>
<td>5</td>
</tr>
<tr>
<td>1971</td>
<td>13</td>
<td>2</td>
</tr>
<tr>
<td>1972</td>
<td>15</td>
<td>4</td>
</tr>
<tr>
<td>1973</td>
<td>19</td>
<td>4</td>
</tr>
<tr>
<td>1974</td>
<td>23</td>
<td>2</td>
</tr>
</tbody>
</table>

Note: Orion Bank was formed in 1970, and consisted of 2 main parts, Orion Bank and Orion Termbank. The latter was formally merged with the former in 1974 together with Orion Pacific and Orion Multinational Services. The figure for 1970 contains a single entry for Orion.

The major expansion in the numbers of consortia occurred after 1970 since when 15 of the 22 consortia established from 1966-73 were created equivalent to 68% of the total. Indeed the rate of growth prompted the Bank of England to give official recognition to the phenomenon in 1972 - separate classification in the Bank's statistics. It was stated in the Quarterly Bulletin that:

"... this group consists of some 15 banks, some of them very recent in origin, which are considered to be sufficiently homogeneous to be worth showing on their own."
More significant however, is that the shareholders of these consortia and those based elsewhere have included the largest banks in the world. Thus 'quasi merger' activity on an international scale mirrored domestic merger activity in that it involved large financial institutions. This emphasises three trends, noted previously: first, the premium of size in international banking; second, the importance of international banking to the world's biggest banks; and third, the need for banks to act in unison in order to combine different national bases to supply the demand for capital investment which the rapid growth in international trade and technological innovation had caused.

Appendices 10 and 11 contain lists of the consortia involving UK and US membership. In this and the following section the analysis is confined to the participation of British banks and should serve as a comparison with other methods of international participation attempted by British banks.

The high volume of medium term eurocurrency lending has been dependent upon the liquidity of the eurocurrency markets providing a plentiful supply of funds. Since the consortia who have been granting these loans derive their funds from the money markets, they have been able to structure their credits in several forms at fixed or variable interest rates, in dollar or multicurrency denominations, syndicated or single bank supplied. As reported earlier, the most popular technique has been a syndication of lenders, organised by a bank or group of banks. Similarly, the application of these funds can be categorised. One can identify three main uses of medium-term funds: first, for expansion by acquisition; second for project financing, and third as a method of evening out a company's debt structure.
The only effective barrier to entering international wholesale banking is large size. If a bank does not have adequate resources (deposits) or capital, the consortium organisation has obvious advantages — for it represents a means of breaking down that barrier, and moreover, does not preclude small banks from joining. Indeed the costs of entry by establishing a branch, especially in London have proved prohibitive in a number of cases; for smaller banks this consideration alone has dictated a joint venture. Hence the pooling of capital and thus the sharing of risk was an original rationale of consortia.

Once established, a number of consortia earned considerable profits. An indication is given in Table 5.10 which compares the rate of return on shareholders' funds earned in 1972/73 by consortia who are separated according to year of formation:

<table>
<thead>
<tr>
<th>Year of Formation</th>
<th>Ave. Rate of Return (1972/73 %)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966</td>
<td>12</td>
</tr>
<tr>
<td>1967</td>
<td>36</td>
</tr>
<tr>
<td>1968</td>
<td>12</td>
</tr>
<tr>
<td>1969</td>
<td>10</td>
</tr>
<tr>
<td>1970</td>
<td>10</td>
</tr>
<tr>
<td>1971</td>
<td>5</td>
</tr>
<tr>
<td>1972</td>
<td>3</td>
</tr>
</tbody>
</table>

These profits attracted other shareholders to form banks, which in the form of consortia, entered the market (see Table 5.9). However the demand for medium term eurocurrency loans stagnated in mid-1972 and furthermore the number of suitable borrowers also appeared limited. The increasing number of banks and the limited demand, increased competition and consequently reduced margins or caused medium term loans to be extended from the traditional period of five years to sometimes ten years and more.
Coinciding with this, the Japanese banks armed with a mass of surplus foreign exchange funds, accumulated as a consequence of successive years of balance of payments surpluses, were able to offer competitive rates of interest and thus further reduced margins.  

The response by new consortium ventures, while varied in form, had a common theme. They were seeking to offer more than mere financial strength, by either specialising in a particular industrial or geographical area, or by diversifying their services; the latter approach was also adopted by the existing consortia who sought to spread their risks beyond the confines of medium-term syndications. Hence, the consortium rationale of pooling of resources and spreading shareholders' risks, assumed a third aspect: new and specialised forms of business required particular expertise which in turn implies the need for banks to develop new skills and techniques. Personnel were required to assess a firm's financial position not only by examining its accounts (credit analysis) but also by analysing the likely profitability of particular projects in geographical locations or industrial sectors. The greater the extent of lending for any one activity, the more will banks find it worthwhile to have their own experts; clearly specialist subsidiaries could perform an essential function in this respect. The extent of this specialisation among the newer consortia vis-a-vis those established before 1970 is represented in Table 5.11.  

Of the 12 consortium banks established from 1971 to 1974, ten were specialised and all but one of them concentrated on 'geography', either by ownership or by direction of aims; there was a single example of 'industrial' specialisation - International Energy Bank created to provide finance for the exploitation of energy resources, especially North Sea oil.
Table 5.11: Specialisation among London-based Consortia, 1964-74

<table>
<thead>
<tr>
<th>Year of Formation</th>
<th>Consortium</th>
<th>Specialisation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1964</td>
<td>MAIBL</td>
<td></td>
</tr>
<tr>
<td>1966</td>
<td>United Bk. of Kuwait</td>
<td>Geog (ME)</td>
</tr>
<tr>
<td>1968</td>
<td>Western American Bk.</td>
<td>Brown Harriman &amp; Intl. Banks</td>
</tr>
<tr>
<td></td>
<td>Rothschild Intercontinental Bk.</td>
<td></td>
</tr>
<tr>
<td>1969</td>
<td>Atlantic Intl. Bk.</td>
<td>Geog (Scan)</td>
</tr>
<tr>
<td>1970</td>
<td>Scandinavian Bk.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Orion Bk.</td>
<td>Geog (Scan)</td>
</tr>
<tr>
<td></td>
<td>London Multinational Bk.</td>
<td>Geog (Jap)</td>
</tr>
<tr>
<td></td>
<td>United International Bk.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Japan International Bk.</td>
<td>Geog (Jap)</td>
</tr>
<tr>
<td></td>
<td>Associated Japanese Bk.</td>
<td></td>
</tr>
<tr>
<td>1971</td>
<td>London Interstate Bk.</td>
<td>Geog (Scan)</td>
</tr>
<tr>
<td>1972</td>
<td>UBAF</td>
<td>Geog (ME)</td>
</tr>
<tr>
<td></td>
<td>Italian International Bk.</td>
<td>Geog (Eur)</td>
</tr>
<tr>
<td></td>
<td>Libra</td>
<td>Geog (LA)</td>
</tr>
<tr>
<td></td>
<td>Eurobraz.</td>
<td>Geog (LA)</td>
</tr>
<tr>
<td>1973</td>
<td>EBC</td>
<td>Geog (Eur)</td>
</tr>
<tr>
<td></td>
<td>Anglo-Romanian Bk.</td>
<td>Indl (Energy)</td>
</tr>
<tr>
<td></td>
<td>International Energy Bk.</td>
<td>Geog (ME)</td>
</tr>
<tr>
<td></td>
<td>Iran Overseas Investment Bk.</td>
<td></td>
</tr>
<tr>
<td>1974</td>
<td>Eulabank</td>
<td>Geog (LA)</td>
</tr>
<tr>
<td></td>
<td>International Mexican Bk.</td>
<td>Geog (LA)</td>
</tr>
</tbody>
</table>

Note: Where no specialisation is shown the bank concentrated on medium-term credits and international merchant banking.

ME = Middle East
Scan = Scandinavia
Jap = Japan
Eur = Europe
LA = Latin America

The established consortia also took steps to specialise.

Orion's shareholders, for example, joined with the Swiss Bank Corporation and Banco Esperito Santo e Comercial de Lisboa, to form Libra Bank, to specialise in international financing in Latin America. More often though they chose to diversify their objectives by supplementing their commercial banking operations with investment banking and other activities. Indeed the necessity to diversify earning has resulted in the establishment of departments handling leasing, consumer finance, venture capital, property and insurance. This strategy is exemplified by measures taken at Orion Bank in recent years. In 1974, Orion was fragmented into four parts:
Orion Bank - investment banking

Orion Termbank - commercial banking (an extension of the shareholders' capabilities, providing medium and long term loans)

Orion Pacific

Orion Leasing

The new chairman, Mr. David Montagu intended to integrate the investment and commercial banking functions and build a successful investment banking operation to complement the commercial banking division which remains the main profit centre. As a pre-requisite, Orion Bank and Orion Termbank were merged in December, 1974 and the whole of Orion Leasing and majority of Orion Pacific acquired by 1976. Orion's main interest lies in the building up of its fee-paying business, that is its investment banking side. Montagu also emphasises the international character of this expansion:

"We are not going into the retail business ... we're not going to do retail corporate finance work. I want us to be viewed as a multinational investment bank." 53

5.3.3.2: British Banking Participation

The matrix presented in Table 5.12 summarises the shares taken by British financial intermediaries in world-wide consortia and the American merchant banking subsidiaries in London. In 1973/74, British banks held 42 stakes in consortia, based both in London and abroad, varying from 4% to 50%. In addition, non-bank financial intermediaries held 5 stakes. The geographical spread is shown in Table 5.13 below:
Table 5.13: Geographical Spread of UK Banks' Shareholdings in Consortium Banks 1974

<table>
<thead>
<tr>
<th>Centre/Country</th>
<th>clearing</th>
<th>merchant</th>
<th>overseas</th>
<th>non-bank</th>
<th>total</th>
</tr>
</thead>
<tbody>
<tr>
<td>London</td>
<td>13</td>
<td>5</td>
<td>1</td>
<td>2</td>
<td>21</td>
</tr>
<tr>
<td>Aust/NZ</td>
<td>1</td>
<td>11</td>
<td>-</td>
<td>3</td>
<td>15</td>
</tr>
<tr>
<td>Europe</td>
<td>3</td>
<td>2</td>
<td>-</td>
<td>-</td>
<td>5</td>
</tr>
<tr>
<td>America</td>
<td>1</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1</td>
</tr>
<tr>
<td>other*</td>
<td>-</td>
<td>4</td>
<td>1</td>
<td>-</td>
<td>5</td>
</tr>
<tr>
<td>total</td>
<td>18</td>
<td>22</td>
<td>2</td>
<td>5</td>
<td>47</td>
</tr>
</tbody>
</table>

Note: *Includes London based US merchant bank subsidiaries

The clearing banks had 18 shareholdings, only 5 of which were outside London. In contrast, the merchant banks had only 5 stakes in London consortia but 17 of their interests were in banks centred outside London or in London-based US merchant banking subsidiaries: 11 of these were in Australasia. Indeed some 15 of those consortia not based in London were in that continent.

This was in response to the Australian mineral boom and the resulting demand for credit and the bond markets, which presented opportunities especially for the innovative merchant banks to apply their expertise to the development of these markets which would complement the Far Eastern financial markets located in Hong Kong and Singapore.

Analysis of the data illustrates a number of points:

1. London merchant bankers were amongst those who vehemently criticised the concept of consortium banking. Their lack of participation in London consortia, reflects that philosophy. It stems partly from their pride of ancestry and long-established position at the centre of the U.K. financial system which was challenged by the recently established and powerfully-backed consortia; it also stems from a conflict of interests with the aims of some of the consortia; as the consortium banks began to develop their investment banking departments it brought them into competition with the UK merchant banks in the management of the international capital issues and in the syndication
<table>
<thead>
<tr>
<th>Financial Institution</th>
<th>Type</th>
<th>Consortium and Centre</th>
<th>Figures are Shareholdings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Barclays</td>
<td>Cl Bk</td>
<td>18</td>
<td></td>
</tr>
<tr>
<td>Nat West</td>
<td>Cl Bk</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td>Midland</td>
<td>Cl Bk</td>
<td>20</td>
<td></td>
</tr>
<tr>
<td>William &amp; Glyn's</td>
<td>Cl Bk</td>
<td>25</td>
<td></td>
</tr>
<tr>
<td>Standard Chartered</td>
<td>Bo Bk</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Hambros</td>
<td>Mc Bk</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Hill Samuel</td>
<td>Mc Bk</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Kleinwort Benson</td>
<td>Mc Bk</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Samuel Montagu</td>
<td>Mc Bk</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>NM Rothschild</td>
<td>Mc Bk</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Baring Bros</td>
<td>Mc Bk</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Brown Shipley</td>
<td>Mc Bk</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>SG Warburg</td>
<td>Mc Bk</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Morgan Grenfell</td>
<td>Mc Bk</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Schroder Wagg</td>
<td>Mc Bk</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Grindlay Brandts</td>
<td>Mc Bk</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Antony Gibbs</td>
<td>Mc Bk</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Charterhouse Japhet</td>
<td>Mc Bk</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Keyser Ullman</td>
<td>Mc Bk</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Wallace-Sassoon</td>
<td>Mc Bk</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>UDT</td>
<td>HP</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Crown Agents</td>
<td>Misc</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Eagle Star</td>
<td>Ins</td>
<td>10</td>
<td></td>
</tr>
<tr>
<td>Prudential</td>
<td>Ins</td>
<td>10</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** Figures in parentheses indicate the percentage of shareholdings.
Table 5.12: Notes

Where no centre is specified, the bank is located in London

1: US merchant banking subsidiary - now wholly owned by Bank of America

2: US merchant banking subsidiary

3: Jointly-Owned subsidiary of US brokerage firm, Merril Lynch. In 1976, Brown Shipley's share was reduced to 5%. Merril increased its shareholding to 95%.

a: Through ABECOR; not specified

b: With other shareholders of Orion; not specified

c: Through EBIC; 14%

d: Through EBIC; 13%

e: Through EBIC; not specified

f: Through EBIC; not specified

g: Through Inter-Alpha; 40%

h: With members of the Five Arrows Group; 45%

Changes in Consortium Shareholdings

In 1975, Hambros sold its 10% stake in Western American Bank (WAB); it had originally held 28%, but reduced its interest to 10% in 1973. The remaining shareholders, Security Bank (US), Bank of Tokyo, National Bank of Detroit and Wells Fargo Bank, now each own 25%.

In 1975, Rothschild Intercontinental Bank (RIB) was bought by American Express. The new bank, Amex became a merchant banking subsidiary in the pattern of Bank of America International limited.

In 1976, Charterhouse Japhet disposed of its holding in Atlantic International.
of loans. It was this conflict that was said to have prompted the sale of R.I.B. The consortium was formed primarily to conduct medium-term lending for N.M. Rothschild. As the increasing demand for wide-spread services induced diversification, R.I.B. came into direct competition with the London and Paris Rothschilds. The sale by Hambros of its share in W.A.B. after being forced, together with the other shareholders, to assist the subsidiary in the problem years of 1974/75 has left just three merchant banks with stakes in London-based consortia. Their pre-occupation with consortia based elsewhere, also gives an indication of their widespread international bank-interests.

2. Clearing bank interests in consortia are no less revealing of their philosophy and overseas connections. Midland Bank (lacking an overseas network), has 9 shareholdings either in its own name or through EBIC. Lloyds has no involvement at all; and following its acquisition of First Western in California it hastened to dispose of the latter's 16% share in London Interstate Bank. Also manifest of the bank's policy, is Barclays' consortium shareholdings. Apart from the long-standing stake in SFE in Paris, its management has emphatically pronounced in favour of independent action, while being "... ready to participate in joint-ventures of a specific and limited nature where opportunities arise." The four stakes held by Barclays demonstrate its pragmatism, providing examples of specialised operations which require the consortium approach. Anglo-Romanian Bank and Iran-Overseas Investment Bank aim to promote trade and investment respectively with and in the countries named; International Energy Bank concentrates on North Sea oil, exploration and development; and Euro-Latinamerican Bank (Eulabank), one of several banks concentrating on Latin America,
was established by Barclays and its co-members in ABECOR, together with Banco Central of Madrid and several South American banks.

It is now apparent that consortia have brought UK and European banks into formal association with US banks with whom they are also competing. The demands of the multinational corporations created the need for the syndication of large, medium term loans and specialised expertise. This requirement was reinforced by the ever-increasing complexity of modern technology, the appearance of high credit risk projects and the continued dependence of industry on bank-raised finance. Such pressures have laid emphasis on inter-bank co-operation both in the forming of consortia and in other forms of cross-frontier collaboration. Nevertheless full international bank mergers still seem to be a distant phenomenon. However, according to the Banker's list, some 70% of the world's top 50 banks are involved in international co-operation - the notable exception being Citibank whose continued philosophy of self-reliance reflects its size and spread, and intention of "going it" alone.

Praiseworthy as the concept of internationalisation is in theory, implementation of close co-operation across international boundaries, involving cultural, legal, fiscal and language barriers, has inevitably brought attendant problems. These would be most apparent where questions of conflict between parents and subsidiary arise. This infers the need for a strong basic agreement between parent banks rather than ad hoc arrangements. Indicative of the recognition of the desirability of parental harmonization are the reports of greater co-operation between consortia shareholders.
Evidence must be specific however. One example, is the alliance between Merrill Lynch (US) and Brown Shipley (UK). The relationship which developed between the US parent and the London-based consortium, Merrill Lynch-Brown Shipley is an indication of the close links between the institutions. In July 1975, it was announced that the Americans' Paris-based eurobond underwriting business would be merged into the consortium; there followed reports that several other of Merrill's international operations would also be undertaken by the bank. While this does indicate the relationship between the two intermediaries, and the prominence of the consortium in plans for further expansion, the increased shares gained by Merrill Lynch through the injection of new capital reduced the British interest to just 5% in 1976; the London operation will apparently become the international merchant banking arm for the US firm, thus mirroring the moves made by Bank of America and Amex Bank. There seems to be no pattern to the growth of international banking teams. Neither British nor American involvement has followed a pattern - and as a result a bewildering array of minority and majority shareholdings have emerged.

Consortia still represent an effective means of entry for smaller banks into wholesale and merchant banking. Unfortunately even casual observation uncovers a confusing web of shareholding links. Some of these have led to disinvestments by British banks; the appearance of banking clubs have had little rationalising impact to date: in the case of ABECOR they have added to the confusion - for while Bayerische Hypotheken-und-Wechselbank is a shareholder of United International Bank, the other six members jointly own with Bank of America and Sumitomo Bank the rival S.F.E. The emergence of fewer and more rationalised groupings must still be anticipated and would be expected to follow a sustained up-turn in international banking business following the nadir of 1974/75.
One generalization is possible. Although the major consortia differ considerably in size, form and operation, they are increasingly becoming dedicated to the provision of a complete international merchant banking service to complement existing commercial banking facilities. To reiterate, this is the major growth area of contemporary multinational banking and one would envisage for the future a greater involvement in the following aspects of investment banking: eurobond issues and placements; corporate finance services for multinational companies and governments; and advice on international mergers and acquisitions.
NOTES

1: The most obvious legal constraint is that which prevents U.S. commercial banks from undertaking investment banking activities - principally the underwriting of (euro)bond issues.

2: See Vision, July/August 1976; and World Banking Survey, Financial Times, April 25, 1977


4: Quoted from the Bankers' Magazine, January, 1976, p. 21

5: The Banker publishes an annual survey, 'Foreign Banks in London'.

6: Table 8.11 (of the BEQB) includes the merchant banking arms of US banks, consortium banks (which all include at least one foreign shareholder), and subsidiaries of UK banks. Disaggregation would prove extremely difficult but it may be assumed that the contribution to advances made by foreign banks is considerable.

7: In an attempt to attain large size to contain the necessary departments and staff expertise, the larger British banks have gradually assumed a structure approximating to the 'universal' or multi-product bank.

8: E. Parry-Williams, 'Bank Services, multinational needs', Bankers' Magazine, April, 1976, p. 43

9: There is very little difference between sterling advances by London clearing banks and total advances (Oct. 1971) - only £7 million in 'foreign currency' - hence there is no difference between foreign banks' loans in sterling as a % of London clearing banks' loans in a) sterling and b) sterling + other currencies.

10: R. Pringle, Banking in Britain, (Methuen, 1975), pp. 84-85


12: G.R. Curtis, 'Profit or Prestige?' The Banker, Nov. 1973, p. 1281

13: The eurocurrency market(s) is composed of key currencies held outside their countries of origin; the largest segment comprises dollars on deposit outside the US. The funds are usually placed on deposit with U.S. or foreign banks in offshore financial centres like London. They are lent-on either to other banks in the inter-bank market or to corporate or governmental borrowers throughout the world.
Two accounts have been advanced to explain the early origins of the market. The first traces the origin of eurodollar deposits to the fact that U.S.S.R. and East European countries transferred their dollar balances from New York banks to banks in Western Europe out of a fear that the balances might be blocked by the U.S. Government. The second traces the origin of the market to the fact that the London accepting house, Brown Shipley enticed the dollar balances of British insurance companies away from the London clearing banks. In both cases the date is around 1953; see J.R.S. Revell, *The British Financial System* (Macmillan, 1973), p. 295

Eurocurrency credit markets are money markets, specialising in 90-180 day loans. The Eurobond market developed to furnish the needs of long-term capital seekers and has since expanded to become the international capital market.


The major sources of eurodollars are Dollars invested by East European countries; less developed countries, multinational companies; more recently oil sheikdoms; see E.R. Shaw, "Arab Funds in Euro Markets", Bankers Magazine, June, 1976.

Major eurocurrency loans too large for one bank to provide are commonly made by a group of banks acting together. Syndication is the procedure whereby the bank(s) which arrange(s) such loans – the Manager(s) – and the bank charged with co-ordinating the day-to-day administration of the loan – the Agent – invite other banks to participate (usually by Telex).

R. Fry, 'Sterling business – playing hard for a breakthrough', The Banker, Nov. 1972, p. 1437

See for example, L. Wilks, 'Sterling business in the new era', The Banker, Nov. 1971

R. Fry, op. cit., p. 1439

See also section 5.3

A full discussion of this is beyond the scope of the study. See Baker and Bradford, op. cit; S. Davis, "US banks abroad: one stop banking", *Harvard Business Review*, July-August 1971; *Forbes*, July 1, 1976

More details are contained in S. Davis, 'Whither the American Merchants', The Banker, March, 1976 and Chapter 3.

See *The Times*, Sept. 3, 1975

D. Vollmer, 'How Bank of America went multinational', The Banker, June, 1972, pp. 783-785. Such predictions did not foresee the recent attempts to circumscribe the activities of multinational companies – OECD guidelines (June 1976).


30: Nevin and Davis, op. cit., p. 232.

31: At the end of 1975 Citibank increased its stake in Grindlays Bank to 49%. Lloyds continues to own 41.4% of National and Grindlay Holdings which in turn now owns 51% of the banking subsidiary. In the Summer of 1975, Chase disposed of its stake in Standard Chartered for £34 million. Midland Bank, who acquired the 11.9% held by Chase, thus increased its interest to 15.9%. This was due to US regulations which made it impossible for Chase to maintain a stake in Standard Chartered whilst the latter conducted banking business in the US. This was conducted through the Chartered Bank of London, a wholly owned subsidiary which in July, 1975 extended its interest with the purchase of Liberty National Bank.

32: In 1973 Barclays and National Westminster were 4th and 7th respectively in The Bankers's Listing. But neither was much more than 1/4 the size of Bank of America.

33: There is a wealth of evidence supporting this view:

(a) United Nations estimates of the total book value of world foreign direct investment is:

<table>
<thead>
<tr>
<th>Year</th>
<th>US</th>
<th>European</th>
</tr>
</thead>
<tbody>
<tr>
<td>1967</td>
<td>55</td>
<td>35</td>
</tr>
<tr>
<td>1971</td>
<td>52</td>
<td>38</td>
</tr>
</tbody>
</table>

(b) Professor Stobaugh (Harvard) reports that the 1970 turnover of foreign manufacturing affiliates of multinationals were:

- US $65 bn.

(c) Growth rates of US and EEC banks 1971-73

<table>
<thead>
<tr>
<th>Year</th>
<th>US</th>
<th>EEC</th>
</tr>
</thead>
<tbody>
<tr>
<td>1971</td>
<td>12</td>
<td>34</td>
</tr>
<tr>
<td>1972</td>
<td>20</td>
<td>27</td>
</tr>
<tr>
<td>1973</td>
<td>24</td>
<td>41</td>
</tr>
<tr>
<td>Ave 71/73</td>
<td>19 p.a.</td>
<td>34 p.a.</td>
</tr>
</tbody>
</table>

34: The wholesale banking bias of merchant banks precludes them from being regarded as an enterprises' main banker. The select provision of specialised services and centralised operating structure calls for a different strategy and approach to internationalisation.
35: See Chapter three for a description of the division of services amongst different institutions and chapter four for an account of the evolution of financial multi-product companies.

36: See The Times, May 24, 1976

37: Union Bancaire was formed by Paribas to hold its equity stakes in the two French banks. Following their merger the new bank is operating under the style Union Bancaire and the name of the holding company was changed to Union Financiers et Bancaire (UFIBA).


39: J. Haley, interview, 'Money Management', April, 1971

40: Chairman's Statement, Standard and Chartered Banking Group Ltd., Annual Report, 1975

41: Initial participation included Booz Allen & Hamilton (US), Banco de Santander and Banif SA (both from Spain), Schoeller & Co (Austria), Banco Totta & Acores (Portugal), R. Henriques Jr (Denmark), NV Slavenburg's Bank (Holland), Bankhaus H. Aufhauser (Germany), Allied Irish Investment Bank and Societe Nationale d'Investissement and Banque du Benelux (both from Belgium

42: J. Hendley, joint general manager of Midland Bank devoted much of a speech at a conference on 'Money in Europe', to trans-European banking. He emphasised that businessmen needing new banking or other financial services should first seek the advice of their British bank (BIM, Jan, 1972)

43: The Banker, August 1973, p. 903

44: Europartners is assessed in detail by M. Green, 'New Model Multinational Bank', The Banker, May, 1971

45: D.J. Harrison, Investors Chronicle, March 9, 1973

46: The Bank of England took an interest in consortia following the banking crisis of 1974. The traditional distrust of a subsidiary operation in which each shareholder had a relatively small stake (and therefore little to lose) led the Bank in September, 1974, to seek assurances from shareholders in consortium banks, regarding 'moral responsibility for their investments in London'.

47: BEQB, March 1972, p. 59

48: The liquidity was due to the continuing US balance of payments deficit; the slow growth in credit demand in the US; attempts by various countries to keep out international money market funds, thereby controlling national money supplies; and the resulting liquidity in certain countries notably, in the Middle East.
49: It is estimated that term loans made up an average of some 1.0% of total sterling advances (new loans taken from April 1971-December 1972). Before 1971, term loans were almost certainly negligible. Significantly, since then the clearing banks have followed the lead of the foreign banks in London: the facilities offered by clearing banks for medium-term lending doubled in the two year period to April 1976 when they stood at c. £1.3 bn. Such loans currently account for 25% of all lending by clearing banks in the UK. Counting export credit and shipbuilding loans, the figure approaches 40%. See T. Stonor, Investors Chronicle, March 9, 1973 also Financial Times, April 7, 1976, and July 2, 1976; April 23, 1976

50: Banks formed after 1970 may be considered too 'new' to be included in an analysis of profit. In 1972, it was estimated that "... the most successful ... are already only slightly less profitable than the British clearing banks." (The Banker, June 1972, p. 797).

51: For details see The Banker, June 1972, p. 797

52: 'Suitable' is gauged in terms of size and risk. In a recent journal article, D. Montagu (Chairman of Orion Bank) remarked on the need to be "quality conscious", qualifying this remark as follows, "We like to feel we are doing blue chip triple-A business all the time" (Euromoney, May, 1976)

53: Euromoney, May, 1976, p. 53; see also Chapter eight

54: At 31 Jan 1974 assets were down to £565 million (£661 million); pre-tax profits to £906,000 (£3.3 million); problems were accentuated by its losses in the secondary eurobond (trading) market; in September, 5 executive directors 'left'; deposits were re-called and the parent banks supported the consortium by taking over its portfolio of long-term bonds.

55: R. Dyson, Chairman Barclays International, quoted from The Banker, August, 1974, p. 925

56: For example, The Banker, August, 1973, pp. 903-905

57: See The Times, July 17, 1975
It is now more than twenty years since the phenomenon of the takeover bid first emerged in earnest. In the formative period of the 1950s, when takeover techniques were being fashioned, a number of personalities gained reputations as skilful practitioners and were constantly in the public eye. Several of the original exponents - Sir Charles Clore, Sir Isaac Wolfson and Sir Hugh Fraser - also figured prominently in the more pronounced merger activity of the last decade.

In the 1960s, long periods of 'bull' markets on the stock exchange gave market leaders greatly enhanced ability to absorb other companies through share exchange deals, and inspired the growth of those companies which had developed the appropriate expertise - Sears Holdings (Clore), House of Fraser (Fraser) and G.U.S. (Wolfson). The process spiralled with the tax reforms announced in 1965 which simultaneously deterred new share issues and made shareholders prefer 'paper' to cash which was subject to capital gains; the culmination was the 'merger boom' of 1967-68.

During those two years nearly 70% of the U.K.'s top 100 firms were involved, 10% of privately-owned manufacturing, financial, distribution and property assets were the subject of some form of achieved or intended takeover and a quarter of all British firms worth more than £10 million were acquired.\(^1\) Four years later these peaks were surpassed, as an expansionist monetary policy, continuing economic growth and a sharp rise in share prices contributed to the total value of acquisitions exceeding £3 billion.

In the course of twenty years, the takeover bid in general, and the contested takeover battle, in particular, have become regarded as being peculiarly British.\(^2\) In part, the high levels of merger activity in the U.K. can be attributed to the vague, ambivalent and neutral public policy on mergers and monopoly. Equally important has been the existence within the City of
adequate market sophistication\(^3\) and a laissez-faire regulatory system of control\(^4\) which has encouraged on the one hand, freedom and flexibility, but on the other abuses of the spirit of 'gentlemanly conduct' which it was intended to engender. In consequence, considerable merger expertise was built up within certain industrial sectors and within the City; it was manifest in a number of developments. First, the desire and ability to exploit 'asset situations'\(^5\) - the so-called cult of asset stripping was responsible for the rise to prominence of several entrepreneurs: Jim Slater, Oliver Jessel and James Hanson, for example. Secondly, established City institutions were developing facilities to accommodate the burgeoning growth area of corporate finance. Thirdly, as acquisitions have become more numerous they have become marked by increasing asperity between the contesting parties, and by increasing sophistication in the techniques for acquiring control. The City's financial institutions, and especially the merchant banks, which have been largely responsible for the conduct of acquisition plans and negotiations, have felt a need to control the financial dealings with which they are concerned. This feeling has been heightened by a desire to retain their independence in the supervision of their business and has prompted them to act jointly in this regulatory function.

In the two chapters which form this section, the second and third aspects noted above, which together constitute the City's role in merger activity, are examined in more detail. Chapter six reviews the role of merchant banks and other institutions in the merger process and considers the wider implications for the 'market for merger'; a case study is also included as a practical illustration of the inter-relating parts played by the various institutions. In chapter seven the ramifications of these issues are discussed;
in particular, as intimated above, despite the level and extent of merger activity, takeover bids for the control of companies still take place in a virtually unregulated market place. This inevitably raises questions as to the virtues of the self-regulation of merger tactics. Moreover, it is during the course of merger negotiations that the propriety and ethics of the institutions and financial advisers are most visible and therefore most frequently challenged. Indeed irresponsibility and unethical conduct on the part of merchant banks and other financial advisers have been blamed for abuses of the 'shareholders' interest', and were instrumental in the initial implementation of the City Code to monitor tactics. Significantly, subsequent altercations have been the trigger to a wider examination of the City's traditional freedom from control. In view of the recently renewed attack on financial institutions and the City's modus operandi it is particularly appropriate to examine the voluntary control of mergers in the broader context of self-government, which despite the attentions of the Left, seems likely to prevail.
NOTES

1: G.D. Newbould, Management and Merger Activity, (Guthstead, 1971), p. 18

2: S. McLachlan, 'Takeover and Merger Administration Today', Professional Administration, September 1972, p. 21

3: D. Kuehn and R. Marris, 'New light on takeovers', The Banker, July 1973: "In present conditions, the stock exchange is much more realistically seen as a market for control than as a market for new capital". p. 758

4: The British system of self-regulation involves the Bank of England, the Stock Exchange and the Takeover Panel; statutory regulation is implemented by the Department of Trade.

5: 'Asset situations' are those where companies, whose assets are considered under-utilised, are acquired for the purpose of increasing earnings and assets per share by improving internal efficiency, and releasing substantial sums for investment elsewhere.

6: See especially, Labour Party National Executive Statement, 'Banking and Finance', 1976, which demanded nationalization of the banks and insurance companies; the Stock Exchange enquiry into Scottish and Universal Investments, 1976; and the Department of Trade Inspectors' Report on Roadships (formerly Ralph Hilton Transport Services), 1976

7: Statement by the Secretary of State, Department of Trade, October 21, 1976, reported in the press October, 22, 1976
Financial Institutions and Corporate Merger Activity

The role played by City institutions in merger activity has probably attracted more headlines and comment than any other activity carried out by financial institutions. However, the literature on this subject has hitherto been restricted to the official reports of the Takeover Panel and the Department of Trade Inspectors, and to articles in the financial press. No systematic attempt has been made to analyse the interaction of the institutions in the mechanics of a takeover bid. The main objective of this chapter therefore, is to provide a factual and informative account of the role of financial companies in the merger process. Collectively, financial intermediaries have the power, whether as merger engineers or as major shareholders of equity capital, to control, or at least exert an influence over, the management of public quoted companies. This analysis concentrates on one source of long-term finance - mergers and acquisitions - which presents the institutions with the opportunity to exercise that power. In particular, it focuses on two aspects: firstly, the technical and strategic details of a takeover bid with which merchant banks as financial advisers and public relations (P.R.) consultancies are intimately connected; secondly, the part played by institutional investors (pension funds and life assurance companies) during the ensuing public negotiations.

6.1 : Merchant Banks/Financial Advisers

6.1.1 Introduction and History

The accumulation of acquisition expertise within industrial sectors was mirrored during the 1950s by the independent U.K. merchant banks. The general high level of merger activity provided the incentive for the banks to apply their entrepreneurial talent to the modification of their new issue departments which were developed into corporate finance departments and
staffed with trained solicitors and accountants, systematically recruited from leading City firms.\(^1\) It was one event in particular, however, that heralded the introduction of merchant banks to the arrangement and negotiation of acquisitions - the so called Aluminium War of 1957-58.\(^2\)

It began with substantial buying of shares in British Aluminium under nominee names by the Reynolds Metals-Tube Investments partnership. It developed into a bitter fight, with Warburgs - then a parvenu in City merchant banking circles - ranged with Tubes and Reynolds against British Aluminium with its alternative proposals for a link with Alcoa and the support of Lazards and Hambros at the head of a powerful group of City interests. Apart from exposing hostilities within the City (particularly between the 'Old Guard' and the newcomers), it brought out the major issue which has run through contested takeover battles ever since - tactics which leave shareholders in a company without a clear choice between opposing proposals and without the information on which they might base a rational decision.

This episode marked a turning point for the City. Henceforth the merchant banks elaborated their professional skill in the conduct of takeover situations; and the main City institutions under the leadership of the Bank of England felt compelled to issue the Notes on Amalgamations\(^3\) which were the forerunner of the City Code. The effects were described by a director of Warburgs as follows:

"After the war there was very little in the way of opposed takeovers. The Aluminium War created a situation which had not previously arisen in the City: a clear division of all the leading merchant banks. After that, merchant banks ... began to realise the importance of specialist departments to deal with these special situations."\(^4\)
As a result independent lawyers and accountants were displaced as the creative force in acquisition and merger negotiations. Moreover, merchant banks extended their earnings from takeover advice. In the 1950s, acquisitions were listed as 'sundry fees'; during the last decade and the early years of this, rates prevailing for handling large takeovers have varied from £50,000 to £100,000. Contested takeovers also command higher fees - although the charge is for success, and merchant banks have waived fees from established customers or reduced them to a minimum if a deal fails.

The merchant banks' focal position in the financial system has also permitted them to dominate the provision of other sources of long-term finance. In particular, the members of the Accepting Houses Committee, itself contained within the Issuing Houses Association, along with other merchant banks and specialist issuing houses (without banking business), are well-placed to conduct new issue business because their contacts in the City enable them to organise underwriting syndicates. Consequently they have become associated with the organisation and arrangement of new capital issues and public flotations. Furthermore, these activities require a similar financial appraisal to that undertaken by merchant banks in merger proposals, and are similarly conducted within the corporate finance department. Although the degree of dependence upon a merchant bank as a source of finance varies enormously from company to company, there has been a trend towards retaining merchant banks for advice on all aspects of financial affairs, instead of employing them for a specific service (for example, takeover advice). This would be expected to reinforce the influence through their less formal, yet pervasive links with industry - through the directorships held by their own board members.
6.1.2 Function

Table 6.1 gives an indication of the prominence of merchant banks in the merger market. The two years selected for illustration represent a contrast in the levels of recorded merger activity. As noted, in 1972 business confidence was very high and stock market conditions favourable for acquisitions financed by the issue of securities. In 1973, expectations were less optimistic, and, especially in the last quarter of the year, merger activity receded sharply. In spite of the differences in magnitude, however, merchant banking involvement is clearly considerable and consistent.

Table 6.1: Mergers and Acquisitions arranged by members of the Issuing Houses Association (I.H.A.), 1972-73

<table>
<thead>
<tr>
<th>Total expenditure on acquisitions</th>
<th>Value of acquisitions arranged by I.H.A.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acting for acquiring company</td>
<td>Acting for acquired company</td>
</tr>
<tr>
<td>(£m)</td>
<td>(£m)</td>
</tr>
<tr>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>1972 2938</td>
<td>2882 (98)</td>
</tr>
<tr>
<td>1742 1697 (97)</td>
<td>1596 (72)</td>
</tr>
<tr>
<td></td>
<td>5472</td>
</tr>
</tbody>
</table>

Source: Derived from Business Monitor M7 (expenditure on acquisitions by industrial and commercial companies); Bank of England Quarterly Bulletin (expenditure on acquisitions by financial companies); Times 1000, 1975, Table 17 (acquisitions and mergers arranged by members of the Issuing Houses Association).

Notes:

In 1972-73 there were 18 members of the Accepting Houses Committee, and these accounted on average for 74% of the mergers and acquisitions arranged by the members of the I.H.A.

These statistics summarise the extent of merchant banking intervention in merger activity and reveal the monopoly they have secured in the conduct of merger negotiations. In turn, this provides some indication of their importance. It is not possible, however, to establish from statistics, the nature of their involvement in the merger market. Their role may be solely that of an intermediary - providing a forum for unemotional argument and thereby facilitating speed and flexibility in achieving conclusions. Alternatively, the banks may do more than merely fuel the market mechanism: through their formal and covert links with industry, they may actually influence
decision-making and instigate acquisition plans. If this is the case, the implications are serious, for it suggests that mergers and acquisitions may be undertaken for reasons which have less to do with long-term industrial strategy than the private financial aspirations of merchant bankers.

Several strands of evidence suggest that this possibility should not be ruled out. Firstly, it has been intimated above that the merchant banks earn high rewards if an acquisition is brought to fruition. Indeed it has been reported that the merchant banks' largest profits in the 1960s derived from fee income earned in respect of takeover advice. Secondly, Newbould (1971) discovered that in half of his sample, "... the whole procedure of analysis (financial, economic and strategic) and preliminary negotiation with the victim firm and/or merchant bankers took eight weeks or less." This was interpreted to infer that little serious analysis of merger proposals was typical and that tactics rather than financial considerations were most important in deciding the outcome of bids. Thirdly, Kitching (1974) reported on the outcome of 145 British acquisitions and discovered a failure rate of 30% implying a waste of over £1000 million of shareholders' funds in 1972 and underlining "the huge cost of a poor acquisition strategy."

These data should be regarded as cautionary rather than defamatory; it is very difficult to assess the influence of merchant banks in this area, and virtually impossible to reach any definitive conclusions. It is neither feasible, nor desirable to generalise; instead, the analysis can offer some general principles and suggest some reasons for the dependence of companies involved in mergers or acquisitions, on merchant banks.
Where a merchant bank is retained as a company's financial adviser, its involvement in a particular acquisition is likely to be preceded by its interest and assistance in the preparation of its clients' corporate plan and the place of acquisitions in the overall framework. In contrast, merchant banks may be employed on an ad hoc basis, by companies which receive takeover inquiries or become the subject of a takeover bid, or alternatively by companies which are planning an acquisition. Irrespective of the stage at which the banks is initially introduced, as the figures in Table 6.1 suggest, merchant banking counsel is sought when a bid is actually made and during the ensuing negotiations.

In practice, the role of the merchant bank will vary according to whether it is employed by the acquiring or victim firm. However, the role they play can be considered generally in two unequal parts: the public stage, that is during the period of the outstanding offer; and the preceding background research and analysis in which the technical details of the bid are formulated, and strategy and tactics discussed. The bank will probably be involved at both stages when working for the acquirer; its role when defending the victim firm may be restricted to the later public stage however - this is discussed later. Both parts are extremely important, though for very different reasons.

Over time, the preparation of bid documents has become increasingly sophisticated and the technical aspects accordingly more complicated. The form of the consideration (cash, shares, convertible stock, warrants, debt or some combination) may have a significant impact on the financial outcome of a proposal and in particular on its acceptability to the shareholders of both companies. The terms, decided upon in the initial analysis are therefore crucial. On the other hand, the argument, drama and intrigue, by which takeover bids are known to the public occur within the regulated period of the outstanding offer. If takeover proposals falter at this stage, those responsible for the acquisitions plan have borne the brunt of the criticism. In essence, the merchant bank's reputation, conduct and expertise are publicly tried and tested - and arguably this is the most
significant stage for the bank. 16

Financial advice, now apparently synonymous with the services of a merchant bank, is required in takeover situations by statute and the City Code. The specific duty imposed by the latter upon the financial adviser is to report on and corroborate profit forecasts and asset valuations made by his clients in the course of a bid. 17 In addition, the City Code suggests that a company "... which receives an offer or is approached with a view to an offer being made should in the interests of its shareholders seek competent independence advice." 18 The function of the merchant bank, as articulated in law, is indicated by the Prevention of Fraud (Investments) Act 1958, which requires that any document concerned with the acquiring, disposing of, subscribing for or underwriting securities must be approved in advance by the Board of Trade (now the Department of Trade) unless it is issued by an authorised person (i.e. a licensed or an exempt dealer). 19

In the circumstances of most takeovers, it would be impracticable for a company to issue its own documents and obtain the necessary official approval; whereas merchant banks, as issuing houses, are invariably exempt dealers and are therefore able to issue documents on their own authority. It is within this framework that the merchant bank performs its role.

Irrespective of the form of the consideration, the circular containing details of the offer must comply with certain procedural rules, and include certain information. 20 In this connection, the Code draws particular attention to "profit forecasts and asset valuations" which, as noted, are the adviser's province. In effect then, the merchant bank is entrusted with the circulation of the offer document and, to a large extent, with its contents.
Acquisitions differ from normal purchases and sales in that the timing is not dictated by the shareholder who is forced in a bid situation to make a decision on what may be inadequate or insufficient information. The merchant bank, whose main consideration is to promote its clients' interests, also has the implicit responsibility of providing shareholders with sufficient information for them to examine the rationale of the offer and the terms that are suggested. Moreover, the merchant bank should ensure that the rationale is clearly defined and that the financial content is presented in a comprehensible form.

In this connection, their responsibility has wider implications. As intermediaries and agents, merchant banks represent a potential imperfection in the merger market which emerges if they fail in their duties of furnishing information to all shareholders, or if they abuse the information to which they are granted privileged access by creating a false market in the shares of either the offeror or offeree company. When considered in the wider context of other features of the market, notably the highly skewed size distribution of acquiring and acquired firms, the presence of institutional investors and the pervasive influence of private managerial aspirations, the bank's role in the dissemination of information becomes more important. Imprudent conduct therefore threatens not only the reputation and integrity of the merchant bank in question and hence their prospective business, but also the interests of the private and institutional shareholder and the managers and employees of the companies involved.

Nevertheless, the bank's primary responsibility is to its client. It is appropriate therefore to sketch briefly the contrasting functions performed when representing the acquiring firm and the victim firm. In both instances, the most valuable contribution by the adviser is probably made during the regulated period of negotiation which must last initially for 21 days and at most for 60 days after the offer is first posted. It is during this time that public attention is focused on events: stock market rumours cause wild fluctuations in share prices, and the arguments and counter-arguments are
threshed out, usually with the close attendance and comment of the financial press. Furthermore with the advent of the Takeover Code and establishment of the Takeover Panel the conduct of bids has come under searching scrutiny; the insistence by the Stock Exchange for more detailed information has imposed greater reliance upon financial advisers, and in general their integrity during takeover negotiations is now more closely examined.

During the period of the bid, the merchant bank acting for each party, will advise on and often actually conduct the strategy and tactics to be adopted. For the bidder, the bank's specific function is to present the requisite information having verified the authenticity of the financial statements. Thus, advice will include the exact timing of the bid itself; the level and nature of the initial offer; the drafting of the offer document to ensure the best possible presentation of the client's offer in accordance with applicable law and the City Code; the revision of the initial offer if that appears to become desirable; and the timing of the ultimate declaration that the offer has become unconditional.

In contrast, the merchant bank acting for those who receive or expect to receive a bid, will advise on the "defences" available, whether for inducing shareholders to reject an offer altogether, for increasing the initial consideration offered or for attracting a counter bid from a third party, either for its own merits or as a means of improving the original offer. Once again the advisers' main concern will be the contents of the offer document and in particular the details of profit forecasts, and the formulation of strategy.

By their nature, acquisitions rarely proceed smoothly: they involve, quite often, clashes of personality between principals and advisers (especially in contested bids); in particular, the negotiations tend to be centred on forecasts of the respective companies future prospects in respect of growth, profitability and dividends. This emphasis on financial aspects has inevitably focused attention on the corporate financier. The monopoly of takeover advice enjoyed by the merchant banks has not endowed them with a monopoly of skilled
financiers however. Indeed financial and legal experts are as likely to be found in the treasury department of an industrial corporation as in the corporate finance department of a merchant bank. Thus the technical details of a bid may have been completed before merchant banking counsel is first sought. No general rules can be established on this point - but there is the suggestion that the successful merchant bank owes its prowess, at least in part, to its ability and skill in securing a higher price for the victim company by contesting the bid shrewdly; or alternatively, when acting for the acquirer, paying as low a consideration as conditions permit.  

Merchant banks, by virtue of their attempts to specialise in the provision of corporate financial services, have apparently gained the experience and expertise to make a unique contribution. While they are pre-eminently qualified to give independent advice they possess the additional, essential advantage of being at the centre of the financial system and are therefore acquainted with the City's specialised modus operandi. Their contacts, developed over many years, enable them today, to use the services of a stockbroker to place shares or to petition institutional support when deemed necessary. Collectively these factors have equipped the banks with the ability to guide companies through the myriad of statutory and self-imposed obstacles which impede the passage of bids. In particular, their knowledge of the intricacies of the Takeover Code has enabled them to ensure that directors, unused to the procedure and complexities, act within accepted bounds in such matters as their duty to provide the same information, with equal promptness to requests from all bona fide potential offerors.
Whatever the virtues, or shortcomings, of the self-regulatory method of monitoring takeover tactics, the inception of the Takeover Code and Takeover Panel appears to have created the need to rely upon the merchant banks. The Code was essentially designed by four 'takeover experts', drawn from City merchant banks - Rothschilds (Mr. Michael Bucks), Hill Samuel (Sir Robert Clark), Morgan Grenfell (Mr. Ken Barrington) and Minster Trust (Mr. Peter Cannon). Furthermore, the Panel's four Director Generals have included three merchant bankers - Mr. Ian Fraser, seconded from Warburgs and now of Lazards (1968-72) and Mr. John Hull, seconded from Schroder Wagg (1972-74) were the first two. In 1976, Mr. David Macdonald, director in charge of corporate finance at Hill Samuel, was chosen to succeed Mr. Martin Harris an accountant from Price Waterhouse and the only previous non-merchant banker to hold the post. The general point has been put most strongly by Franks (1970) who criticised the Panel for having no legal basis, for failing to operate in the real interests of shareholders or with a proper understanding of the duties of a board of directors, and significantly, for greatly enhancing the status and power of merchant banks. Subsequent events have confirmed the view.

Nevertheless, the merchant banks' capacity to seize the initiative has also undoubtedly contributed to their elevated position. The ability to provide financial advice seems to owe much to "... the existence" within the banks "of individual skills of separate units which could join forces on an ad hoc basis". In this respect, it should be stressed that the overriding impression is that merchant banking and corporate finance are very personalised businesses: provision of financial advice utilises skills which are unique to the personnel of the advising institution and are tailored to the needs and situation of each client. Illustrative of the importance of individual skills in corporate finance is the career of Mr. Charles Ball, who whilst vice-chairman of Kleinwort Benson, gained a reputation as one of the City's leading tacticians in the defence of companies subjected to unwanted bids. His accomplishments since he first acted on behalf of Telephone Rentals in their successful defence against
G.E.C. are indeed remarkable. For example, he helped prevent Waddingtons being acquired by Mardon International and played a leading part in Debenhams' fight to remain independent of U.D.S. He managed to extract an extra £7 million from Reed International in its acquisition of I.P.C. in 1970, and perhaps most notably, secured an additional 35p a share for Shipping & Industrial Holdings' shareholders when the bidding Vlasov-Capitalfin consortium already held 61% control. More recently, he won a higher price on behalf of Fenchurch Insurance against Kleinwort's rival merchant banking group Guinness Peat. The extent of Ball's expertise is perhaps best indicated by the furore and comments that was prompted by his appointment as chairman of the re-named Barclays Merchant Bank (B.M.B.) in 1976. It seems peculiar that the recruitment of one man should be heralded as the beginning of a new-style era for the clearing banks in their competition for the business which has traditionally been the exclusive preserve of the independent merchant banks. Yet, the financial press were, for once, unanimous in their prognosis. The Times, for example, proclaimed that:

"Barclays' aim, plainly, is to prevent its customers turning automatically to other merchant banks when they need sophisticated skills, for instance in arranging mergers ..." 36

The Financial Times reported:

"... it seems to highlight just how well regarded are those special few merchant bankers who rate as the top corporate finance experts." 37

Having gained a reputation as a defence strategist, Ball also displayed willingness to act for the predator, when B.M.B., acting in concert with Kleinwort: on behalf of Tate and Lyle negotiated for the acquisition of Manbre & Garton in a much discussed battle during the summer of 1976. In the absence of Ball, it is clearly unlikely that B.M.B. would have attracted the attentions of Tate & Lyle; indeed, B.M.B. would probably still attract the common allegation of the clearers' merchant banks that they lack the flexibility and the competitive edge of their independent rivals due to their institutionalised nature and uninspired staffing policies.
6.2 : Public Relations Consultants

6.2.1 : Introduction and History

The increased sophistication of the technical aspects of takeover bids, especially the financial content of offer documents, and the asperity characterising contested bids, have given rise to a number of further developments in the merger market. Notwithstanding the expertise of the merchant bank's corporate finance department, the basic point at issue in takeover negotiations is whether or not a company's shareholders can be persuaded, coerced or merely 'informed' into accepting or rejecting a merger proposal. Despite the growing domination of institutional equity holdings, the ownership of industrial private enterprise is still widely varied. Thus the small, private shareholder cannot be dismissed as unimportant in takeover situations. The assertion by Mr. Nicholas Stacey\textsuperscript{38} that "the ordinary shareholder is desperately innumerate"\textsuperscript{39} is therefore potentially serious. If Stacey is correct, then, by implication, a number (perhaps a majority in some cases) of shareholders during a bid cannot understand the printed documents that are circulated and hence the merchant banks are failing in their implicit duty to inform all shareholders with equal promptness of the relevant factors, in a comprehensible manner.

The recognition, during the late 1960s, of the need for more positive forms of communication with investors\textsuperscript{40} whilst endorsing this point emphasised, in addition, the need for greater disclosure of information. This was also the consequence of the publicity that the unprecedented merger activity had provoked which in turn had focused attention on the integrity of merchant banks during takeover deals. The banks have been among that stoutest defenders of the self-regulatory framework within the City and have feared that concern at their methods and integrity would be interpreted to infer that the traditional restraints of City behaviour which have been dependent upon the values of personal and collective honesty were not a satisfactory alternative to detailed legislation.\textsuperscript{41} Thus anxieties developed within the merchant banking community and in consequence the gradual process of self-revelation evolved.
Both the accountability of merchant banking activities and the need for greater disclosure in takeover situations are linked by a common denominator - the attentions of the financial press, which have become an important force in contemporary merger activity. Attracted initially by the recurrence of contested bids and the apparent inviolability of merchant banks, financial journalists have since made a number of positive contributions. They served to make the City more accountable in the sense that more was revealed of its activities by, and through, the press. Furthermore, by their efforts to add comment and opinion to the reporting of events, journalists have encouraged the City to disclose more information of its own accord. It is doubtful, for example, whether the Takeover Panel would have been established when it was had it not been for the bitter outcries of the press. Moreover, during the P & O bid for Bovis, in 1972, which is analysed at the end of this chapter, small shareholders were apparently influenced more by press comment than by the advice of stockbrokers and other financial consultants.

These separate, yet inter-related developments, created a situation for the merchant banks which they were ill-equipped to handle. In effect they were being asked to retain their professional status and yet inform effectively all denominations of shareholder; and to be accountable to the public and shareholders while observing a strict code of conduct which stresses, inter alia, secrecy and integrity with respect to "price-sensitive information".

The growth of the financial public relations industry in the late 1960s was a direct result of these developments and the merchant banks' quandary. This is explained by the chief executive of one of the most successful public relations (P.R.) consultancies, John Addey Associates, who described his role as:

"... on a par with other City advisers - solicitors, bankers, accountants and stockbrokers - aiming at filling what seemed to be a basic gap in the range of services being provided."
At the outset, P.R. consultants were contracted by merchant bankers with responsibility to present to the public and shareholders the relevant arguments in a form that could be readily understood; to intermediate between the bank and the press, controlling the timing and contents of press releases; and in general to promote and conduct the publicity campaign.

Most City consultancies were offshoots from advertising agencies. These had developed from solicitors' offices when it became necessary to translate certain undertakings given to the Stock Exchange, prospectus documents, for example, into a form suitable for advertising and the press. As 'disclosure' grew into a subject of topical debate, pressures on merchant banks increased and attention was focused on the specialised P.R. profession conducted by consultants with similar training and the ability to match their contemporaries in the banks' corporate finance departments.

Their responsibility for the shareholders' and public's view of a company varies according to the situation: in an unopposed takeover bid, for instance, the function of the P.R. consultant is merely to assist in the presentation of the arguments in a readable and comprehensive form. In this respect the task is: "... not to interpret information but to crystallise it." The violent resistance to unwelcome takeovers which was particularly noticeable in the merger euphoria of the late 1960s and early 1970s, brought about more desperate defence measures and prompted P.R. campaigns of greater sophistication and wider scope.

As contested bids became more prominent in this period, the P.R. function assumed increased significance. It was recognised as an integral part of the initial team formed before every major acquisition proposal was made, or defended. The role of the P.R. consultant has been complementary to that of the merchant banking adviser whose principal task is to concentrate on the 'financial' and 'technical' aspects of a bid proposal or defence. The role of the P.R. consultant, in contrast, is to attempt to exploit the 'psychological' aspects of merger negotiations, in particular the expectations of shareholders who are the ultimate owners of the companies
which are being bought and sold. Their influence, whilst originating from the number of contested bids which arose, has owed much to the interest taken by the financial press in the subject of acquisitions and mergers. As soon as journalists started to examine matters in detail, and had an influence over shareholders by taking a view, their existence became important to financial advisers.

P.R. consultants, as intermediaries between the two, therefore occupied a key position, in which they determined the presentation of information (style and medium) to shareholders and the methods by which defensive advisers should harry the aggressor or create doubts in the minds of their opponents - both advisers and shareholders. In performing this function the P.R. consultants have had an important impact on the merger market. The implications of their involvement stems from a transformation of their role vis a vis the merchant banker. First, the emphasis in bids has shifted from financial detail to daily narrative of bid and counter-bid, laced with personalities and related not so much as a technical duel between two merchant banking advisers, as a psychological battle between public relations men. Secondly, as a result, the dissemination and the quality of information has improved; the presentation of offer documents has changed radically, with colour and logos replacing financial and legal detail. In consequence, private shareholders, often the recipients of masses of paper in a bid, find the documents easier to consult and to comprehend.

A third implication concerns a change in the methods employed to communicate with shareholders. Particularly during contested bids, there has been a substantial increase in the use being made of press, radio and television for the advancement of rival views. Arguably press relations have always been highly developed within the City which makes the financial press an attractive and expedient means of communication and advertising. The other media are as yet relatively unused. Although warnings of their potential were sounded by the Takeover Panel in 1972 and welcomed by Stacey who considers that in the future takeover statements
will appear on television as paid advertisements:

"It is possible to consider ... when chairmen of large public companies will give a five-minute summary of their companies' achievements on commercial television."

The growing use of public relations has taken a number of further forms and is displayed by two examples during 1972. Both campaigns were prompted by the large number of small shareholders of the companies involved. In the bid by Grand Metropolitan Hotels (G.M.H.) for Watney Mann, the 29,000 individual shareholders of Watneys were urged to give public proof of their loyalty by displaying stickers on their cars bearing the legend "Keep Watneys Watneys"; beer mats conveyed the same message. The propaganda potential in thousands of public houses was exploited by the P.R. campaign in an attempt to gain the support of the private shareholder. Despite Watneys' exhortation, G.M.H. won control of the brewers when a large institutional shareholder, Prudential Assurance, voted in favour of the acquisition.

Perhaps furthest from the City's approved method of communicating bids and lobbying support was that chosen by Debenhams in their successful opposition to the bid by United Drapery Stores (U.D.S.). The tactics adopted by Debenhams and their advisers (Kleinwort Benson, Morgan Grenfell, Greenwells, John Addey and Charles Barker) were similarly influenced by the composition of Debenhams' shareholding. Some 70% of the equity was held by the 46,000 small shareholders (holding less than £1,000 worth of stock), most of whom, it was considered would be customers as well. The decision was taken therefore to conduct an emotional ("psychological") battle rather than a purely financial one. Staff and customers - whether shareholders or not - were involved in the defence which exploited an easily identifiable image, with the aid of posters, car stickers and badges worn by staff appealing to shareholders to remain independent, in order to mobilise the support of small shareholders. The hallmark of the defence was the attempt to employ an unprecedented mode of direct communication with shareholders. The main example, was entirely the result of the P.R. approach and featured a "personal message" from the Chairman,
Sir Anthony Burney, in the form of a three-minute gramaphone record dispatched to shareholders with the offer documents. The importance of this approach lay in its originality; it represented a unique method of achieving effective and wide coverage in a company's attempt to inform shareholders of the reasons for resisting the bid. Moreover, it proved relatively inexpensive: costing some £1,000 as opposed to £200,000 to convey a similar message on television. From here, it seemed a logical next step to use the broadcasting media.

The course of events in the U.D.S./Debenhams battle, from February to May 1972, are important in a wider sense as well. In particular they illustrate how a successful campaign can be waged with the emphasis on public relations rather than technical/financial detail.

Debenhams' strategy was formulated by a co-ordinated team of financial and public relations advisers, and the Chairman, Sir Anthony Burney, who remained prominent throughout. The events are chronicled, in order to present a composite picture of the outcome and how it was effected. Of greater explanatory value, and of some general applicability however, are the motives behind some of the occurrences. Thus in Table 6.2, each significant event is classified with respect to the three broad types of strategy listed below which form an overall framework to be employed in most takeover defences:

A. DEFENCE IN DEPTH - being prepared to force the bidder to raise his price at least once.

B. SHAREHOLDER SUPPORT - tactics should vary within the overall strategy, according to the composition of the shareholding.

C. 'PSYCHOLOGY' - combining psychological aspects of the defence with technical support; aimed at harrying the bidder into mistakes and wresting the initiative, with the intention of achieving B. above.
In brief, the background to the takeover bid was as follows:

**U.D.S.** : Chairman - Bernard Lyons  
: Merchant Bank - Hill Samuel

**Debenhams** : Chairman - Sir Anthony Burney  
: Merchant Bank(s) - Kleinwort Benson  
Morgan Grenfell

March 1972: U.D.S. bid 305p a share for Debenhams, worth a total consideration of £116 million; offer open until April 17.

: Rationale - a) Debenhams' under-utilisation of assets, especially property  
b) Poor management

The defence mounted by Debenhams shows how, in an imperfect market, tactics can be as decisive as the relative strengths of the opponents' technical cases. The defence exploited the clearly defined public image which Debenhams enjoyed (and U.D.S. lacked) and was characterised by the personal interest of the chairman and the background position occupied by the merchant banking advisers, Kleinwort Benson and Morgan Grenfell. In contrast, Hill Samuel, advisers to U.D.S., were to the fore during the negotiations. The extent of Debenhams' private shareholding favoured the former approach, and in particular Burney's recorded contribution proved significant as a means of reaching small shareholders and rallying their support, whilst provoking an untimely and badly-received response from U.D.S. Moreover, the conduct of the campaign apparently convinced the institutions that the newly-constituted Debenhams management team deserved the chance to prove themselves. With Debenhams' final share price at a 44p discount on the offer price, it would indeed seem that the credit was owed to "the public relations tour de force". 54
Debenhams share price averaging a premium of 40-45p above the U.D.S. offer

Durney spurns the U.D.S. bid before the official documents are sent out as 'Totally inadequate'

Debenhams strengthen their management team by the appointment of Mr E.E. Crabtree (chairman of Harvey Nichols) and Mr J.C. Talbot (managing director of Debs. -central planning) to the main board

Debenhams aim a series of appeals at customers: posters proclaiming 'Help Debenhams Stay Independent' and car stickers

Debenhams release profit figures for year to January 1972: showing record 20% increase in profits to £8.4 million (pre-tax), Dividend increased from 20% to 22%

The defence document containing the profit figures was very low key mentioning the strengthening of the management but containing no profit forecast, and no estimation of the property revaluation that was being predicted (estimates indicated that the property was worth more than twice the book value)

U.D.S. raises bid to 35p a share; total value £131 million. Offer extended until May 3. Debs.' share price 34p

In a letter from Durney Debenhams reject the offer as inadequate and injurious to the quality of Debenhams' stores

In the letter Durney attacks the methods of U.D.S. in employing a market research team to interview Debenhams' shareholders (organised and advised by Hill Samuel) as 'unwarranted invasion of privacy'.

Only 1% of small shareholders were approached in this way which was quite normal in 1972.

Durney's accusation given wide press coverage; Hill Samuel's defence scarcely covered.

Durney visits different Debenhams stores to meet staff and customers

Debenhams issued formal rejection document plus the recorded 'personal message' from the chairman (see p. 18 ante)

In document: statement that £10 million worth of property development would yield annual rent of £1.75 million

Warned of impending rights issue by U.D.S. if they acquired Debs thus requiring cash

Praise for Debs' management and urges rejection

No profit forecast or property revaluation, but hint that sales and profits will ahead for the first 8 weeks of the current year cf. last year and promise of healthy future

U.D.S. induced to mail attacking letter signed, not by Lyons, but by Robert Clark of Hill Samuel, urging Debenhams' shareholders to ignore anything said by their management and criticising their ability.

In comparison with the record personally sent by Durney the U.D.S. response was reported in the press as "unimpressive"

Debenhams' share price below the offer price

Offer closes; too few acceptance for the bid which lapses with announcement by U.D.S. that there are no plans to make a future bid - which would require a higher offer price and would still be likely to be rejected by Durney

Durney writes to shareholders and in letter includes the profit forecast which was presumably held in reserve to counter a further increase.

Impressive forecast: £10.5 million for 1973 - a 20% increase; with rejoinder "I am confident you will not regret your decision to keep your shares" (£1973 pre-tax profits - actual - £12. million)
The focus in this connection is on the P.R. consultant and on his ability, in particular, to exploit incomprehension and indifference which are common characteristics of some private shareholders. Skilfully deployed public relations which highlights personalities and concentrates on the method of presenting information can in such circumstances, supercede financial considerations - the price being offered for the shares, and sophisticated technical arguments.

In any takeover bid, shareholders require some guidance. The complexity of the documentation in modern acquisitions alone means that it is no longer sufficient merely to communicate with investors. Rather, their exacting and very different needs have imposed upon the P.R. consultant an interpretative role whereby he selects the relevant information and presents it in a succinct form. Offer and rejection documents must appeal to the broadest strata of the shareholding. Thus the first judgement that the advising team relies on the P.R. consultant for, is to ensure that the issues being presented are understood; and this means that the contents will vary according to the shareholders. Following from this, it is possible to discern the second important quality - flexibility. In the U.D.S./Debenhams example, the shareholding remained uniform. During the G.M.H. bid for Watneys, however, the shareholding changed considerably. Towards the end of the protracted defence only the institutions were left, a fact suitably reflected in the presentation of the offer documentation. A third essential function is to control the timing of communications - deciding which material will have the maximum impact and when, and via which media it should be delivered. It should be added that although the P.R. consultants have increased in importance in the merger market, their task has also become more exacting. In particular the financial press pose a problem; for whilst providing the most convenient means of communicating and achieving publicity, they are also the most critical of methods and tactics. With so many reputations hinging on the successful outcome of takeover negotiations, the need for careful, but effective, use of the press becomes essential.
6.3 : The Voice of the Institutions

6.3.1 : The Emergence of Latent Power

A third institutional force in the mechanics of takeover bids arises from the voting power conferred by the investment resources which are controlled and owned from within the City. These resources have increased in recent years both absolutely and proportionately. Between 1963 and 1973, individual shareholdings as a proportion of total shareholding fell from 59% to 42%. The holdings by institutional investors (pension funds, insurance companies, investment trust companies and unit trusts) showed a corresponding increase from 25% to 41%. Moreover the trend is apparently increasing. Analysis of purchases of U.K. equities reveals that in the first 9 months of 1975, net new investments by the institutions amounted to £1.5 billion, whilst individuals disposed of £1.1 billion net. In percentages, the institutions increased their end-1973 stock of £15 billion by 10%, whereas individuals reduced their investments of £17 billion by 15%. More specifically, the pension funds have assumed a more powerful position. In the 10-year period to 1973, they increased their proportionate shareholding from 7% to 12%, and from January-September 1975 accounted for 60% of all institutional equity investment. Furthermore, the unprecedented merger activity in the U.K. since the early 1960s has concentrated still more power in their hands, as merged companies pool their pension funds.

Unless the institutions choose to exercise this power, it remains potential. Indeed until the late 1960s 'latent' was a very appropriate description of their ascendancy. For many years, the institutions avoided displaying their strength. They considered themselves to be investors and their expertise to be money-management. They showed no wish to involve themselves in the administration of the companies which they partly owned, complaining that they lacked the time and knowledge to act as industry's nursemaids or indeed its conscience.
A number of developments have militated against a continuation of this passivity however. First, the option of 'selling out' has declined as institutional investors have acquired greater control of British industry. The possession of such large equity holdings as now exist effectively prevents the possibility of disposal because of the resultant effect on the share price. Secondly, and as a consequence, City institutions appear to have realised that the only real sanction they have against poor management is essentially to persuade another company to undertake an acquisition. Thirdly, fund management has become generally more competitive, particularly since the diversification of merchant banks into the area and this has increased the pressure to apply force on company managements.

6.3.2 : The Emergence of Real Power : Takeover Bids

Apart from these specific pressures, it appears that a gradual realisation of responsibility to their own shareholders has induced the institutions to show more direct interest in industrial performance. Thus the emergence of their role as an important force in bid and merger situations is part of the much wider interest shown by institutional investors in British industry. In contrast to other changes in attitude, however, their intervention in the market for merger and acquisition promised a more immediate impact on the management of the companies involved.

When existing co-operation arrangements for investment protection among the associations representing the four main groups of institutions were formalised there were hopes for effective intervention. Although mergers and takeovers were ostensibly outside the terms of reference of the Institutional Shareholders Committee (I.S.C.) which was formed in 1973, it had an approach which, in spirit, could lend assistance to any institution finding it necessary to become embroiled in a public contest, as Midgely points out:
"... with the formation in 1973 of the Institutional Shareholders Committee, which represents upwards of one-third of all ordinary shares, the institutions have the potential to exercise control over most of the large companies, if they choose to do so. Furthermore, as in the case of previous use of power by individual investors or the separate investment protection committees, the new joint committee intends to work discreetly and without publicity, the approach considered to offer the best prospect of co-operation with company management."

The creation of the ginger-group appears to have been in response to the Green Paper to the proposed Companies Reform Bill (1973) and was seemingly as interested in freeing institutional investors from becoming 'locked-in' to their equity holdings as in improving City/industry relationships. Indeed it also reflected concern that the institutional investors were threatening the operation of 'competitive' securities markets.

Whatever the rationale, the need for a monitoring body appeared necessary, in view of the haphazard pattern of intervention which had prevailed hitherto. A former director of Keyser Ullmann, John Hoffmann, formed an advisory service for institutional investors to instruct them on how best to persuade the boards of companies to improve their performance. His motives originated from what he describes as the institutions' "... duty as a representative of an above-average shareholding ... to take the initiative and associate with each other to force action on inadequate management", and reflected the decisive and unpredictable influence that the institutions have had on the future direction of a company.

Since the acquisition by G.E.C. and A.E.I. in 1967, which was an important landmark in the development of institutional power, the institutions have taken considerably more interest in intervening in takeover bids. As implied, however, their intervention has often been quite unpredictable, and caused industrial and financial companies to become deflected from their expansion and diversification plans. The Rank Organisation was prevented from acquiring Watney Mann for example, although one institution in particular was instrumental in the takeover of Watneys by G.M.H. Similarly, Hill Samuel's plan to merge with Metropolitan and Estates Property Company (M.E.P.C.) to create a merchant bank/property holding company was thwarted due partly to
institutional conservatism within the insurance industry. Ironically, Hill Samuel's principal opponent, Prudential Assurance, acquired a 20% stake in Keyser Ullmann and then backed the merchant bank's takeover of Cental and District Properties in 1972. Institutional intervention also affected the outcome of Burmah Oil's planned merger with Laporte, Imperial Tobacco's bid for Courage and the P&O/Bovis takeover battle which is discussed in the next section. It should also be noted that the institutional shareholders of Vickers, led by the Prudential and Kleinwort Benson, and encouraged by Hill Samuel did act in unison to replace its top management in 1970; and in 1973 insurance companies and merchant banks brought sufficient pressure on Distillers for them to improve their compensation to the thalidomide children.

In summary, when the latent power has emerged it has often done so in an unpredictable fashion and with consequently varied results. Although the over-riding motive for intervention in bid situations might be expected to be price, the different needs of the various institutions are not conducive to consistent intervention. Institutional investors are clearly not an homogeneous group. Pension funds, for example, because of their tax structure, would prefer an acquiring firm (even if it is offering a slightly lower consideration) which is committed to a policy of cash dividends, to an acquirer which intends to distribute shares in lieu of dividend. Furthermore, even within a group of similarly based institutions, variations can arise in needs which become translated into different actions and decisions. In 1974, for example, it was reported that the Imperial Group pension fund had "a distinct penchant for cash offers where takeovers affect its portfolio."
6.3.3: Concentration of Power

The examples of institutional intervention are as yet few and far between. However, the proportionate rise in their equity holdings and the growing support for their active interest in British industry (both from within and without the City)\(^{63}\) suggest that, in the future, the institutions will become an important force. Thus it is important to consider not only how far the institutions are disposed to wield their power, but also who it is that takes the decisions to intervene. Two separate developments are relevant in this connection, both of which stem from the analysis in Chapter four. On the one hand, there has been a tendency for investment decision-making to be concentrated into fewer units. Investment trusts, unit trusts and insurance companies have all undergone a period of consolidation in which mergers and acquisitions have reduced the number and increased the size of individual units. Moreover, there has been a tendency for insurance companies, in particular, to develop a managed fund investment service for medium and large pension funds. While constituted as insurance companies, managed funds are effectively run as unit trusts and are open to tax-exempt pension funds. As such they represent competition to self-invested funds managed by merchant banks. The extent of their growth is indicated by figures for the total value of 'managed funds'; in 1973 it was £320 million; in 1976, £840 million, and before the end of 1977 it is expected to exceed £1,000 million. In March, 1976, 17 insurance companies were offering this service in the form of 35 different units, 33 of which have been established since 1971.\(^{64}\)
The second development is more disturbing for it raises a fundamental question of the merchant bank's role in mergers and acquisitions, and has wider implications for the competitive efficiency of London's capital markets. Specifically, it concerns the increasing incursion by merchant banks (and other financial institutions) into fund management. All the large merchant banks manage outside investment portfolios (as well as their own), although the emphasis placed by each bank on this activity varies considerably. For example, Robert Fleming has long specialised in portfolio management and holds a 26% share in Save & Prosper, Britain's largest unit trust management company, controlling assets of about £700 million; Baring Brothers holds a similar stake in the group. Whereas Hambros has recently achieved a public flotation for its life assurance subsidiary, Hambro Life. There are many other examples, which are detailed in chapter four.

It is seldom possible to make any quantitative assessment of the influence that merchant banks exercise in this way. With few exceptions, merchant banks prefer not to be associated with industrial companies as holders of the latter's equity capital. The cases where links of this sort are seen publicly to exist tend to be in the nature of small companies which merchant banks have colonized with the intention of promoting sufficient growth for a public flotation. Their power in this respect may be attributed to the position they occupy as the focal point of the City's power nexus - whereby they are the centre-point for mustering support among the institutions, as occurred in the Vickers incident. Concern at their involvement with the institutions and investment management, however has arisen because of the possibility of a conflict of interest which occurs because of their prominence as corporate financial advisers. This concern is summarised by the Panel on Takeovers and Mergers which was induced by critical newspaper comment, to study the situation in 1970:
"All the Merchant Banks and others concerned were involved in the possibility of some conflict of interest or of professional propriety in that they were all, to a greater or lesser extent, in possession of confidential information about the position of the particular companies to which they acted as corporate advisers, or on whose Boards some members of the firm might sit, whilst they were also engaged as investment advisers to pension or other funds or to individual clients whose investment portfolios they managed. In all cases, therefore, the theoretical or indeed actual possibility existed that information gained in the one capacity, as for instance about an impending takeover transaction or about some alteration in a company's affairs or profitability, could be used with advantage in the other capacity in advising a sale or purchase of securities.

6.4: Case study - The proposed merger of P&O and Bovis, 1972

The roles of and interactions between merchant banks, P.R. consultants and institutional investors are illustrated in the abortive merger proposal between P&O and Bovis in the Summer of 1972. The shortcomings of case study analysis are well-known, and it would indeed be misleading to draw any general conclusions from this example. However, the history of the financial sector, the development of its institutions and changes in its self-regulatory system of government have been influenced and tested by specific events such as this.

The merger proposal was launched at a time when the stock market was reaching its peak and large acquisitions were very much in vogue. The important events in the background and public stages of the bid are chronicled in Table 6.3; the following serves as a brief introduction. P&O were suffering from an out-dated management structure and were achieving a return on assets of less than 5%. Their chairman, Ford Geddes was a close associate of Lord Poole, a non-executive director and chairman of Lazards and welcomed his proposal to merge with Bovis, a fast growing construction company. The bid was extremely complicated and was expressed as a merger rather than an acquisition despite the disparity in the companies' sizes, owing to expectations of Bovis' future results. Initial terms valued Bovis at between £120 million and £137 million but negotiations centred on the proposed management structure rather than price, with Frank Sanderson, a proven property entrepreneur and chairman of Bovis being the chairman-elect of the new company.
First plans for the merger evolve. They were the design of the chairman of merchant bank, Lazar's, Lord Poole, who was also a non-executive director of both P&O and Bovis. The intention was to accommodate Bovis' expansion plans within a large group and simultaneously to eradicate P&O's out-dated management structure, partly by installing Frank Sanderson (Bovis chairman) as chairman of the enlarged group.

Initial negotiations implied merger rather than acquisition. Lazar's proposed an equity split of 35%-15%, but they were unable to specify which company's shareholders would receive the majority share of the enlarged group.

Morgan Grenfell & Co (both directors of Bovis) announced in a press release that it proposed to contact Independent Intervention of merchant bank unprepared.

Sanderson suggested a new formula whereby Bovis would receive 40% of the new group and P&O would receive a scrip issue of the same convertible stock (exercisable from 1974); P&O would receive a scrip issue of the same convertible stock but with warrants attaching, entitling them to buy new stock from 1977 onwards at 325p a share, some 50p above their previous high. This implied that P&O's shareholders would have to raise some £37 mn in cash to benefit from the deal - a sum in excess of Bovis' book assets.

Bid became public, apparently with the agreement of all parties concerned.

Lord Inchcape makes public his objection to the bid, revealing a board room division within P&O and implying that the votes of non-executive directors (both directors of Lazar's) swung the consensus.

EMR convened by Geddes in response to the opposition to the bid. Inchcape's bid and P&O apparently split to proceed. But bid documents delayed and did not appear for a further 21 days. In all some 9 weeks elapsed before the formal offer documents approved.

President announced in a press release, that it proposed to contact major shareholders in P&O on its own behalf, to examine jointly the merger proposals. MG's rationale = £1 mn of their managed funds were invested in P&O.

Press conference at which Lazar's stated that the merchant bank had valued P&O's ships on the basis of earnings power, irrespective of their Balance Sheet value. This reduced the contention that stock market price reflected the capacity of the enlarged group; the announcement considered by P&O financial staff as despicable.

Lord Poole resigned as chairman of the enlarged group.

Lord Poole, who was also a non-executive director

Inchcape's bid was recognised as bona fide bid by Takeover Panel, cf. MG's intervention as institutional shareholder rather than bidder. P&O forced to re-examine decision.

Lord Poole resigned as chairman of P&O; Lord Poole resigned as chairman of Lazar's who waived fee.

Lazar's motives impinged because of their dual role representation. Their intention was to withdraw from Bovis, being replaced by Barburgas and to be assisted independently by Williams, Olyn (MG) as advisers to P&O.

This was prompted by Bovis' forecast future performance. Lazar's made no allowance for P&O's £100 mn unutilised tax credits.

Apparent financial dead-lock. Neither side considered the deal acceptable.

The deal was accepted by respective chairmen, and merchant banks, and implicitly agreed by P&O board. In fact Lord Inchcape objected and so (silently) did five other non-executive directors. Geddes assumed conformity to majority decision.


This time lapse very important because it gave P&O dissenting directors the opportunity to harden their position and to extend beyond 1972. MG also sought adjournment of P&O's AGM, convened for Oct 12 to gain Board support for the merger, so that full consideration could be given to the proposal.

MG and Lazar's refused MG's request. MG put formal request to the Executive of the Takeover Panel that it should seek postponement of the EMR; this also failed and an appeal was made to the Full Panel when the case was once again rejected. MG's reaction = letter to P&O's shareholders urging rejection of the bid.

Against background of argument re. release of P&O's profit forecast which MG board dissidents were prevented from undertaking, Lord Inchcape, as chairman of Inchcape Group, backed by Barburgas (and with the promise of £60 mn in finance), made a reverse takeover bid for P&O, which valued the group at £210 mn. This bid equivalent to 25 times the value placed on P&O in previous Bovis merger discussions.

A hastily-arranged meeting between the 3 merchant banking advisers, interrupting proposals.

A new proposal arose and was presented to the Board.

By the new proposal, the ultimate P&O stake in the new company was raised from 40% to 60%; Bovis was valued at 475p a share, Lazar's tried to abandon the merger, but this was rejected by P&O and Bovis. Another alteration in the proposals resulted with Bovis' value increased to 510p a share. Refusing to accept the new proposal, it was agreed to proceed. Final EMR fixed for Nov 17.

Interview with Dr. Donald Anderson (co-chairman of P&O and Geddes' predecessor) published in Daily Telegraph, in which Anderson made clear his opposition to the bid and announced his intention to vote against the proposal.

At final EMR, proxies voted 5-2 against the merger proposal. Geddes resigned as chairman of P&O; Lord Poole resigned as chairman of Lazar's who waived fee.

The final and damaging intervention to the proponents of the bid.

The institutional shareholders were split equally. Thus private shareholders' votes had been decisive in defeating the bid.

Implications for development of Takeover Code particularly with respect to Rule 15 and General Principle 3 re. possession and dissemination of information. See Appendix and chapter 7.

See assessment; Inchcape's bid was recognised as bona fide bid by Takeover Panel, cf. MG's intervention as institutional shareholder rather than bidder. P&O forced to reveal more info. (profit forecast) and rearrange schedule

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The abortive merger between P&O and Bovis is important for several reasons. First, because it highlights the role and influence of the financial advisers and investors which are intimately involved in the mechanics of mergers. Secondly, because of its implications - for it prompted several developments which affect the conduct of intermediaries in takeover bids and the whole process of merger negotiations.

A number of fundamental questions, for example, were raised of the merchant bank's role in takeover bids. These were prompted by doubts about Lazards' motives in engineering the merger at the outset, and their later interpretation of financial data and analysis of the companies' respective markets which proved to be inaccurate. There were two notable shortcomings in the bank's calculations. One concerned the timing of the bid which was planned at the nadir of P&O's stock market and profit cycle without due allowance of the companies' relative valuations. More disconcerting was the inaccuracy of the profit forecasts upon which the terms were partly decided. Furthermore, the projections were believed by some members of the P&O board to be wrong; the majority of the directors, however, implicitly accepted the advice they received from their merchant banking advisers. Such reliance is a testimony to the high regard in which merchant bankers were held. Rather than justifying their right to such an elevated status, however, the outcome merely demonstrated their fallability. This was particularly significant, for the merchant banks claimed privileged access to information from which they asserted that the terms agreed were substantiated by the companies' relative prospects. The publicly revealed failure by a merchant bank to interpret correctly the material it was not required to release but to which it had a unique right, prejudiced the remainder of the merchant banking community and highlighted a basic injustice in respect of the availability of information. Changes in the Takeover Code, detailed in Chapter seven, have subsequently ameliorated the situation.
A second important development relates to the role of the institutional investor in bid situations. In this instance, the issues underlying Morgan Grenfell's unsolicited intervention on behalf of, but without the explicit support of, large institutional investors in P&O related to what extent major shareholders should become involved in takeover negotiations and what should be their status be if they choose to intervene. It is now clear that, before 1972 these were questions to which the City establishment had not addressed itself. The response was an attempt to formalise a mechanism for institutional intervention in takeover bids through the establishment of the Institutional Shareholders' Committee. With hindsight, the initiative of the Governor of the Bank of England might be considered an implicit criticism of those very institutions represented by Morgan Grenfell, for allowing the negotiations to develop in the way in which they did and for failing to notify P&O's advisers of their reservations to the proposal.

This seems paradoxical however, because effective institutional intervention was constrained by the Takeover Code which only recognised the importance of third parties where they represented potential counter bidders. Thus Morgan Grenfell's appeal to the Full Panel for more information and more time in which to consider it, was rejected. This indicated that a strict interpretation of the Code was of little use in the unprecedented situation which their intervention represented - that is where a third party wanted to open up new areas of debate. The distinction between third parties was highlighted by Inchcape & Co's bid for P&O. This was recognised as a bona fide acquisition proposal and forced the P&O board to reveal the profit forecast to which Morgan Grenfell and shareholders had not been granted access.

The bid by Inchcape & Co followed the split among P&O directors over the original terms of the bid. This was in fact first revealed by Lord Inchcape, the chairman of Inchcape & Co, but also a non-executive director of P&O.
Before the counter bid, it was apparent that the P&O board majority was able to exercise great control over how and when information should be released and presented to shareholders thereby making any opposition to the bid more difficult. The division within the board room of a bidding company was itself extraordinary and unprecedented. Apart from signalling more general opposition to the bid, it illustrated the role played by the P.R. consultants in engineering, not only Morgan Grenfell's intervention, but also the release of information regarding the opposition, for maximum effect. Press releases were timed just before significant events during the negotiations, particularly P&O board meetings, and attributable interviews with P&O executives were similarly scheduled.

The problems involved also illustrate some unresolved issues which are of general importance because they represent gross imperfections in the market for corporate control, and the contribution of the P.R. consultants in helping to overcome them. The problems centred around how dissidents can receive or present information when the initiative rests with others who have opposing sentiments. The continual refusal of the P&O board to release information or to submit to audit the 1972-73 budget forecast, hampered not only the dissidents but also left shareholders with insufficient, indeed often inaccurate, details upon which to make a judgement.

The solution, tacitly endorsed by the Takeover Panel, was to allow constant use to be made of the press by the dissidents leaking information of divided board opinion, and by the proponents emphasising that profit forecasts had been calculated by P&O's merchant banking advisers and were therefore reliable. A survey of small shareholders' opinions conducted by J. Walter Thompson, revealed the importance of press comment showing that the press was a more significant influence than stockbrokers and other investment advisers.
To summarise, the P&O/Bovis takeover battle, ostensibly one of the events which obliged the City to re-examine its Code of self-regulation, also had a wider significance. First, it marked some hardening in governmental attitudes towards the merger phenomenon; secondly, it illustrated the need for a more efficient exchange of information between board and shareholder. This is one major imperfection of the merger market - a market characterised by incomplete information and strongly influenced by the power of investing institutions and the aspirations of financial advisers and company directors.
1: A number of prominent merchant bankers originated from the legal profession: for example, Sir Robert Clark (Hill Samuel); Henry Fisher ( Schroder Wagg); Stanley Berwin (Rothschild); Philip Sherbourne (Drayton Corporation and now Draymont Securities)


3: Issuing Houses Association, Notes on the Amalgamation of British Businesses, (London, 1959); see chapter seven

4: Mr. F. Smith, quoted from R. Spiegelberg, The City - Power without Accountability, (Quartet, 1973), p. 70

5: The fees charged by merchant banks for acquisition advice are a matter for separate agreement between banker and client on each occasion; depending on size, a fee of between ½% and 1% of the consideration is not unusual. It was reported that Hill Samuel received £250,000 for the G.E.C. takeover of A.E.I. (H. McRae & F. Cairncross, Capital City / Eyre Methuen, 1973), p. 59)

6: Merchant banks may raise finance from their own funds; but are more likely to join a consortium of other financial institutions to provide the money, or to arrange for other banks to provide all of it.

7: It was estimated by Spiegelberg that the 400 directors of the Accepting Houses Committee held 2,000 other directorships; and that 36 of the U.K's largest 100 companies had a merchant banker on its board, Spiegelberg, op. cit., p. 65. Quite often the links that are forged in this way make it virtually impossible for the client to change his merchant bank without good cause. The recent economic stringency has, however, caused a number of industrial companies to abandon this sort of relationship for an ad hoc use of the merchant bank as financial adviser.

8: See note 7

9: McRae & Cairncross, op. cit., p. 59


11: ibid., pp 115-116

12: ibid., p 85

13: J. Kitching, "Why acquisitions are abortive", Management Today, November, 1974, p 82

14: See Sn 6.3

15: Many examples are cited in Spiegelberg, op. cit., pp 167-202
16: The extent to which merchant banks believe their reputations depend on the successful outcome of takeover bids (or the successful issue of shares) is reflected in the exhaustive investigations carried out beforehand; see R.J. Briston, The Stock Exchange and Investment Analysis, (Allen and Unwin, 1968)

17: **City Takeover Code**, Rule 16; see also General Principle 12

18: ibid., General Principle 6; see also rule 4

19: 1958 Prevention of Fraud (Investments) Act, Sn 14, 15, 16. It does not apply to a prospectus issued under Sn 38 of the 1948 Companies Act

20: **City Takeover Code**, Rule 15: "The offeror will normally be expected to cover the following points in the offer document ... 

(1) its intentions regarding the continuation of the business of the offeree company;

(2) its intentions regarding any major changes to be introduced in the business, including any re-deployment of the fixed assets of the offeree company;

(3) the long-term commercial justification for the proposed offer; and

(4) its intentions with regard to the continued employment of the employees of the offeree company."

21: ibid., Rule 16

22: This is particularly the function of the P.R. consultant; see Sn 6.2

23: **City Takeover Code**, General Principle 10

24: **City Takeover Code**, General Principle 5

25: Newbould discovered that directors of a victim firm who do not oppose a takeover bid may act for reasons of personal security. Despite this, relatively higher considerations were paid where there was some form of opposition from the directors. Thus it seems that managers did not always seek to secure the best terms for their shareholders (Newbould, op. cit., p. 59).

26: **City Takeover Code**, Rule 22


28: See Sn 6.2

29: According to Newbould: " ... on average the terms obtained by the shareholders in a victim firm when the directors of the firm did not oppose the bid are inferior to those obtained by shareholders whose directors were opposed to the bid in question" (Newbould, op. cit., pp 83-84).

31: See "Bankers as Brokers", *The Economist*, June 10, 1967

32: See Sns 6.3 and 6.4

33: City Takeover Code, Rule 12


35: Angus Grossart, Chairman Noble Grossart, quoted in *Sunday Times*, April, 18, 1976

36: *The Times*, April 9, 1976

37: *Financial Times*, April 9, 1976

38: Managing director, Chesham Amalgamations (merger brokers)


40: See Spiegelberg, op. cit., pp 22-23, for example


42: Survey undertaken by J. Walter Thompson; see Sn 6.4


44: Interview with the author, November, 1974

45: The complex jargon of modern financial techniques tends to give the impression that the City has a mystique which puts it apart from the everyday world. The need to simplify the jargon, explain the complexities and insist on an understanding developed in line with the calls for more public accountability for City professions. In recognition of the importance of the broadcasting media, the first positive moves were taken in late 1976 to establish a 'City Communications Centre' as a liaison between non-specialist journalists and broadcasters and City personnel; see B. Sharpe, "The City's Screen Test", *Bankers' Magazine*, October 1976

46: J. Addey, quoted in E. Bacot. op. cit., p.21

Financial journalism has stood in an uneasy relationship with the City. This is particularly apparent when ownership of the press is considered. Despite a section in the 1965 Mergers legislation devoted to the acquisition of newspapers (1965 Monopolies and Mergers Act, sn 8), S. Pearson owns the Financial Times, the Banker, the Investors' Chronicle and a substantial portion of the Economist. It also owns Lazards, the accepting house. Moreover, the company which publishes the Times and Sunday Times has included among its directors, Sir Kenneth Keith, of Hill Samuel and Sir Eric Roll of Warburgs; similarly Evelyn de Rothschild has been chairman of the Economist.

The case for radio and television as media for discussion is very much less good (than that for the financial press), both on account of the haphazard coverage and because of the lack of written record easily available to the public. Company directors and their advisers are therefore recommended to exercise great caution before accepting invitations to participate in such programmes." (pp 8-9).

The City Takeover Panel have made it very clear what it considers as the first and most important forum for discussion of takeover bids: The Panel on Takeovers and Mergers, Report of the Year ended 31st March, 1972: "The circular (addressed to registered shareholders) alone can ensure total and, as near as the postal services will permit, simultaneous coverage of the shareholding body. The circular has the additional advantages that it can be comprehensive, it can be read and (if not fully understood on first reading) re-read, it can be discussed with professional advisers and, finally, it is a document which unequivocally engages the responsibility of its authors and thus is capable of being used as the foundation of any later court proceedings." (p.8).

This is also evident from changes in the methods of industrial finance. In particular the trend towards increasing bank finance (with a move away from reliance on the overdraft towards medium term lending). U.K. clearing banks increased their firm commitments to lend medium-term from £1.5 billion in 1975 to £2.75 billion in 1976 (Budget speech, 1976), and have indicated that "... they are prepared to take a longer term view of their involvement with industrial and commercial customers." (Financial Times, July 2, 1976)
K. Midgley, "How much control do shareholders exercise?", Lloyds Bank Review, October 1974, p. 36; the bodies involved were the Association of Investment Trust Companies, the Association of Unit Trust Managers, the National Association of Pension Funds and the British Insurance Association. The Accepting Houses Committee and the Issuing Houses Association refused to participate, thereby excluding merchant banks from the group.


Quoted from ibid., p. 50

Prudential Assurance, Pearl Assurance and the Church Commissioners effectively assured G.E.C's victory.

Financial Times, October, 18, 1974

For example, see quotes attributed to Sir Charles Villiers whilst as managing director of the I.R.C. in Spiegelberg, op. cit., p. 51; more recently the Wilson Committee was established with the brief to examine the flow of capital funds for industry and trade, see Financial Times, January, 19 1977

Source: Willis Faber Advisory Services Managed Fund Investment Performance Measurement Service

The incursion by merchant banks into fund management was of sufficient extent, that by 1967 they were able to by-pass the stock market (The Economist, June 10, 1967); as they have grown and increased their investment business, it has become easier for them to match bargains in their own offices, arranging for one client to buy directly from another. The entry of clearing banks into capital market business (for example Barclays Unicorn) has caused concern that they might too easily use their position as short-term lenders to attract new capital issue business for their developing merchant banking subsidiaries at the expense of competitors.

In February 1976, the shareholders of S&P started discussions about a possible public flotation of the company. Other institutional investors in S&P are Atlantic Assets Trust, an investment trust managed by Ivory & Sime (26%); Bank of Scotland (11.7%); and Phoenix Assurance (5.6%)


The Panel on Takeovers and Mergers, Report on the Year ended 31st March, 1970; Appendix I THE USE OF CONFIDENTIAL PRICE-SENSITIVE INFORMATION, p. 10

70 : See for example, The Times (September 20, 1972); Glasgow Herald (September 20, 1972); Daily Telegraph (September 21, 1972), Source: John Addey Associates Press Cutting Service

71 : In 1973 nine mergers were referred to the Monopolies Commission; in the previous four years the total number referred was ten.
CHAPTER SEVEN

Control of the Merger Market

"The world will always be governed by self-interest. We should not try to stop this; we should try to make the self-interest of cads a little more coincident with that of decent people."


7.1: Protection of Shareholders' Interests

In its submission to the Bullock Committee, the Stock Exchange made the following point:

"The shareholders of a company bear the ultimate risk so far as the capital of the company is concerned and it is only just that they should retain the ultimate legal control of the company. To deprive them of full legal control while their capital in the company remains a full risk would be a serious erosion of their proprietorial rights."

Although this submission was made in a quite different context, its implications are extremely relevant to the question in hand.

Subject to the provisions of company law, the shareholder is regarded as being able to look after his own interests. Bullock's rejection of the views expressed above suggests that what legal rights the shareholder does possess will be curbed. Only in very restricted circumstances would it be possible for shareholders to propose resolutions at meetings. They would retain their right to veto proposals put to them by their board, as at present, but the entitlement of shareholders, controlling 10% or more of a company's equity to call for a meeting and put up proposals in a number of crucial areas would be removed.
In takeover and bid situations, the shareholder has been arguably at his most exposed and least protected. It is quite clear for example that U.K. merger policy is not specifically concerned with the protection of shareholders. As Sir Geoffrey Howe, the first Conservative Secretary of State for Trade and Consumer Affairs said:

"This may be a matter for company law. The City Code, also, is designed to ensure that bids preserve equity between one shareholder and another, that all relevant information is made public, and so on. But the fact that a bid may seem to offer a rather poor deal for the owners of the company taken over, or that the benefits may seem somewhat inequitably distributed, is not really relevant to the question whether the case should go to the Monopolies Commission".

Moreover there is now little credence in the argument that the takeover market mechanism itself provides a form of discipline on management by punishing a poor performance with a low share price, thereby attracting potential bidders. That management discretion still prevails may be witnessed by the ineffectiveness of this mechanism in that companies can continue with persistently poor performance for a number of years without attracting a bid. Furthermore, the major limited factor on management discretion is the degree of competition. Effective competition may be in the interest of shareholders, but management may seek mergers to move towards increased control of the market and to initiate fast defensive moves to preserve existing market and industrial positions. As Newbould has noted:

"... managers bring about mergers, because, basically, mergers are advantageous to managers. The increased control and safety inherent in a larger share of the market and in a larger firm is the advantage that has re-occurred ..."
The characteristics of this market also constitute a strong case for some kind of regulation. If there were no rules aimed at shareholders receiving equal treatment, then the bidder would escalate his bid so that the shares that took him over 51% control commanded a very high price. Since all shareholders would try to offer the shares that carried control, bids would get hopelessly "bogged down". There is also a case for extending protection to shareholders who either have an effective choice of being left in a minority or selling out and/or are unsophisticated in their dealing and have to rely on poor quality professional advice. In view of the doubts raised in Chapter 6, it is not feasible to consider that each individual is free to decide whether to buy or sell shares, and if he is not aware of the true value of his investment then he deserves no protection from the misfortunes of his ignorance.

7.2 : The Administration of the Regulation of Market Behaviour

The most convincing rationale for regulation of behaviour in the market has, not surprisingly therefore, come in the field of takeovers. As implied above, the free enterprise economy presents opportunities for the exercise of private entrepreneurial initiative; it also provides opportunities for exploitation and mismanagement, however. Thus it is expedient, for some form of supervision to ensure that individuals do not take unfair advantage of the freedom they have in controlling their own and possibly other peoples' economic interests.

7.2.1 : Background to the Code

It is not necessary for the purpose of the discussion to examine in detail the events which preceded and influenced the present Takeover Panel and Code. It is, however, illuminating, to consider briefly the nature of the problems which the system has been designed to solve and the circumstances which formed the background to current thinking.
The first general point is that it was a very long time before the City felt the need to establish any kind of organised and active control over takeover tactics. In London, the Stock Exchange had established a long tradition of supervising the market and using its influence over the companies which required a market quotation for their shares to press for an even greater degree of disclosure of information to shareholders. For a long time it has been able to boast that in this respect, control of the securities market has been in advance of the law. But it was not until the late 1960s, that the City felt it necessary to begin the creation of rules to govern its own activities in the context specifically of takeover bids, and recognised the need for specific rules to control its own members.

The reasons for this long delay and the eventual form which the regulation took lie deep in the psychology of the City's establishment. At its extreme, this took the form of firm resistance to any interference in the activities of the City, the resentment of any publicity given to its operations, and the conviction that what the City does is its business and its business alone. This attitude has by now largely disappeared, and even the most traditional merchant banks, for example, have accepted the need to create and maintain good relations with the press and other outsiders. More rationally, however, the traditions of the City encouraged the belief that within the gentlemanly traditions of the City establishment, no regulation apart from self-regulation could be needed. Beyond providing the minimum of protection against fraud and against the unavoidable mishaps which were bound to happen in a competitive climate, the City's professional ethics should leave no room for the kind of sharp dealing which would require strict control. Against this background it has taken a long time to understand that the problem, not of honesty but of protecting outsiders (specifically shareholders) against the effects of the City's own activities, was an issue of quite a different nature - one which would require its institutions to subject themselves to a strictly enforced code of practice.
The second main point, is that it has been only a very small number of major cases which have brought the issue to a head. Perhaps half a dozen prominent takeover battles, contested in public, established the need for regulation. Out of all the merger and takeover activity witnessed in recent years, only in these few cases did the scandal reach proportions which attracted public attention. In these major arguments, the issues became too clear to be ignored. They were sufficient to make the City realise, in the first instance, that some kind of rules would be necessary to govern its conduct in bid situations, and secondly, to reassure the Labour Government that confidence in the City required not merely a set of rules, but in spite of the City's traditions, somebody to enforce them and enough power to ensure they were observed.

Finally, from this experience it is possible to identify the nature of the problem which the present system is designed to cope with. It is this background - and the general experience of the merchant bankers who have taken the main responsibility for writing and enforcing the code of conduct - which has determined the nature of the Code and the form of the operation of the Takeover Panel.

Acquisition and merger activity is of course only a microcosm of the nation's commercial life. Nonetheless the issues involved and the fact that takeovers provide eminently readable copy for the financial press have recently given this field of study greater currency and more far reaching implications than could hitherto have been considered possible. Thus, the problem of the securities market is not confined to the control of takeover bids. But it is in the context of contested and protracted battles, where large amounts of money and many personal reputations are at stake, that the issues are raised in their starkest form. Winning and losing become as important as the merits of the offer; decisions which may vitally affect the outcome are taken on the spur of the moment.
In the outstanding cases, the issue appeared largely as one of tactics - manoeuvres adopted in takeover situations which could win or lose a battle without reference to the merits or shortcomings of a particular proposal. The arguments highlighted two equally undesirable characteristics of the merger market in the late 1950s. One stemmed from the merchant banks' free interpretation of the traditional lack of restraint. They allowed themselves to deviate from implicitly accepted standards of conduct by entering into public quarrels where professional disagreement gave way to open belligerence. The second, arose partly because of the actions of the merchant banks which not only offended a general sense of fair play, but also led to decisions being taken without reference to the main body of shareholders. This erosion of shareholders' rights was well illustrated in the so-called Aluminium War of 1958, one of the principal events which brought the property and ethics of the City into question. The technique pioneered in the British Aluminium case, was that of a company frustrating an unwelcome bidder simply by issuing new shares to a favoured third party. This example provided the simplest form of this manoeuvre, where, without the prior knowledge of shareholders, the Board was able to propose the issue of enough shares to give Alcoa a one-third interest and block a joint bid from Reynolds Metals and Tube Investments.

Following the resolution of the Aluminium War, the questioning of City behaviour prompted the Governor of the Bank of England to summon the representative bodies of the merchant banks, investment trusts, insurance companies and London clearing banks, together with the Stock Exchange to form a working party. What resulted were the first guidelines - issued in 1959 - on how to behave in takeover bids - the so-called "Notes on Amalgamations". The key principle was quite clear, "that boards must at all times bear in mind the interest of all the holders of all the respective classes of share and loan capital of the companies, according to their respective rights." They were vague in expression, reflecting a determination not to interfere with the freedom of the market; there were no detailed points of procedure, no machinery to ensure that.
principles were observed and, above all, no sanctions against those who infringed the principles. Nevertheless, they marked for the first time the recognition that takeover tactics required guidance and that shareholders had a right to justice.

Another major theme apparent in recent arguments - that all shareholders should be treated alike - was also brought out early in the Richard Thomas and Baldwin bid for Whitehead Iron and Steel in 1963. R.T.B., advised by Rothschilds, assured its success against a rival bidder, Stewart and Lloyds through a market operation which guaranteed institutional investors the full value of R.T.B's subsequent bid, but left the minor shareholders to their own devices. This led directly to a revision of the Notes which for the first time established the evolving principle that a bidder who buys shares in the market or through a deal with a large holder is bound to offer similar terms to all shareholders. The main procedural point introduced in the revision was that a board should conduct its attack or defence in the best interests and full knowledge of shareholders.

A new wave of discontent was sparked off in 1967, when, in the course of two takeover battles, the rules were ignored. In one case, Aberdare Holdings had already established control of Metal Industries, (MI) with the help of 19% of the latter's equity purchased from Morgan Grenfell who had been buying in the market; but this control was destroyed by M.I's agreement to buy a subsidiary of Thorn Electrical in exchange for a substantial share issue - and the deal, conditional on the success of a Thorn bid for M.I. was evidently only a paper transaction. The other bid was between Courtaulds and Rodo Investment Trust for control of Wilkinson and Riddell in which Courtaulds paid more than 4 times the final bid price for shares on the market for the shares which guaranteed them control.
7.2.2 : The Takeover Panel and Code 1968-76 - Development

By 1968 the City's battles had become so conspicuous as to attract the attention of the Prime Minister as well as City authorities themselves. Thus, under threat of legislation a meeting of City institutions produced a new Code of conduct in 1968\(^{10}\) with the backing of the Bank of England and involving the establishment of the Takeover Panel, to supervise its operation and administer its rules. Since its inception the Code has been revised four times, and now contains 14 general principles, 39 detailed rules and 9 practice notes.\(^{11}\) There is little point in detailing the Code - it provides the basic guidance needed for all participants in takeover situations, the companies, their advisers, the stockbrokers concerned directly or indirectly, and the associates of all of these. Its revisions have reflected changes in market behaviour and difficulties in the interpretation of rules.

The objective of this section is to assess the efficacy of the Code and the authority of the Panel. This is perhaps best achieved by examining briefly the particular problems that have arisen and how effectively they have been dealt with. As an introduction, it should be stressed that the Code is not a binding document in the legal sense. It was created by a group of merchant bankers whose experience in takeover negotiations contributed to the drafting. It is designed not merely to cover the market tactics of companies and their advisers during bid situations, but to cover all aspects of their dealings with shareholders. It includes, for example, detailed provisions to govern the techniques of profits forecasts - an aspect of the takeover problem which had not been conspicuous in the particular battles culminating in regulation - but which had repeatedly caused retrospective trouble through the over-enthusiasm of company boards in the course of numerous unreported battles.
Its success must be determined by its acceptance as a fair and reasonable code of conduct by those who know how they ought to behave anyway. The nature of the Code has been a compromise between, on the one hand, the desire for freedom and flexibility, and, on the other, the need to ensure that the ethics and reputation of the City as a whole are seen to be questioned. Its approach is perhaps best indicated by the important first general principle, which enjoins all participants in bids to observe the "spirit", as well as the "letter", of the principles and rules. The City which created the Code for the City, should understand that tenet quite clearly.

7.2.2.1 : 1968-69 Problems

At the outset, the Panel were faced with a clear pattern of problems which, with variations, lay behind the public scandals of 1958-67 and behind those too which followed during its experimental first year. In general, simply by existing, the Code was designed to reduce the acrimony between competing companies which it had been shown could arise in bid situations - and which, to the City's concern, could be carried over to their merchant bank advisers and destroy the carefully cultivated image of the City's civilised aristocracy. It had been seen in the first battle, for British Aluminium. It reached its peak after the new Code in 1968 with the outburst of Sir Frank (now Lord) Kearton at several of the leading City institutions in particular, and the press. His complaint arose directly out of the first public efforts made by the Panel, which criticised Courtaulds and its advisers Hill Samuel for its conduct in the battle for control of International Paints.

Three specific issues figured repeatedly in takeover situations during this early period. The most conspicuous was perhaps the technique of a company frustrating an unwelcome bidder simply by issuing new shares to a favoured third party. Some examples of this practice have already been cited but the one which completed the demise of the City's first attempt
at creating a workable system of control was that featuring the successful attempt by the News of the World to defeat an unwelcome bid from Pergamon Press.

The second issue, also unforeseen in early attempts at control, is the fundamental question of equal treatment for all shareholders, and covers both the now outlawed practice of paying special terms to gain control of large single blocks of shares and the question of the price paid for normal purchases through the market. It was at the centre of the Whitehead Iron case (1963), arose in the Courtaulds - Wilkinson and Riddell incident (1968) and figured in the American Tobacco partial bid for Gallaher, also in 1968. American Tobacco had offered for half the Gallaher capital; its acquisition of shares was noted because institutional holders were able to sell the whole of their holdings at the bid price whereas other shareholders could only sell half. The incident resulted in public criticism of the merchant bankers and the brokers involved, Morgan Grenfell and Cazenove, by the Panel. It also brought direct intervention by the Governor of the Bank of England. But neither of the City participants suffered any punishment.

Finally, there was the issue which is central to the problem of control in the wider context of the securities market as well as takeovers, which is still exercising the Panel and which perhaps will never be brought under complete control; the problems associated with market dealings during a bid. By leaving the market deliberately unfettered, the Rules leave the way open to activities which are the most difficult to subject to control. In the News of the World case, by the time the Panel stopped dealings, enough votes had been secured to ensure success.
In summary, it is apparent that on a few occasions, the system was found to be lacking in the sense of being unable to control powerful City and industrial interests. This was perhaps for two reasons. First, the constitution of the Panel was weak because it was given no "sanctions" - no power to punish transgressors. Secondly, even after the City had accepted the need for a Code of Conduct, it still basically rejected the idea of its activities being controlled in this way. The Panel was weak, because its position was weak.

This made it possible for the Panel's decisions to be openly questioned and its authority to be put in doubt during the Gallaher affair. The Panel used its main weapon of public censure, on Morgan Grenfell and Cazenove, over their handling of the American Tobacco purchases of Gallaher shares which clinched the bid. But these two institutions stated in public that they disagreed with the Panel, and neither the Stock Exchange nor the Issuing House Association, the two professional bodies concerned, showed complete conviction in their support of the Panel.

7.2.2.2 : Revision of City Code and Reconstitution of Panel 1969

The incidents cited above were the major causes of changes instituted in early 1969. These removed, it seems, the weaknesses which afflicted the City's first attempt at policing takeovers through the Panel. The main developments fell into three groups. First there was the revision of the Code itself. This was limited to strengthened control over profit forecasts in bid situations. By restricting to one year, the period for which forecasts could be made, it was intended that a main defensive weapon could be retained, without the problems arising from long-term enthusiastic forecasting. Furthermore, the accounting profession, in its manifestation as company auditors, and merchant banks, as financial advisers, were persuaded to put their names to the bases on which forecasts were prepared by the companies concerned.
Secondly, there were changes made to the constitution and methods of the Panel. Day-to-day administration of the Code passed to a newly established full-time Director General reporting directly to the Chairman, and an appeals procedure was instituted. With this change the full Panel adopted a supervisory function. Its rôle was to consider progress reports and questions of policy at routine quarterly meetings, and to hear, usually at ad hoc meetings, appeals against rulings of the Director General, disciplinary cases and cases of "exceptional importance". The appointment of a full time official was extremely important because it enabled the Panel to build a reputation for dealing quickly with enquiries, and for acting rapidly and decisively to avert an impending problem. In effect the Panel became able to match the merchant banks themselves in speed of decision and action, and in tenacity. The personalities chosen as Director General have since been important as well - three of the four have been experienced merchant bankers, presumably familiar with all the details of merger negotiations and the available tactical manoeuvres.

Thirdly, changes were made in the relationship between the Panel and its sponsoring bodies, the City institutions. Thus for the first time, the Panel was able to use against any offending bank, broker or other institution whatever disciplinary powers were available to the appropriate professional bodies and the Board of Trade. While providing sanctions to deal with opposed and apparently irreconcilable points of view, it also required for the first time a public commitment to the principles of the Code by the whole of the City, including the institutional investors, and in effect by the whole of industry and commerce.
These changes apparently strengthened the authority of the Panel and two events in 1969-70 reinforced its position as the chief arbiter of City takeover tactics. The first, the Leasco bid for Pergamon, in particular, established the authority of the new Panel and its executive. It was the first instance in which the Panel was called on to adjudicate an issue which attracted constant publicity and which involved well-known personalities as well as utterly opposed interests. Terms were agreed, but with Leasco having purchased in the market some 38% of Pergamon's shares, mainly from investment trusts managed by Robert Fleming, the bidder retracted. This was because of Pergamon's unrealistic profit forecast and their reticence in releasing more detailed financial information.

The Panel, faced with technical breaches of the Code, attempted to arrange a conciliation, and set up through the Board of Trade, an investigation to discover the precise state of Pergamon, part of the problem which was outside its own area of responsibility.

Despite the acrimony, the Panel's reputation was strengthened by the dispute. Most importantly it showed that it represented a tenable framework for conduct and quasi-law in the City. The Leasco-Pergamon battle was not, of course, a typical problem and was less important for the development of the Code and the philosophy of the Panel than the numerous other less publicised cases in which it was involved. However, it was also significant for its implications. First it highlighted the incidence of insider trading and focussed attention on the merchant bank which acted as investment manager on the one hand, and corporate financial adviser on the other. Secondly, it made the accountancy profession realise that reform of their standards was needed.
Perhaps more indicative of the change in the atmosphere in the City as a result of the Panel's constitution, was the case involving Kleinwort Benson acting on behalf of Trafalgar House in the battle with Bovis for control of Cementation. This was a straightforward problem of interpretation of one aspect of the Code - which provided a contrast with the experience of the Panel in 1968 when it was put in the position of having to criticise a merchant bank. The problem arose out of Kleinwort's purchase for cash of a block of shares in Cementation which had been built up in the market by Samuel Montagu, acting for Bovis. When Bovis withdrew its offer, Kleinwort acquired Montagu's shareholding on behalf of Trafalgar House. The Panel executive ruled that the purchases made by Montagu through the market (when the opportunity to sell was available to all holders of Cementation shares) was quite different to buying a single critical block from a single holder, as Kleinwort had done. Under General Principle 8 of the Code the executive ruled that Kleinwort should make a similar cash offer to the rest of the Cementation shareholders. Kleinwort disagreed and appealed to the full Panel against this ruling. The Panel supported the executive, and, in contrast to the arguments which had followed the Panel's censure of Morgan Grenfell in 1968 - Kleinwort accepted the decision.

7.2.2.3 : 1970-1976

The problems which greeted the first panel in 1968, the subsequent changes, effected in 1969 and the authority which resulted were the major elements in the formative stages of this system of self-regulation. That voluntarism has prevailed ever since owes much to these early developments which, together with the threat of legislation, have established a high regard for the Panel's self-governance. The revisions in the Code, in 1972, 1974 and 1976 were made because of particular difficulties in the interpretation of the rules in previous editions.
Two new rules were introduced in order to deal with two types of transaction which did not appear to be specifically, or even by implication, covered by the Code as it then existed. The first made it obligatory for an offeror with a paper offer outstanding to provide a cash alternative in cases where his offer is accompanied or preceded by large cash purchases; the second, brought within the scope of the Code any series of purchases (or other acquisitions) of shares, however gradual, which causes a change of effective control.

There followed a general revision of the entire Code in February 1972 which represented the experience of the principal City bodies as well as that of the Panel gained in the three-year period following the publication of the previous edition. Few fundamental changes were in fact instigated. Particular problems presented themselves, however, in respect of so-called "shut-out" bids - those transactions which are only announced after the controlling shareholders of the target company have already committed themselves to the transaction. Thus, controlling shareholders (quite probably company directors) may effectively commit their company to a bid from an offeror of their choice. The re-statement of Rule 11 required controlling directors to obtain the consent of the Panel executive regarding shut-out transactions, and expressed the concern of the Panel that public shareholders' legitimate interests could be subordinated to the convenience of controlling directors, which could in some cases lead to a choice being made by them which is not purely related to their capacity as shareholders.
b. 1972-1974

As new techniques evolved, further revisions of the Code became necessary. Several cases before the Panel in this period exposed a number of difficulties of interpretation of the 1972 edition of the rules. Thus, an amended version of the Code was published with effect from June, 1974.

The most important amendment (embodied in Rule 34) was:

"to require that a general offer should be made when a person (together with persons acting in concert) acquires shares carrying 30 per cent of the voting rights of a company or when such persons, already holding between 30 per cent and 50 per cent of the voting rights, increase their percentage of the voting rights by more than 1 per cent in any period of twelve months."  

The offer was to be in cash and conditional upon the receipt of acceptances resulting in more than 50% control of the company. The principal and beneficial effect of this new ruling was two-fold; first, it eliminated the problems arising from the distinction between purchases from selected sellers and general market purchases, and secondly, it established 30% of the voting rights of a company as effective control for Code purposes in virtually all circumstances.

Another amendment in the form of Rule 35 sought to prevent companies being under prolonged or permanent siege. In essence it provided that an unsuccessful offeror must not purchase shares during the twelve months following the close of its offer if it would thereby become obliged to make an offer under Rule 34.

The final significant amendment reflected the hardening of political attitudes to mergers and acquisitions during the period. A specific condition is now required in cases falling within the statutory provisions for possible reference to the Monopolies and Mergers Commission that the offer will be withdrawn if the case is referred to the Commission.
c. 1974-1976 : The Present State of Takeover Control

At the time of writing, the control over the merger market exercised by the City is represented in the City Code which was revised in April, 1976. Overall, very few fundamental changes were instituted, indicating the satisfactory working on the 1974 Code in a period of very little takeover activity. Most of the changes in the latest edition have the effect of making the rules rather less restrictive, which, in the light of some recent developments may be regretted.

The most important changes relate to the easing of conditions for launching partial bids which recognise how common such offers are in other markets, particularly in the United States; and the removal from the purview of the Panel, offers for companies not resident in the U.K. even if the shares are listed on the British Stock Exchange. Elsewhere, the rule which banned shut-out deals between directors and a prospective bidder without the Panel's consent was amended so that this type of sale (triggering an obligation for the buyer to bid for the balance and effectively ruling out an alternative offer) no longer needs the Panel's consent. Instead, new safeguards were implemented requiring arrangements between directors and the bidder to be disclosed. Another specific change relates to additions to large stakes (Rule 34). Increases of 2% rather than 1% may now be made to existing large share stakes (in excess of 30%) without the holder having to make a bid for the rest of the shares. Finally, and in response to the P&O/Bovis battle, the views of the dissenting directors must now be given to shareholders if a board is split on an offer.

The remaining alterations concern insider dealings and the imposition of greater reliance on merchant banking advisers. In respect of the former, the ban on stock market dealings by insiders is explicitly extended to close relatives of company directors, staffs and other people concerned. In the context of a Code dependent upon Voluntarism, it was considered that this could be best achieved by more detailed secrecy guidelines listed in Rule 30. Regarding the merchant banks as
advisers, it was made obligatory for boards to seek independent advice on all takeover offers, and, furthermore, new emphasis was imposed on bidding companies to make certain first that the necessary finance is available. The obligation was extended to the merchant banks advising them.

The last amendment, in common with some of the earlier changes to the Code, referred directly to a case in hand. This was the protracted struggle for control of Ashbourne Investments. From the saga which lasted more than two years, clear guidelines for merchant banks emerged from the Panel's published report and were included in the revised edition of the Code (Rule 18). Although releasing Ashbourne's advisers, Brandts, from any obligation to observe its original agreement to finance part of the offer, it was made apparent that financial advisers entering into similar arrangements would find themselves under such an obligation. In its report, the Panel stressed that merchant banks are under "a very high and strict duty" if they give assurances as to their client's financial capacity to complete a takeover offer.

7.2.3: The Operation of the Panel - Assessment

This section focuses on the performance of the Panel and the evolution of the Code to date, and concentrates on those aspects which seem important to the future development of a voluntary system of control. First, its method of operation. Even cursory observation of the Panel's Reports reveals that it was in the context of the very large number of less conspicuous bids involving a mass of mundane work, that the Panel's authority was established and its views became respected.
Table 7.1 gives an indication of the volume of business handled by the Panel executive.

Table 7.1: Takeover Bids with which the Panel Executive was concerned

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<tr>
<td>Successful bids</td>
<td>239</td>
<td>184</td>
<td>231</td>
<td>214</td>
<td>163</td>
</tr>
<tr>
<td>Unsuccessful bids</td>
<td>37</td>
<td>47</td>
<td>60</td>
<td>36</td>
<td>36</td>
</tr>
<tr>
<td>Proposals withdrawn</td>
<td>29</td>
<td>35</td>
<td>43</td>
<td>32</td>
<td>20</td>
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<td>before issue of documents</td>
<td></td>
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<tr>
<td>Minorities/</td>
<td>87</td>
<td>65</td>
<td>93</td>
<td>106</td>
<td>67</td>
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<td>Preference Issues</td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>Total</td>
<td>392</td>
<td>331</td>
<td>427</td>
<td>388</td>
<td>286</td>
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In the 1970 Report, it was further revealed that, in one way or another, some 80% of the total number of bid proposals were the subject of consultations or Panel enquiries. The majority of these activities involved minor points and would have meant a telephone call or perhaps a short meeting at the Panel's offices. However, while subsequent reports contain no reference to the proportion of cases involving the Panel, the point is clearly represented by the 1969-70 period in which the Panel was consulted in a high percentage of bid activity, and it was in this way that its presence was most strongly felt. As a result of these operations, the principle was firmly established that the Panel executive should be asked in advance whenever a company or its advisers were in any doubt about their plans.
On the one hand, it has become accepted to approach the Panel informally; on the other, the Executive, for its part, has used its own initiative to intervene in cases where it foresees problems. Its members have gained experience of the likely difficulties, and the circumstances which can be presumed to give rise to them. In effect then the Panel has attempted to work by prevention - acting in the early stages of bid situations to anticipate trouble. It would be hypothetical and thus invalid to compare the situation with and without a Panel (or indeed to contrast self-regulation with some form of legally enforced administration), however, the fact that between 50% and 60% of takeovers have proceeded smoothly may be attributed at least in part to the Panel.

Second, the need for quick and irrevocable decisions was facilitated by the operation, constitution and philosophy of the Panel. Flexibility is an essential pre-requisite and one promoted by service of the kind given by the Panel with the emphasis, not of creating a precedent, but of regarding each case uninhibitedly on its merits. Flexibility also allowed the Panel to adopt a heuristic approach - seeking to reflect contemporary standards of acceptable behaviour. Thus the principles detailed in the Code have been continuously developed as a result of the Panel's experience in interpreting those principles in relation to actual situations.

To summarise, the Takeover Code and Panel were born of a need to bring order to the negotiation of acquisition and to "legislate" so as to preserve a sense of equity for all involved. In the eight years since inception, the Code has been subjected to many changes to achieve its purpose. Its main contribution which, in turn, has been dependent upon the flexibility and method of operation adopted, has been to produce a more just system of arrangements for the conduct of takeover negotiations. In the process of evolution, the Code and the Panel have been the topic of criticism from a number of sources: from those who feel that a gap in the Code's provisions has affected them adversely; from observers
who consider they have the answer to the Code's apparent failings; and from those whose political suasion dictates that they should reject a system of self-government which the takeover regulations represent.

Referring specifically to failings and weaknesses in respect of takeover administration, the most serious criticisms are levelled at the sanctions which the Panel can impose. These stem from its quasi-judicial status and the voluntary nature of the system from which its advantages also arise. It should be impressed that its authority depends on the retention of confidence in the nature of the system and in the operation of the Panel within it. Thus its success ultimately requires the support of industry and commerce as well as just that of the City. In particular, though the ability to exercise its authority—that is to punish transgressors—depends upon the general acceptance by City institutions and their representatives of the body set up to monitor the code of conduct which they helped to create. It works best through prevention; the sanctions may represent a useful stick to wield but when they have to be invoked then the Panel can consider itself to have failed.

Nevertheless, sanctions have been imposed, and it is these which have attracted criticism, together with the more general concern that the Panel has no legal authority and therefore no "teeth". Of the first of its two main sanctions, that of public censure, critics might refer to the "gentlemanly nonsense" of public reprobation. This argument is best countereed by the first director-general of the Takeover Panel, Mr. Ian Fraser, who, in 1972, crystallised the delicate nature of merger and acquisition business:

"A public censure, in a community concerned largely with the intangibles of credit-worthiness, reputation and goodwill, results in an immediate diminution of this class of asset. The public censure will only cease to be effective when members of the financial community are no longer concerned about their intangible assets." 25
Other criticisms are better founded and more serious. They are best understood in relation to the main initial purpose of the Code; the protection of the interests of shareholders. There are two aspects to the issue. Firstly, suspension of the shares of a company involved in a takeover situation may harm the very group whose interests it is trying to protect. Secondly, in those cases where the Panel was forced to report, shareholders have apparently not fared well. In the Leasco-Pergamon case, the compromise solutions evolved by the Panel with the two parties concerned quickly vanished. In spite of the Panel's efforts, which earned it much praise, shareholders were left with a share quote suspended for months and their hopes of eventually receiving a bid dependent on the outcome of lengthy negotiations. Similarly, in the recent Ashbourne report, the Panel's statement while giving a clear guide-line to merchant banks was of little practical importance for the long-suffering Ashbourne shareholders. Both instances relate back to the earlier general criticism regarding the weakness of a panel that attempts to operate without statutory backing.

Finally with respect to sanctions, a well founded criticism concerns the scope of deterrents available to the Panel. The most serious omission appears to be the use of fines for fraudulent misconduct. This effectively leaves a gap between severe censure or in its most extreme form a request for the expulsion of an offending firm from its professional association, and a warning not to sin again. In this connection civil penalties for misconduct might be instituted (along with fines) to prevent the fraudulent from exercising functions which put them in a position of trust in charge of other people's resources.
The implications of this suggestion, introduce a different, yet relevant aspect of concern. To grant merchant bankers and other financial advisers the almost unimpaired right to continue in practice, albeit with rather more care, singles out the City community as special, different and above the law. Thus it effectively creates one standard of morality for its members and another for those outside. Moreover it provides general criticism of the whole concept of self-policing of the securities markets—a system which can apparently show a party to be guilty, condemn it and then effectively grant an unconditional reprieve. This line of criticism gathers strength when one considers the personalities involved on either side of the quasi-legal fence. It has been claimed that merchant bankers are in the best position to judge the conduct of other merchant bankers because from experience, they understand the pressures and devious tactics available to the aggressor and defender. Yet a sense of injustice inevitably persists. Why should poachers turn gamekeepers? Is the Takeover Code a charter for merchant bankers?

On practical grounds, the acknowledged expertise in the conduct of takeover negotiations is necessary but hardly sufficient to qualify merchant bankers for a role in which they are required to act as judge and jury. On moral grounds, the City is answerable to itself for its behaviour. But while one element is attempting to maximise the efficiency of the funds at its disposal, the other is attempting to safeguard the interests of shareholders who may be reduced to pawns in the process.

A final point which arises indirectly concerns the piecemeal approach to the revision of the Code, which has been substantially changed on four occasions in just eight years. This has been praised as showing appreciation of the need for flexibility and readiness to respond to changes in market behaviour. However, merchant bankers have been credited with ingenuity, adaptability and foresight. Is it likely therefore, that they would be so surprised by unanticipated behaviour that amendments to the rules were thought necessary? Could it not be that by effecting changes to improve
interpretation of the Code they were in fact doing no more than was absolutely necessary at the time? This would achieve two important aims: firstly, it would display a visible interest in the form and suitability of the controls, while secondly, it would not obviously offend those whose activities they were designed to curb.

7.2.4 : The Need for Legislation?

The principal objective of any regulatory authority in this field must be to maintain a securities market in which shareholders and potential shareholders have confidence that when they deal with their investments they will receive equal treatment. Equity between shareholders must exist and be seen to exist and it must be possible to carry out transactions with speed and certainty. Since a takeover bid is a special situation for the securities of a listed company, it is essential that the highest ethical standards of conduct be maintained by those engaged in such transactions. Moreover, since the law regards a company as belonging to the shareholders, control must be primarily concerned with the protection of the interests of the shareholders.

In consequence, it may be postulated that the emphasis in a system of control will be on three principles:

1. That there shall be equity between all shareholders of the same class

2. That 'control' of a company has a value in itself and the 'control premium' should be shared by all shareholders - and that, therefore, control should not be acquired by "stealth" or by discriminatory purchases

3. That all shareholders shall have sufficient information and sufficient time to arrive at a decision on the merits of an offer and that nothing should be done meanwhile by directors of the offeree company (or by others with a commercial interest in the outcome of the offer) to frustrate the offer.
Historically, restraints on City behaviour have essentially rested on what is implicit than what is explicit. The values of personal and collective integrity and honesty have been promoted as satisfactory alternatives to detailed regulation. Any rules, so far as they have been explicit have tended to be de minimis. The desire of the authors and the executors of this system of quasi-law has been to retain flexibility and yet ensure equality of treatment, and to steer a middle course between laissez-faire and institutionalised capitalism.

Of course, City institutions have to operate within the broad framework laid down by legislation - the Companies Acts, the Prevention of Fraud Act and a number of other laws which impinge, in varying degrees, on the conduct of the financial community. The object of the voluntary system, however, is to extend beyond this - to enforce a higher standard of conduct in takeover transactions than is required by the various statutory provisions. Thus it has an underlying philosophy that in merger negotiations, good business standards and ethics impose wider duties and responsibilities on directors, financial advisers and shareholders than are imposed by the general corporate law; and indeed which the law, because of the myriad situations arising in takeover transactions, would find it impossible adequately to define and impose.

The role of the Panel, is, therefore to supervise and enforce through the Takeover Code, a pattern of behaviour in takeover bids which keeps to a minimum the opportunities to abuse access to privileged information. No set of rules, however extensive, could cover all the various circumstances arising in the transactions and, accordingly all parties to a deal are enjoined to observe the "spirit" of the Code - a spirit which insists on fair dealing and equity as between shareholders. The Code is not written as if it were a statute, and, therein lies one of its major advantages - flexibility. This enables the deserving case to be treated as an exception without the fear of creating a precedent, and permits the introduction of alterations to counter changing circumstances as
new techniques are evolved. Furthermore, the constitution of the Panel and, in particular, the accessibility of the executive, while helping to engender confidence, also allow speed of decision-making which, in turn, has enabled preventive action to be taken.

The extensive merger activity of the last decade raised many questions over the advantages of takeovers and the methods by which they were effected. In spite of the inevitable strain imposed on the Code, the Panel has emerged as a body which is widely considered to work well. Its achievements have depended on the acceptance of its authority by all those engaged in acquisitions and the solid, voluntary support of all the major institutions - support which should be guaranteed by an ultimate sanction of the loss of self-regulation.

Inevitably, the Panel, and the system it represents have attracted criticism. The central issues to be considered are the philosophy of self-control and how effective it has been. If moral issues were discarded, the questioning of the self-policing principle will concentrate on whether self-regulation is possibly compatible with equity of treatment and fairness of decision. Paradoxically, while the virtues of the system emanate from its voluntary status, so do its drawbacks.

Inevitably, certain parts of the Code are unworkable. Profit forecasts, for example, and dealings during a bid have remained a constant source of trouble and represent elements of the Code where rules have been subject to constant change and refinement. It is not in the Code, however, that the real problems are to be found. Weaknesses can be gradually eliminated or at least reduced, and the Panel has already succeeded in refining the Code as a result of experience in enforcing the rules.
It is in the character of the system itself that more fundamental shortcomings are to be discovered. The Panel has no standing except in relation to the goodwill of the City. It depends for its effectiveness on retaining that goodwill and, above all, on the personal contacts of its executive within the City. Owing to the difficulty of devising formal rules to cover all the variations which arise in takeover operations, the Code has conferred on the executive of the Panel considerable discretion in its application. Thus while it remains effective, the voluntary system concentrates a great deal of power in the hands of a small number of men. This is considered acceptable in the City and has indeed secured general acceptance and the full support of the major City institutional bodies. Whether the authority of the Panel is based on agreement of its view of what is right and proper conduct or whether it is because the alternative is understood to be direct intervention by government (and legal sanctions) is not clear. It is evidence though that its success must depend on those men on the Executive and their successors in keeping the confidence of the City and the public at large.

This, in turn introduces two more pressing problems. The measures to control takeover transactions cover only one aspect of the securities market - but the Panel is the most recent and conspicuous body dealing with the market, and it is concerned with that aspect of share dealings which has been the most prominent in recent years and which has caused the most trouble. But the problems which have appeared in the context of takeovers are only the symptoms of a much deeper malaise.27
Secondly, the problem faced by any system which depends on honouring the spirit of a code rather than the letter of a law is how to make its workings clearly visible. In other words, the Panel must fulfil two conditions. It is sufficient to police the market; it is necessary to be seen doing so. To the unacquainted observer the workings of the securities market must appear so complex that the market cannot be conceived of doing this on its own. It needs either a seal of approval from politicians of standing, which it patently cannot rely on, a supervisory umbrella that has public confidence, or sufficient and satisfactory publicity to ensure that its achievements receive wider currency. In all respects the City must admit failure. However well it has policed itself, the securities market, of which the Takeover Panel is an integral part, is still open to criticism.\(^{28}\)

The model most frequently suggested as a panacea to these drawbacks is that of a Companies Commission based on the Securities and Exchange Commission (S.E.C.) which has been in force in the U.S. with legal sanctions since 1934. Two questions are critical to the acceptance of a statutory body. First, would this form of control prevent some of the abuses, which the proponents of self-regulation readily admit have occurred - insider trading and warehousing? It is by no means clear that the situation would be improved if the Code was turned to law; a statutory system of control would be much less able to adapt its principles to changing circumstances and to cope with the continuing development of City practice.\(^{29}\) Replacing flexible rules with rigid laws would hardly constitute an improvement.
Secondly, statutory methods of control, whether of takeover tactics in general or of specific issues such as the merchant banks and their conflict of interest between corporate financial advice and investment advisory business, has two major drawbacks. They are far slower in operation than the voluntary system - imposing long delays on the operations of the capital market which may greatly hinder its effective operation. And they are less flexible; on one hand, setting out rigid rules simply invites people to discover and exploit loop-holes; on the other, it would be impossible in a statutory system to carry out the kind of development and extension of thinking about takeover tactics which has been a feature of the Panel's operations in London.

It is perhaps most appropriate to summarise the undeniable advantages of a self-regulatory system by citing some of the incontrovertible evidence contained in the Inquiry of the Department of Trade, July 1974:

"Provided that the organisations and the general body of individuals in any field are aiming at a high standard of conduct (as they are in the area with which the Panel is concerned), control can be imposed more simply, more effectively and much more speedily by self-regulation than under any other system. Rulings by the Panel executive are usually given within a matter of hours and a meeting of the full Panel can normally be summoned within forty-eight hours. If an abuse is suspected or is being organised, the self-regulating body can at once impose the necessary restrictions. For example, the City Working Party, on the advice of the Panel, required disclosure in takeover situations of certain types of warehousing before they appeared in any significant form. A statutory body may be reluctant to act in the absence of specific evidence of abuse that can make its action publicly defensible."

The fact that the abuses and inequities occurred before the formation of the Panel (exemplified in such cases as Thorn/Metal Industries and Courtaulds/Wilkinson Riddell), but no longer occur is a testimony to the effectiveness of the Panel in achieving, to a large degree, the objectives laid down at the beginning of this section. Notwithstanding its success, which suggests that commercial standards can for the most part be maintained without codification in statute law, as practice evolved, certain matters dealt with by the Panel would clearly be more conveniently and expeditiously
handled by statute. Insider trading and warehousing are probably the best examples.

Unfortunately issues always seem to create a choice between extremes - either legal backing or flexible voluntarism. Moreover, political expediency, rather than economic criteria, tends to be decisive in the introduction and execution of policy; the City is currently a matter for distrust and political debate, yet the Government has rejected the notion of a body based on the S.E.C. to control the securities market.

Thus the suggestions which follow should be considered not only in the context of political uncertainty and inconsistency, but also and more importantly in a climate of opinion characterised to date by an apparently insatiable appetite for official intervention.

The suggestions are based on two notions: firstly, that abuses are the exception rather than the rule; secondly, that malpractice, when it does arise is serious, both in itself and in its implications and should be eradicated swiftly. They would require the retention of voluntarism and the infusion of others to the executive of the Panel, from outside the City, to give a wider basis for interpretation and more importantly to induce confidence in the public at large.

Of course insider dealing and warehousing would still fall beyond the scope of a voluntary Code, or indeed a system enforced by an S.E.C. and should be incorporated into law. However, the question of achieving disclosure of information through a system which emphasises adherence to the spirit of a code rather than unyielding interpretation of the law, is contentious and calls for a radical revision of the structure of control.
7.3: Control of the Securities Market/Role of Legislation

In this final section, the notions and concepts developed earlier are presented in suggestions for controlling the merger market, which aim at rationality and fairness, but above all at devising a workable framework for supervision. The objectives and practicalities of this system would be three-fold:

1. To secure greater dissemination of information
2. To make insider dealing and warehousing criminal offences
3. To retain a voluntary system of regulation, monitored under a single body with responsibility for the supervision of all aspects of the securities market

The structure which is developed below should be considered in a wider context; it should, in particular, be understood in the light of a debate which encompasses the whole of the securities market and, indeed the meaning of capitalism in Britain. Thus, calls for legislative control of the merger market, arise not specifically because of the nature of the Code and the Panel as applied to takeover transactions. But, rather because this covers only one aspect of a more far-reaching problem which is only now being grasped; and which has been accentuated and publicised recently through the collapse of Slater Walker Securities, the report on Scottish and Universal Investments (S.U.I.T.S.), the revelations of misconduct in Lonrho and the Lowson empire, and the more general collapse of the fringe banking sector. Such episodes support the critics of the City and strengthen the demand for bank and insurance nationalisation. The debate on the securities market was inevitable. The 1960s and early 1970s saw rapid growth in the financial service industries and the ever increasing use of an exposure to the media. As the social and political climate altered the excesses of those financial entrepreneurs dealing in "paper" became inextricably associated with the activities of the City establishment.
The actions of the Takeover Panel have served to highlight this more general problem. Furthermore, there have been equally important debates proceeding about other parts of the financial services sector — the regulation of banks, insurance companies and accountants for example. However, given the way that politicians (and indeed the public) still tend to equate the financial sector with the City, and the City with the Stock Exchange (and Takeover Panel), any scandal in, or debate on the securities market has tended to implicate the financial services industry as a whole.

Restrictions of space preclude any more than a brief discussion of the wider question of the securities market. Indeed the topic calls for more attention than it can receive in a study principally concerned with merger activity. The remainder of this section concentrates on devising a framework to regulate the latter.

The pre-requisites of this system are that investors' interests are safeguarded and that attempts to ensure efficient supervision gain government and public support as well as that of the City's institutions.

The scheme of existing arrangements exhibits two main weaknesses. One concerns the scope of the Companies Acts and the structure of merger legislation. A second concerns the thoroughness with which the self-regulatory authorities perform their responsibilities. Under the present system of self-government, there will remain doubts whether or not the casual approach or lapses on the part of some City institutions, which enjoy special privileges, and whose activities have cost shareholders large sums of money, have too often escaped unpunished, apart from the damage to their reputations.

On this basis, a number of measures are suggested to provide a flexible, stringent and efficient system for protecting the investor.
(a) Disclosure of Information

As long ago as 1933, Berle and Means, crystallised the solution to the problem, which they suggested lies ...

"not in prohibitions upon the directors but in imposing rules requiring general disclosure by the corporation of all material facts tending to change open-market appraisals. As the standards of disclosure of corporate affairs become more exacting, the problem of directors and managers in the market will become increasingly less important." 36

Moreover, the availability to shareholders of adequate information concerning their company's financial affairs constitutes the greatest source of protection against the misuse of private information on the part both of takeover bidders and of directors of the offeree companies. In this context, the reasons why adequate, up-to-date and accurate information is so important are three-fold:

1. To attract a takeover bid - the shareholders' ultimate protection against inefficient management - where the assets of the company are not being utilised to best effect 37

2. To enable shareholders to appraise a bid

3. To prevent unfair "insider trading", by narrowing the range of extra information available to directors and associates 38

In the case of a quoted company, every member of the public is a potential shareholder so that, in principle, the same information should be made available to the public as to shareholders: buyers of shares are entitled to be given as much information as sellers. Indeed the Takeover Panel has recognised this, and, in rejecting the argument that it should be concerned only with disclosure in the offer document or in any reply by the offeree company, it stated:
"One of the main objects of the Panel is to secure fair treatment for the investing public. The object can be seen plainly to run through the City Code. Information given at the time of a bid cannot be wholly divorced from pre-bid information which the shareholder has been given or ought to have been given." 39

The Jenkins Committee pointed out that a statutory requirement on a bidder to disclose his intentions and/or disseminate information would frequently be ineffective in securing useful information. 40 Notwithstanding the efforts of the Panel regarding disclosures of information, 41 it has become evident that the Panel executive cannot fulfil its role unless directors and advisers, as well as others are prepared to disclose, on request, full details of all transactions that are made. Moreover, the Executive limits its request for disclosure to the minimum necessary to enable it to have an understanding of the issues, and is for consideration by the members of the executive alone. The Panel stresses:

"... that confidential information obtained from one party in this manner is not available to another for publication or in order to secure an unfair advantage." 42

Herein lies a fundamental contradiction of aims; on the one hand, it is stressed that absolute secrecy should be maintained so as to minimise the incidence of leaks; on the other, "third parties" are denied access to information which financial advisers are granted privileged rights to. 43 It would, of course, be naive to imagine that equality of information could be ensured. Quite apart from officers in the companies themselves, there is a whole network of people within the City - stockbrokers, bankers, financial journalists - who, through experience, are in a very much better position to know when to buy and when to sell in a takeover bid than the ordinary private shareholder. The best that can be aimed at is the provision of information which is accurate and speedily distributed.
In some respects these aims have been partly fulfilled. Dissemination and presentation of information have been greatly improved by the intervention of P.R. consultants. Moreover, steps have been taken to enhance the quality of information as well. Regarding profit forecasts and asset valuation, potentially the most crucial and contentious financial data in takeover situations, specific objectives are now stated in the Code. These require the endorsement by independent auditors and advisers of the accounting bases and calculations made by directors, and the publication of the commercial assumptions upon which forecasts and valuations are made.

Such advances are indeed important. The treatment of intangible assets, particularly goodwill, is a critical factor in takeover negotiations where the book value of a company's assets is greatly exceeded by the market valuation. If, in addition, the consideration represents a premium over market price, the goodwill element becomes more important to the acquiring company because of its deleterious affect on tangible net worth and hence capital structure, gearing ratios and attractiveness to investors and creditors. Similarly profit forecasts and cash flow projections are often integral parts of a company's case for, or defence against, acquisition for they are the bases upon which future prospects and dividend policy are decided. However, projections and asset valuation remain in part matters of judgement and functions of the experience, ability and policy of directors. Thus it should be recognised that even if more information were available it would not necessarily be dependable - while this is regrettable, it does not detract from the maxim that more information is greatly preferable to less.

One method of securing this would be to impose the burden of proof onto firms initiating acquisition proposals, thereby making them reveal the full assumptions and expectations of their proposed amalgamation. This information would also provide the market with considerably more detail than is usually the case in takeover negotiations or published in bid documents.
While this approach to public merger policy constitutes a radical revision of the existing structure of control, it has precedents in other areas of public policy towards industry - namely restrictive practices legislation. The need for control over merger activity, to protect the "public interest", is as apparent as that for a code to supervise the market in which acquisitions are effected, and to protect "shareholders' interests". The primary rationale for government intervention, that the likely public (social) and private benefits accruing from a merger may not be necessarily coincident, may be explored through the theory of economic welfare. It is patently obvious that the economic values sustained in the City do not coincide with those which reflect the interests of society as a whole. Furthermore the Panel does not concern itself with the merits of an offer - that is for investors and company directors to decide. The Panel's concern is that shareholders should not be hurried or blackmailed into making a decision or forced to make a decision without adequate information. While the Rules of the Code go some way to securing reasonably full information for investors, the ultimate protection of shareholders and the public at large must lie in the improvement of the general standard of information to which all interested parties are entitled.

Legislation which considers all mergers to be considered contrary to the public interest unless important counter-balancing increases in industrial efficiency or other acceptable effects on competition can be demonstrated would represent a significant step towards the desired aim; it presumes, inter alia, the existence of a less than perfect market for merger; a market characterised by incomplete information, by the skewed size distributions of bidding and acquired firms, and by the considerable influence of management objectives and preferences, and corporate financial advice, on shareholders' decisions; a market wherein countervailing control and objective supervision is politically and
and economically necessary for the maintenance and promotion of the wider Public Interest. In addition this approach obviates a number of the weaknesses evident in existing merger legislation; one concerns the very limited applicability of micro economic theory in enabling economists to allocate products to particular markets; a second arises from traditional interpretations of the paradigm of industrial economics which attributes a causal role to structural characteristics in the determination of a firm's conduct and performance. Moreover, increased information would make the merger market more 'perfect' than is now the case.

Briefly, if such an approach were adopted, all mergers would be against the public interest unless it could be shown that a particular proposal was likely to satisfy a number of criteria which are presented below, in the form of "gateways". The machinery of legislation might be considered to be an effective approach to the supervision and control of merger activity. For such purposes three Basic Gateways are distinguished within which increasingly more operative criteria are established - the intention being that a merger can only be approved if some parts of more than one of the Basic Gateways are satisfied. In detail, a proposed merger would be deemed contrary to the public interest unless a Mergers Commission is satisfied that it complies with at least one of the minor gateways (shown by number) of at least two of the Basic ones (shown by letter).
A. STRUCTURAL CRITERIA

1. PRIVATE COSTS - that internal economies of scale at plant/firm level are (i) available and (ii) significant, and (iii) could not reasonably be achieved in any other way than by merger

2. SOCIAL COSTS - that these costs borne by the community (i) will be reduced following the merger, (ii) that they will not be internalised or passed onto the consumer and (iv) that they could not be reduced in any other legal way than by merger

3. DEMAND - that future choice will in no way be impaired as a result of merger;
   - that countervailing power by consumers necessitates amalgamation to comply with the public interest (legislatively defined);
   - that the existence and amount of excess demand will be more effectively and speedily reduced as a result of merger.

B. BEHAVIOURAL CRITERIA

1. STABILITY - that competitive instability on (i) the firm (including management, labour and shareholders), (ii) suppliers to and purchasers of the firm and (iii) on the macro economy would be significantly reduced by the merger, and that this would be in the public interest;
   - that industrial instability on (i), (ii) and (iii) above would be significantly reduced by merger, and that this would be in the public interest;
   - that the merger would significantly diversify the firm's portfolio of activities and products, that this would significantly reduce the risk of insolvency and be in the public interest;

2. GROWTH - that the economies of growth of the two combined are significantly greater than the sum of the two separately;
   - that the existence or development of stronger financial units is necessary owing to the unavailability of finance in the market

3. INVESTMENT - that without the merger, investment by the two firms would be unlikely to take place in the short-run;
   - that the sum of investment by the combined company is expected to be significantly greater than by the two firms independently;
   - that research and/or development will not be reduced in the short-run
   - that the number and frequency of innovation(s) by the combined firm is likely to be greater, and that this will be in the public interest;
   - that any reduction in the number of decision-making R&D units is unlikely to affect significantly the frequency or diffusion of inventions and innovations.

C. PERFORMANCE CRITERIA

1. DOMESTIC PERFORMANCE - that profit or value-added or production volumes will be significantly increased by acquisition

2. INTERNATIONAL PERFORMANCE - that exports will be significantly increased and international market share raised;
   - that the merger facilitates international entry which would not otherwise be possible
   - that dealerships/channels of distribution would otherwise be costly or impossible to establish
Insider Dealing/Criminal Law

The City has always preferred self-regulation in most matters for a number of sound reasons. Essentially, it has been effective in dealing with changing circumstances. More important, whatever is not specifically forbidden by law is in effect permitted; the looser rules of self-discipline are in fact more demanding since any conduct which damages trust on which City relationships must be based brings its own heavy penalties.

"Insider dealing" is an offence of a different kind, because many of those involved are company officials and advisers who are beyond the reach of the City's internal sanctions; and because the law provides no effective remedy at present, civil or criminal. In essence, insider dealing is fraudulent and the only way to attack it effectively, in the long-term, is by legislation with a precise definition of the transaction. Neither the Panel nor the Stock Exchange, in spite of their efforts, have been able to extirpate the practice and indeed in a statement issued in February 1973 concluded that criminal sanctions were the only solution which would be effective and satisfactory to the community. A similar conclusion was reached more recently by the City Company Law Committee which recommended the extension of the Companies Act to make insider dealing in securities a criminal offence.

Although no definitive version of what constitutes insider dealing presently exists, it might be defined as the conversion to private gain, by way of stock exchange transactions, of valuable information obtained about a quoted company by a person whose relationship with that company (or its associate) is of a fiduciary or confidential nature. Severe penalties for offenders, including fines and prison sentences, have been envisaged; but, in addition, if it were a criminal offence, this abuse of trust and confidence would no longer be tolerated by employers. Further, the fact that a criminal act would almost certainly
invalidate a contract of employment would be an additional deterrent, and, for the sake of equity would prevent bankers, financiers and agents, who were proven guilty, of continuing in a position where they could control the resources of others.

"Warehousing" is perhaps best described as wholesale insider transactions. The Panel understands it as:

" ... the practice whereby a person or company (or group of persons and/or companies) accumulates, without public disclosure, a substantial block of shares in a company with a view either to making a takeover bid or to selling the block to someone else who then makes a bid."

Warehousing has been particularly noted as a pursuit of Slater, Walker Securities, among others and has been especially difficult to establish. The Takeover Panel, while holding the view that the practice should be prevented by law sought to limit its occurrence in takeover situations, by requiring bidders to expose details of those with whom they were acting in concert. Effectively, however, the Panel were, without any other jurisdiction, attempting to remedy a weakness in the law - the 1967 Companies Act - which required that holders of a significant holding in a company must declare themselves when they own 10%. The weakness is that a holding of 9.9% need not be declared - and thus four persons "acting in concert" could effectively acquire control of a company without a report being made.

The 1976 Companies Act has made amendments which should remedy a proportion of these practices. New rules on the notification of interests in shares came into force in April 1977. The threshold for disclosure of any class of voting shares is reduced from 10% to 5%, and the period for notification from fourteen to five days. Moreover, listed companies are empowered to inquire into nominee shareholdings - that is the names of the beneficial owners of shares held under nominee names.
It should always be accepted that as practice evolved, certain matters dealt with by the voluntary system would preferably be covered by statutory law. Insider dealing and warehousing, are good examples of this. The boundary between self-regulation and statutory control must be flexible. Furthermore, much can be dealt with by statute law and still leave a large-field for self-regulation. The final part of this section examines some of the improvements that might be made in respect of the latter.

(c) Retention of Self-Regulation

The intervention of criminal law was an inevitable response to changing social attitudes and the development, in extent and nature, of a limited, yet particularly serious field of activity. That insider dealing is only now being contemplated as illegal, is not itself a criticism of the system of self-regulation in general. The "lawlessness" generally attributed to the City is true only to the extent that its power seems largely impervious to outside control. Insider dealing, specifically, is a suitable subject for criminal legislation, despite the considerable difficulties involved; these difficulties represent in themselves, however, an effective argument against wider legislative control of security dealing. 49

Indeed a note of warning to the proponents of a U.S.-type S.E.C. to "police" the City was recently sounded. Professor Benston had introduced a strong counter-argument to the claim that the City Code has been aimed at the interests of London's merchant banking by asserting that the multitude of rules and regulations, court cases and articles generated by the S.E.C. has benefitted investors only slightly, if at all while greatly enhancing the "bar". 50 A final indictment is more important. On the question of fraud in U.S. public companies, Benston simply quotes the remark of a former S.E.C. and Justice Department lawyer:
"I must admit, the principal difference between now and the late 1920s is that you need the help of a lawyer to commit a successful fraud. But it is still good business. These people are almost never caught. If caught they're almost never indicted. If indicted, they are rarely found guilty. If found guilty, they almost never are fined much or sent to jail. If sent to jail, they get out on parole in a few months or years at most and then are welcomed back to their country club in Westchester." 51

In rejecting this approach in the U.K., 52 it is realised that a number of improvements can still be made in the measures to supervise the securities market. Although this, once again, extends beyond the strict boundary area of takeover regulation, the Takeover Panel is the nearest approach Britain has to a body whose main aim is to protect shareholders and to ensure that the stock market is efficient. Whilst its brief is limited and concerned essentially with a peculiar aspect of stock market operations, many of its decisions have far wider implications. The real failing of the Panel, and of the whole City has been their inability to display to the public and Government, that they are dealing with abuses as they occur.

A probable cause of the weakness has been the nature of the composition of the City and, in particular, of the disparate bodies which regulate the securities market. None of these bodies (the Stock Exchange, the Takeover Panel, the Bank of England and the Department of Trade) is in a position to take an overall view of the situation. If the securities market is to continue to regulate itself it must be under the surveillance of a body with greater public standing and a body which would be able to view the broader issues from a more objective standpoint.
There remains the question of the nature of the organising body. The status of the Bank of England, for example, remains a mystery to the public at large; and more recently, its role has become a subject of increasing debate. A preferable suggestion is that the Takeover Panel, which brings together different parts of the securities industry including the clearing banks, accepting houses, pension funds and insurance companies "could be a model for working together in a wider supervisory role."54

The proposed review body would have a number of functions. First, to cover the occasional cases of unethical conduct which are not within the jurisdiction of any particular body and thus escape formal condemnation. Secondly, to possess the legal powers discussed earlier and to represent the body to which its delegates would be publicly accountable. Thirdly, to close the existing gap between the City and government - by allaying the latter's fears through the second function, and by publicising the role of the bodies which answer to it. The removal of genuine distrust in official circles, which partly stems from ignorance, would be the removal of the greatest threat which those responsible for the administration of voluntary control face.55
NOTES

1: Report of the Committee of Enquiry on Industrial Democracy (Bullock Committee), Cmnd 6706, H.M.S.O., 1977

2: Quoted from The Times, January 27, 1977

3: These areas are the winding-up of companies, changes in articles and memoranda of association, dividend recommendations, changes in capital structure, major disposals, the allocation of resources, and the appointment of management (and their remuneration). In justification, Bullock argues that such legal changes would involve very little practical change since shareholders rarely initiate measures in this way; see K. Midgley, "How much control do shareholders exercise?", Lloyds Bank Review, October, 1974

4: M. Gort & T. F. Hogarty, "New evidence on mergers", Journal of Law and Economics, April, 1970, concluded that the owners of acquiring firms lose on average and the owners of the acquired firms gain on average, which suggests that shareholders of the acquiring firm have more to fear from takeovers than those of the victim company.

5: Sir Geoffrey Howe, "Government policy on mergers", Trade and Industry, 1 November, 1973, p. 235. The Department (previously Board) of Trade has the responsibility for controlling and guiding legislation on companies and their disclosure of information. The civil servants who have carried the main responsibility in this area, while strict on their application of the law and insistent on the proper disclosure of information by companies, have taken an approach which is defined in terms of the law and is not directly related to the needs of investors. It is the D.O.T.'s task to regulate companies, to prevent fraud, to ensure the Companies Acts are observed; it is not its job, except incidentally, to protect shareholders or to ensure a proper market in company shares or acquisitions.


8: "Notes on Amalgamations of British Business", Issuing Houses Association, 1959


10: "The City Code on Takeovers and Mergers", Issuing Houses Association, 1968 (hereafter City Code or Code)

11: City Code, revised April, 1976


13: The merchant banks was also acting as financial advisers to Pergamon in the bid negotiations
14: At the conclusion of its investigation of the Leasco/Pergamon matter, the Panel instituted an enquiry in general terms into the question of conflicts of interest that may confront merchant banks who conduct both corporate finance business and investment advisory business. See Report (1970), op. cit., pp. 10-14.

15: One audit of Pergamon's accounts showed a £2.1 million profit; another £495,000 loss over the same period.

16: The conflict between "manager" and "owner" in this specific context reflects the wider debate on ownership and control which still occupies a number of economists; see S. Aaronovitch & M.C. Sawyer, Big Business, (Macmillan, 1975), pp. 159-174. In takeover situations, the influence of the merchant banking advisers and the prominence of institutional investors confirm a scenario of very large individual and institutional shareholders competing for control using the build-up of ownership stakes as a crucial instrument; see Financial Editor, The Times, November 27, 1972


18: The Panel on Takeovers and Mergers, Report on the Year ended 31st March 1974, p.8

19: Originally Rule 8, now Rule 9

20: An indication of its scope, general principles, rules and practice notes is contained in Appendix 15.

21: The relaxation of the Code in this respect is in contrast to the recent interest taken, for the first time, by the Office of Fair Trading (O.F.T.) in partial acquisitions. For example, in 1975, the O.F.T. used the threat of a Monopolies Commission reference to encourage Courtaulds to reduce its holding in Highams, to less than 25%; it had previously been 29.8% and Courtaulds were planning to increase its shareholding; in the event, it complied with the O.F.T.

22: This was instituted in the realisation that the Code cannot be enforced upon companies subject to foreign jurisdiction.

23: This new ruling was exposed soon after its revision and proved not to be effective. In June, 1976, Anthony Carrimore and its advisers Ionian Bank, irrevocably committed 44.6% of the company's equity to an offer from York Trailer, which was promptly followed by improved terms from the original bidder, Edbro. The result was that York could not garner an additional 6% of the equity for the bid to go unconditional - thus introducing the prospect of stalemate for shareholders; see The Times, June 21, 1976

24: Quoted from The Times, April 15, 1976. It was impressed on merchant banks that where the bank's assurance is based upon its own provision of finance (Brandts were to raise £920,000), the Panel considers that the obligation to provide finance will continue to subsist, at least so long as the mandatory bid obligation remains in being and unless the bank has been expressly relieved of it by the Panel.


27: Referring to the wider debate on the regulation of the securities market; see Sn 7.3

28: Particularly from those on the left wing of the Labour Party and from outspoken academics; see for example, The Banker (1976) - various editions; Management Today (February 1975) and R. Opie, "Time for a radical reappraisal", The Banker (February 1977)

29: This point is well illustrated by the fact that the Code has been the subject of constant revision, whereas the Licensed Dealers (Conduct of Business) Rules, 1960 have remained unaltered and are now largely out of date, although the Department of Trade has sporadically expressed the hope and intention of revising them.

30: Viz; Accepting Houses Committee; Association of Investment Trust Companies; Association of Unit Trust Managers; British Insurance Association; Committee of London Clearing Banks; Issuing Houses Association; National Association of Pension Funds; Stock Exchange

31: The Panel on Takeovers and Mergers, Supervision of the Securities Market, 1974, p. 7

32: For example the bid by Tate & Lyle for Manbre & Garton was not referred to the Monopolies and Mergers Commission because the views of the O.F.T. (which were in favour of referral) were overriden by those of other Government Departments, most notably the Ministry of Agriculture, Fisheries and Food and the Department of Employment, which said that the merger would help preserve employment; see financial press, September 10, 1976

33: Despite calls by the Labour Party national executive for nationalization of the banks and insurance companies

34: For example see Mr. Gordon Richardson, Governor of the Bank of England, "... the scale of malpractice must not be exaggerated. The incidents are warts on an otherwise healthy system and they owe something to climate and temptations of frothy markets and easy gains in years now past", Bankers and Merchants Dinner, Mansion House, October 21, 1976

35: For example, Clive Irving, True Brit (Jonathan Cape, 1974) pp 102-103 described the City as "the most lawless square mile in the country - virtually a nation-state on its own, with ... its own police-force, its own clubs, and its own ancient rituals and modern rackets"; see also A. Giddens, "The Rich", New Society, 14 October, 1976, p.65
It is considered in the interests of a free enterprise economy that a person who feels that he can make better use of the assets of a company than its existing management should be able to make a bid for that company, and the law should not impede this provided that there is no unfair dealing in relation to existing shareholders.


In takeover situations the Code requires very full, and in certain circumstances, speedy disclosure. For example, public disclosure is required within 24 hours of dealings, in shares of the companies involved in the bid, by persons associated with those companies; see *City Code*, Rule 30 and Rule 31.


See Chapter six, Sn 6.4.

The Panel has probably been at its weakest in dealing with the generation of financial entrepreneurs which developed (and has disappeared) in the last decade. The swift accumulation of fortunes by 'financial conglomerates' (cf. financial multi-product companies), with interest in unit and investment trusts, property investment and dealing, was characterised by the acquisition and dissection of companies whose asset values far exceeded their share prices. The Panel and code represented an inconvenient encumbrance rather than an authority whose voice of censure was to be feared; see Spiegelberg, op. cit., pp. 190-200.

A more recent challenge, and one with relevance for the future, concerns acquisitions by overseas companies of indigenous U.K. enterprise; in the event that a foreign bidder ignores the custom of gentlemanly guidance, the Panel could only rely on the Bank of England to use its powers over foreign exchange transactions; see *Investors' Chronicle*, 21 January, 1977, pp. 145-146.


*City Code*, Rule 30.
48: For full details, see Financial Times, February 4, 1977

49: Perhaps the major problem is a metaphysical one: when does the company that plans to make a bid decide that it is going to make a bid, and who is to prove it?


51: ibid., p. 494

52: It should also be recalled that the Takeover Panel has reduced one obstacle in the way of fair, workable competition. A company can now feel that its position is more secure, and that if it is acquired by another company the acquisition will be the result of a contest in which it has had a reasonable opportunity to defend itself.

53: A clearer definition of the role of the Bank may have to await the outcome of the Wilson Committee inquiry; see Chapter 8, Sn 8.32

54: Suggested by Mr. Nicholas Goodison, Chairman, the Stock Exchange, at the Bankers and Merchants Dinner, Mansion House, October 21, 1976; the notion gained further support from Lord Shawcross in The Panel on Takeovers and Mergers, Report on the Year ended 31st March, 1976

55: See I. Wriggleworth, "Without the city walls", Bankers' Magazine, September, 1976
8.1: Summary

In this dissertation, I have attempted to present an analysis of the role of financial institutions in merger activity. It was prompted by the huge increase in the acquisition activity of financial companies in the period 1966-1973 which had remained largely unresearched. In this period, mergers and acquisitions by financial companies increased by 943% in value and 184% in number. In the first two years of the period the number of firms acquired and the expenditure on acquisitions were quite small; thus from 1968 to 1973 there was a significant boom in financial sector merger activity.

This study collected data on every acquisition by financial companies that took place in the U.K. and was reported by the Bank of England, regardless of the sizes or industrial types of firms acquired. A sum in excess of £2.4 billion was offered for the equity of the victim firms. Since the assets acquired were transferred to companies already in control of other assets, the acquisitions contributed to an underlying trend in the U.K. economy towards increasing concentration in the control of assets. Moreover, the largest financial institutions participated; each of the ten largest banks and insurance companies undertook acquisitions or were involved in mergers.

Concern at increases in seller concentration arises from economic or political doubts. From the economic viewpoint, increasing asset concentration increases the likelihood of a firm using its ability to divert resources to coerce its competitors. Politically, some are worried about the power of the managements of very large firms which may not be sufficiently responsive to the public interest.
The merger activity in the financial sector from 1966 to 1973 would appear to be important to those people concerned with such increases in concentration. An investigation showed that nearly 60% of the expenditure on acquisitions was accounted for by companies whose main activity was banking or insurance. Furthermore, their acquisitions became larger and were increasingly diversified.

The summary above is based upon data and analyses which were necessary at the introductory stage to characterize the merger activity of financial companies from 1966 to 1973. Subsequent data and analyses departed from the discussion of asset and seller concentration, but were linked to the various aspects of the relationship of financial institutions with merger activity.

One analysis revealed that external growth was also an important feature of U.K. banks' international expansion. Mergers and acquisitions amongst British overseas banks and the clearing banks' overseas subsidiaries facilitated rationalisation and helped to create institutions of sufficient size to compete with US and continental wholesale banks. Growth by acquisition was also the method most readily employed by British banks in establishing or extending overseas branch networks. In addition to many examples of formal acquisition activity, various other forms of co-operation emerged within the financial system. Informal, ad hoc syndicates arose to meet the increasing demand for medium term funds of increasing proportions. The concept of co-operation was then extended and resulted in the growth of the consortium banks.

The analysis to this stage concentrated on the involvement of financial companies and particularly banks as acquiring and victim firms. The underlying theme was that the environment within which the institutions competed governed the extent and direction of their expansion. Changes in that environment were caused by a number of different factors. Structural changes for example resulted from the entry of foreign banks into London; the consequent growth of the eurocurrency markets heightened rivalry for wholesale commercial and investment banking business. Institutional
changes, such as those resulting from the new credit controls of 1971, also affected the competitive environment of financial companies. Changes in the Bank of England's official attitude to amalgamations had similar effects. The responses which were evoked were varied. There was a common theme to the institutions' reaction, however. In general, their responses to the shift in emphasis in favour of international wholesale banking business, were characterized by co-operation and invariably merger.

Further analysis revealed that the role of financial companies in mergers extended beyond these preliminary findings. Merchant banks in particular, but specialist consultancies and institutional investors as well, have played an influential role in the corporate merger market. Accepting houses were consulted in over 90% of mergers and acquisitions which came to fruition in 1973 and 1974; P.R. consultants became increasingly important with the increased incidence of contested takeover bids during the late 1960s and early 1970s. The role of both these financial advisers is to determine the pecuniary merits of a bid and to conduct the ensuing negotiations. The over-riding impression from the analysis was that the choice of strategy and tactics during a takeover could be as important as the price being paid for the target company. With the growing concentration of share ownership into fewer institutional funds and the increasing involvement of merchant banks in fund management, the latent power and influence of financial institutions appeared to be far in excess of the strength of their financial statements.

This impression of their influence was supported by examining the role of financial institutions in regulating behaviour in the same market. It seemed that "poacher turned gamekeeper". Prominent merchant bankers were involved in the evolution of the Takeover Code and the development of the Takeover Panel. Moreover, the method of controlling the market, which has relied upon self-restraint, has been attacked on the emotional grounds that the City was behaving like an elite 'club' and on other
grounds by those who believe that self-regulation can never be an effective as explicit policing backed by statute. In the analysis, evidence was offered to refute these misapprehensions: the City is not a compact League of Gentlemen but a unique collection of sophisticated financial markets which deserve special attention and require a flexible system of control.

The evidence led to another view. This was that the corporate merger market is characterised by several imperfections which include the dominance of large firms, the aspirations of managers and financial advisers, and the paucity and quality of information available to the public and shareholders. These imperfections are accentuated by the nature of existing public mergers policy which is based on unsound economic theory and employs empirically unworkable criteria. The final analysis in the study attempted to remedy the faults with public policy and the imperfections in the merger market by suggesting a new approach to the regulation of firms engaged in takeover bids which would require acquiring firms to demonstrate that a proposed acquisition was in the public interest.

Throughout the analysis, emphasis was placed on the causal relationship between changes in financial companies' competitive environments and changes in their behaviour. During the period from 1966 to 1973, many such changes occurred. Whilst these were extremely varied in nature, decision-taking must have been influenced by the general climate of opinion which seemed to prevail during that era. It was characterised by rapid expansion which was created by a unique mixture of factors: real economic growth, changes in official and institutional ideologies, the evolution of competitive international market structures in the financial system and a self-perpetuating optimism which diffused through financial and commercial markets alike. The extent of the resulting structural change in the financial system was such that central banks and their regulatory climate were superceded. When in these circumstances, a number of specific dangers were added, it was inevitable that several banks would suffer difficulties.
8.2 : 1971-1977 A new era of competition and domestic/international banking crisis

8.2.1 : Origins

The current era is quite different from that studied earlier in the dissertation. The events of the last three and a half years have radically altered the environment in which financial institutions compete. The remainder of this final chapter is concerned with analysing the nature of these events, their direct consequences and their implications. For much of the current period the world's financial markets have been digesting the ramifications of a crisis of confidence which affected both domestic and international banking systems. These crises which became apparent in 1974 had their origins in the earlier formative period of expansion.

The main feature of the domestic and international credit booms of the early 1970s was the substantial development of the parallel money markets. The easy availability of commercial funds in a period of rapid monetary expansion made possible the growth of the secondary banks. It also enabled the finance houses, which had previously been dependent upon the clearing banks for their funds, to reduce their reliance on this method of financing and to expand their activities outside instalment credit. The larger finance houses were also induced to seek full banking status which required them to maintain a reserve asset ratio of 12½% but which also gave them access to an extra source of deposits in the inter-bank market thus compensating them for the 'locking-up' of an extra 2½% of resources in low yielding reserve assets.

These developments occurred against the sudden increase in British money supply, an inflow of surplus cash to finance houses from industry and commerce seeking the highest obtainable rates, and an upward spiralling property boom. The latter featured a rapid rise in property prices from 1971 to 1973, and a proliferation of developers and organizations concerned with property. The key to this growth, however, was the ready availability of finance. Although some of this was soundly-based in the form of long-term institutional demand from pension funds and insurance companies, most of the finance comprised short- or medium-term bank money.
Bank lending to property companies quadrupled in three years to reach £2.8 billion in November, 1974. Most of the increase was due to the increased exposure of the secondary banks and finance houses. In the year ended November 1974, their advances to the property sector increased by 29% compared with an 8% increase in clearing bank advances. At the end of the year, secondary banks accounted for 64% of the banking sector's total exposure to property companies. Part of this expansion may be attributed to the rapid growth of the money supply and the consequences of the policy of Competition and Credit Control. The main motivation for the increased flow of funds from secondary banks to the property sector, however, was the belief that the rise in property values would be both general and continuous.

There were several distinct characteristics of bank lending in the period of rapidly rising property values. First, such was the rush to find an apparently profitable destination for the funds which were being amassed that security for the loans was often insufficiently checked. Sometimes, for example, the price paid for the property was taken as evidence of its value. In other cases, a high proportion of 'value' was advanced. Thus many loans were essentially without security. In addition, loans were invariably made against property that produced no income at all, or yielded only 3-4% while the interest on loans could have been as high as 18%. Borrowers were expecting to service loans from capital profits rather than cash flow generated from income; in the meantime, the interest was added to the outstanding debt ('rolled up').

This was the scenario when property prices began to reverse their upward trend in late 1973. From the bankers' perspective it is now apparent that a number of prudent practices were not observed. There is little doubt, that despite variations in the relative levels of exposure, the banking sector as a whole was over-committed to property lending. The secondary banking sector was especially over-committed in this respect.
In November, 1974, property advances accounted for more than 13.5% of their portfolio to U.K. residents as compared with approximately 5% in the case of clearing banks. Moreover, in the euphoria, several essential rules were ignored. For example, information as to the eventual ownership of properties was often not known or sought, furthermore bank lending tended to exceed institutional demand. In effect, bankers were frequently providing, under the guise of loans, what was essentially risk capital - with the disadvantages of equity financing, but without the advantages. Finally, it has also become evident that a large proportion of the lending especially from secondary banks was against poorer quality schemes or development sites which the institutions would not have considered anyway. The situation was accentuated especially in the instance of finance houses, by imbalanced funding of loans. Liabilities were attracted as short-term deposits in the money markets, whereas they were employed as medium-term advances with collateral in the form of illiquid property investment.

The problems experienced in international banking markets had their roots in the same period. Indeed the distinction between the origins of the international crisis and that effecting domestic banking business in the U.K. was one of degree not kind. Notable features were the rapidly growing world money supply and the easy availability of funds in the eurocurrency markets. The latter in particular attracted banks of all sizes and nationalities to compete for business which may be seen now to have been potentially unprofitable and risky. In the more restricted climate which has prevailed since 1974, these activities have been exposed and smaller international banks have found it difficult to fund their lending.
The origins of these pressures may be attributed to a lack of prudence on the part of those banks affected, the interdependence which characterises the infrastructure of international banking markets and, with hindsight, excessive expansion in certain types of activity. Several contemporaneous factors were the precursors of the eventual problems which became manifest in 1974. The advent of generalised floating in 1973 signalled large movements in currency values and the transfer of risks formerly borne by central banks to the commercial banking sector. This coincided with considerable publicity for the large profits made by a number of banks particularly from foreign exchange dealings. The prospect of new opportunities in exchange market operations encouraged the setting of unrealistic profit targets for foreign exchange departments at a time when the balance of risk shifted against them.

In addition the unconditional growth of the world's money supply encouraged the creation of new institutions (the consortia or 'euro-banks') and attempts to cover overheads quickly. The result was a commitment to lending operations of longer maturities and smaller lending spreads than had hitherto been considered and which have subsequently proved ill-advised. The example of property advances made by U.K. indigenous banks, was followed in the U.S. with the expansion of the Real Estate Investment Trusts (R.E.I.T.S.) and in Europe where property 'booms' were experienced, especially in France, Belgium and Holland, between 1971 and 1973. A similar over-exposure of loan portfolios has been in respect of advances to shipowners to finance the purchase and servicing of supertankers.

A third factor, the oil-price rise, which aggravated the problems of the shipping industry, also raised doubts as to the capacity of commercial banks to recycle the resultant oil revenues. By the summer of 1974, the limits of private recycling were reached as banks' capital bases began to prove inadequate for the deposits they were 'being forced to accommodate'.
Finally in 1973-1974 there was a sharp decline of world security markets, which effectively prevented banks from raising new capital to restore prudent capital-liabilities ratios. Furthermore, it meant that financial institutions suffered large book losses on their own investments.

8.2.2. Evidence of Crisis

The extent of the U.K. banking sector's over-commitment in property advances became apparent following a rapid rise in interest rates in July 1973 when Bank Rate (now Minimum Lending Rate) rose from 7½% to 11%. An increase in the industrial demand for funds fuelled the upward trend. To finance their lending commitments, the commercial banks were forced to rely upon the money markets for deposits thus forcing fringe banks to pay even more to compete. As a result, one month inter-bank rate (LIBOR) rose from 12% in November, 1973 to 16% in December at which level it remained until April, 1974. A corollary was a mortgage famine as building society investors sought the higher rates they could earn elsewhere. The repercussions on the property and construction sectors were severe. Builders were unable to sell houses and land values began to fall. Hence, developers who had been dependent for funds on secondary banks were caught in a liquidity squeeze caused by the rise in interest rates and simultaneous fall in unmarketable investments.

In November 1973, London and County Securities, one of the biggest and most aggressive fringe banks collapsed, triggering off a crisis of confidence which accentuated the fall in property values, spread uncertainty and was accompanied by revelations which involved the largest finance houses and implicated even the more respectable accepting houses and commercial banks.
The loss of depositors' confidence effectively prevented secondary banks and finance houses from relying on the money markets as a source of funds. The once plentiful supply of short-term money disappeared as corporate lenders, other financial institutions and the general public either withdrew funds or refused to 'roll over' existing deposits, and in any case, did not offer new commitments. The decline in the flow of new money and signs that bankers were considering the recall of their property loans removed the key prop to the 'boom' and signalled the decline in property values. The artificially buoyant market became almost equally artificially depressed.

The implications for the banking sector were two-fold. First, many loans against property became undersecured. Secondly the stagnation of property sales, with the substantial fall in property prices meant that revenue generation from these sales became minimal causing cash flow problems for the property companies. This combination of severe illiquidity and falling asset values, left bankers with the choice of foreclosing on security (and thereby risking a further depression of property prices and undermining of the security of other loans that were still covered) or 'rolling up' the interest charges.

The general unwillingness to 'dump' property induced some finance houses, such as UDT and Mercantile Credit, to make provisions against such possible loan losses. Indeed the finance houses were perhaps the institutions to suffer most from the events of 1974. The rise in interest rates in particular adversely affected their performance. The mismatching of liabilities and assets was apparent in respect of their property advances but in addition much of their instalment credit business was traditionally on a fixed interest rate basis. Thus loans for up to ten years arranged before 1973 when rates were much lower, were still being funded after 1973 with short term deposits, for which they were forced to pay much higher rates. As a result, profit margins were either eroded or losses incurred.
At the end of 1973 it became clear that the problem which at first seemed no more than a temporary shortage of confidence and liquidity among the secondary banks was far more serious. In consequence, whilst London and County Securities was being supported by First National Finance Corporation (FNFC), Keyser Ullmann and National Westminster, the Bank of England launched the 'lifeboat' support group of clearing banks to provide the necessary funds for the beleaguered finance houses and secondary banks.

The Bank of England's move to avert a complete collapse of the secondary banking system was, however, aggravated by events abroad. The effects of the international banking crisis also manifested themselves in a loss of depositors' confidence. A specific cause, indeed the outstanding single cause of losses among banks in 1974, lay in the foreign exchange markets. A series of substantial foreign exchange losses were experienced by a number of banks which differed markedly in character, size and location. Union Bank of Switzerland, for example, sustained an estimated loss of $150 million; Westdeutsche Landesbank disclosed foreign exchange losses of £108 million and Franklin National Bank $46 million, whilst Lloyds Bank suffered losses of $77 million from foreign exchange dealings at Lloyds Bank International's Lugano branch. Most damaging perhaps, was the collapse of Bankhaus I.D. Herstatt in July 1974 with a possible foreign exchange deficit of $160 million but with far wider implications. The closure of Herstatt by the German Federal Authorities while New York was still trading, left a number of spot foreign exchange transactions uncompleted. This particularly affected Morgan Guaranty, Seattle First National Bank and Hill Samuel who were involved in the deals. The latter has since written off $10 million which represents 50% of the uncompleted deals.
8.2.3: Results

Although the causes of the problems experienced throughout the banking industry can be conveniently considered in terms of 'domestic' and 'international' events, the consequent changes in the competitive environment and in the structure of the banking markets should be discussed together.

Summarising, the main features of the problems experienced by banks, appear to fall into three categories. First, a number of banks were caught in a 'liquidity squeeze' caused by the rise in interest rates and simultaneous fall in values of unmarketable investments. Such was the fate of many U.K. fringe banks and of Hessische Landesbank which incurred losses as a result of its majority shareholding in Investitions und Handelsbank. Secondly, several large banks incurred foreign exchange losses. Particularly disturbing are those instances where losses were directly attributed to an individual dealer exceeding his authority as was the case of Lloyds Bank's losses in Lugano. Thirdly, there were those banks whose collapse was precipitated by fraud and deliberate misapplication of funds. In some cases fraud has been proved and the guilty parties have been prosecuted. It is certain however, that many more remain unpunished.

Several banks also suffered directly as a result of the decline in confidence itself. The developed infrastructure of the U.K. financial system, which incorporates both domestic and international markets, might be considered as a major cause of the so-called 'domino' effect where a crisis of confidence, sparked off by one bank, quickly affects a number of others. This was particularly evident in the U.K. sterling money market where finance houses were confronted with indiscriminate withdrawals of short-term deposits.
In international markets similarly the implicit assumption that inter-bank loans to all market participants were virtually riskless disappeared. The reaction of major lenders in the inter-bank market was the reduction or severance of dealing lines to smaller and newer banks, and was characterised also by the indiscriminate treatment of banks of a particular category - the newly established consortia, for example.

In the wake of Herstatt and the collapse of London and County Securities, there was a danger that the prophecy would be self-fulfilling in that banks would be unable to meet obligations because of the desire on the part of lending banks, to reduce their exposure to presumably weaker institutions.

8.3 : The changed competitive environment 1974-77 and the importance of size in contemporary wholesale banking

The response of individual banks to the climate of ebbing confidence which confronted them in 1974 was inevitably varied. Nevertheless, from an examination of aggregate behavioural trends several common traits have emerged which given an indication of the philosophy of different types of bank, and permit some speculation as to likely future developments. The principal emerging trend has been the accelerating growth of international wholesale banking business. The large, American, European and Japanese commercial and investment banks have initiated this growth. During the crisis of 1974 and 1975, when indiscriminate treatment prevailed, large size became associated with security. Moreover, for technical reasons explained below, the role of the pure intermediary in the eurocurrency markets largely disappeared and underwriters of both syndicated credits and bonds, have been forced to accept larger proportions of loans and issues. To support this, increased capital and resource bases became necessary which has further confirmed that substantial resources are essential to compete in contemporary banking markets. A further trend to emerge is a result of the continued breakdown of demarcation lines between various financial markets. This will be discussed in the context of a debate between the proponents of the 'specialist' and 'generalist' functions in wholesale banking.
8.3.1: Domestic Issues - 'Lifeboat' Support Operation and Other Rescue Missions

The 'lifeboat' support action was launched in December, 1973, to control the crisis of confidence precipitated by the collapse of London and County Securities. The machinery, established by the Bank of England with the help of the clearing banks, was intended to review the liquidity of fringe banks and to reinforce their liquidity when necessary. It was set up, in particular, because money market deposits with which the secondary banks funded their protracted lending commitments, ceased flowing to these banks as depositors sought more 'secure' outlets for their savings. The relative scarcity of new deposits made it difficult to sustain even existing volumes of business and in order to forestall the collapse of the entire secondary banking system, the Central Bank and the clearing banks made available funds although at a premium over usual borrowing rates. The aim of the Bank of England and the clearers was to secure eventual repayment of their loans with as little loss as possible. But this had to be achieved consistently with safeguarding confidence in U.K. Banking - the prime motive of the action.

At the outset, approximately £1,300 million was committed to the rescue operation of which £1,200 million was contributed by the clearing banks with the remainder from the Bank of England. The funds originally supported more than 30 secondary banks and finance companies but the majority was earmarked for a few relatively large groups which had previously been financed to a large extent with short term funds from the money market. With the exception of Keyser Ullmann, these were concerns with a traditional consumer credit business onto which had been grafted a banking business, often with considerable outstanding loans against property. The latter was also true of Keyser Ullmann whose bad loan provisions for the years 1974 and 1975 were £30.6 million and £64 million respectively. These were necessitated principally as a result of property lending activities which accounted for about 80% of its total loan portfolio and possibly over 95% of the provisions.
The five largest companies which depended on the 'lifeboat' and the extent of their support in 1974/1975 were:

<table>
<thead>
<tr>
<th>Company</th>
<th>£ million</th>
</tr>
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<tbody>
<tr>
<td>U.D.T</td>
<td>450</td>
</tr>
<tr>
<td>F.N.F.C</td>
<td>360</td>
</tr>
<tr>
<td>Mercantile Credit</td>
<td>166</td>
</tr>
<tr>
<td>Bowmaker</td>
<td>90</td>
</tr>
<tr>
<td>Keyser Ullmann</td>
<td>37</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1103</strong></td>
</tr>
</tbody>
</table>

At the end of the Bank of England's last financial year (February 1976) the support operation had been reduced to approximately £800 million. All the surviving companies had significantly reduced their dependence and a number had dispensed with it altogether. The latest available information suggests that U.D.T. and F.N.F.C. are the only major groups in need of lifeboat funds but that they account for £650 million or 81% of the total.

The lifeboat is notable for its success in averting the 'domino effect' which threatened to overtake the secondary banking system. It is also remarkable as an illustration of the nature of the City operations and for its wider implications. It reveals for example, the inter-dependence of the financial system and the Bank of England's reluctance to allow the demise of financial institutions which may upset the delicate infra-structure. More germane to this study is its function in over-ruling free market forces and its repercussions on banking structure. Those concerns which have continued trading and extricated themselves from the rescue mission have in common a relationship with a large financial group.

In some cases this existed before 1974 but for the majority, major capital restructing or full acquisition by a strong group proved to be the only way in which they could attract deposits in the market, and the only long-term alternative to liquidation.
There are several examples of acquisitions undertaken to eliminate lifeboat assistance. The largest of these was the £36 million takeover by Barclays Bank of Mercantile Credit announced in August, 1975. The immediate effect was the finance houses' ability to dispense with lifeboat support. By becoming part of a clearing bank group, Mercantile Credit became totally reliant upon Barclays for its funds.

In those cases where major restructuring took place the clearing banks were also often involved. Cannon Street Investments, for instance were supported by National Westminster which acquired 63.6% of its capital and took over Cannon Street Acceptances. At Keyser Ullmann, the deputy chairman of Barclays, Mr. Derek Wilde became chairman in March 1975, and the merchant bank's managing directors and chairman resigned. Within seventeen months Keyser Ullmann was able to rebuild deposits from normal market sources and to repay its lifeboat borrowings of £65 million. In contrast, Bowmaker, the credit finance and leasing subsidiary of C.T. Bowring extricated itself with the help of a £20 million syndicated loan from the clearing banks arranged by Lloyds Bank and a £5 million three year credit facility from the Bank of England.

The point of these illustrations is to give an indication of the importance attached to a secure capital base and intangible assets such as goodwill and reputation in times of tension and declining confidence. Practical support for this view is available from the experiences of the independent finance houses which suffered indiscriminately from the withdrawal of, and failure to roll-over, deposits. It appears that they suffered equally, irrespective of their investment and loan portfolios. Thus Bowmaker, a wholly-owned subsidiary of a prominent insurance broking group and without property lending in its outstanding portfolio, was forced to rely upon lifeboat assistance. In so doing, Bowmaker and other assisted concerns were forced to pay a premium of some 1½ to 2% over the rates at which the bank-controlled financed houses were able to borrow.
Inevitably, therefore Lombard North Central (National Westminster Bank), Forward Trust (Midland Bank), Hodge Group (acquired by Standard and Chartered Bank in December, 1973) and Lloyds and Scottish (Lloyds Bank and Royal Bank of Scotland) fared relatively well.

In the restrictive climate of the post-credit boom era, the importance of size and the reputation attached to a large resource base became very apparent. In the case of smaller secondary banks and non-members of the Accepting Houses Committee there has been a clear trend towards acquisitions mainly by stronger, but certainly by larger, groups. Not all the acquired companies were dependent upon lifeboat assistance, indeed in several instances acquisition obviated the necessity. The major takeovers of this kind are tabulated below; unless specified the acquisition was 100%.

8.3.2 : International Issues: Injections of Capital - U.K. Banks

The secondary banking crisis did not adversely affect the fringe banks and independent finance houses alone. The dominance of the big banks extended beyond the limited area of consumer finance to embrace most kinds of banking activity. Sheer weight of resources has unquestionably become of increasing importance in developing new banking business particularly in international markets. Furthermore, the capacity to meet growing international financial requirements tends to be concentrated in a limited number of banks.

A major reason for the premium put on the ability to raise very large amounts of money is simply the growing scale of the finance required, particularly for major international projects. In the past, the innovative U.K. merchant banks could accommodate international financing deals - eurocurrency credit syndications or the management of bond issues - by fulfilling a specialist intermediary role. As managers or co-managers they were able to arrange a syndicate for large credit demands by petitioning other banks to provide the funds, leaving their own resources intact. Thus their revenue was derived from fee income earned as managers rather than from interest rate spreads.
Table 8.1: Rescue acquisitions in the U.K. banking industry 1972-1977

<table>
<thead>
<tr>
<th>Date</th>
<th>Concern</th>
<th>Acquirer</th>
<th>Consideration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec. 1973</td>
<td>Hodge Group</td>
<td>Standard &amp; Chartered Banking Group</td>
<td>£34.7mm</td>
</tr>
<tr>
<td>Jan. 1974</td>
<td>Western Credit Holdings (now Philadelphia Credit Holdings)</td>
<td>Philadelphia National Bank (U.S.A.)</td>
<td>£1.5mm (majority stake)</td>
</tr>
<tr>
<td>Jan. 1974</td>
<td>Bovis (including Twentieth Century Banking)</td>
<td>P &amp; O</td>
<td>£25mm</td>
</tr>
<tr>
<td>Sept. 1974</td>
<td>British Bank of Commerce</td>
<td>National &amp; Grindlays Bank</td>
<td>£3.3mm</td>
</tr>
<tr>
<td>Dec. 1974</td>
<td>Hawtin &amp; Partners (subsidiary of Hawtin)</td>
<td>Gulf and Western Inds (USA) N.K.</td>
<td></td>
</tr>
<tr>
<td>Feb. 1975</td>
<td>Burston &amp; Texas Commerce Bank</td>
<td>Texas Commerce Bank (USA)</td>
<td>£2.2mm</td>
</tr>
<tr>
<td>Feb. 1975</td>
<td>Cripps Warburg</td>
<td>Williams &amp; Glyns Bank</td>
<td>Nominal</td>
</tr>
<tr>
<td>March 1975</td>
<td>Anglo-Portuguese Bank</td>
<td>Norwich Union Insurance Group</td>
<td>£12mm</td>
</tr>
<tr>
<td>March 1975</td>
<td>Northern Commercial Bank</td>
<td>Algemene Bank Nederland (Nederlands)</td>
<td>£2.5mm</td>
</tr>
<tr>
<td>Aug. 1975</td>
<td>Mercantile Credit</td>
<td>Barclays Bank</td>
<td>£36mm</td>
</tr>
<tr>
<td>Dec. 1976</td>
<td>Wallace Brothers</td>
<td>Standard Chartered Bank</td>
<td>*Deferred cash basis</td>
</tr>
</tbody>
</table>

Note: *Up to a maximum of £1mm to be related to net worth calculated in 1982*
Events in domestic and international banking in the past few years, however, have to a marked extent increased the need for the individual bank to put up a significant proportion of the funds raised itself. There are several reasons for this, the first of which is a result of the post-1973 financial environment. The aftermath of the Herstatt collapse and other problems brought a renewed conservatism among depositors of large funds, including the international banks themselves, which meant that for a period at least the biggest - and therefore presumably the safest - banks were able to dominate the markets.

Their domination was manifest in the decline of the specialist intermediary function - as represented by the merchant banks which in the past had been able to underwrite loans of perhaps $100 million with confidence in their ability to 'sell out' a high percentage to other banks in the euromarkets. The key to their success was 'placing power'. The market for participation is now dominated by the major North American and European Banks which have matched the merchant banks in expertise but have the advantage of also being able to employ their own enormous resources. As a result of market forces reacting to uncertainty and conservatism, a bank without tied-placing power is now able to 'sell down' approximately 30-40% of its allotment as compared with 70-80% two or three years ago.

In addition, competition to lend eurocurrencies has become extremely fierce with spreads forced down to about 1% or below for first class borrowers. The edge in the rivalry to receive a syndication mandate lies with those banks which can offer large amounts. During 1976 the crucial underwriting commitment level required to obtain a co-managership (and thereby earn fee income of ½-1%) has risen from $10-20 million to $20-30 million. By implication, therefore, an underwriter may have to commit itself for approximately $25 million and with a sell-down of 40% would have to accommodate up to $15 million in its own loan portfolio. For the merchant banks, the economics of loan syndications have inevitably deteriorated and hampered by their relatively small deposit base and the decline of their pure intermediary function, their presence has tended to diminish.
A final reason stems from the deep world-wide recession of 1974-75 which caused severe strains on the financial structure of corporations, project financing, the shipping industry and developing countries (LDCs) — all borrowing customers of the euromarkets. The consequences were bankruptcies, foreclosures and debt rescheduling, all of which call for sensitive negotiations and flexible interpretation of agreements. This is particularly difficult to achieve when there are several lenders, few of which are in direct contact with the defaulting borrower and each with their own interests to protect. This poses technical problems for international bankers in preparing placement memoranda, in obtaining warranties from borrowers as to the accuracy of information and representations and in incorporating, in loan documentation, covenants of absolution from participating banks. The solutions seem to be changes in the arrangement of loans, which will be increasingly subscribed by small groups of large banks. This structure would allow each bank to take a major participation as a co-manager, sharing full responsibility for the credit and sharing equally in the front-end fees.

The increasing stress on international banking business has also brought out the importance of size in making it possible for a bank to achieve extensive coverage abroad. The big U.S. banks and increasingly the U.K. clearing banks are in a position to develop branch and representative networks spreading across the world. Even the largest independent merchant banks cannot compete on equal terms with the big commercial banks; indeed, the volatile money markets have proved to be an imperfect substitute for branches in providing cheap, reliable deposits. Proof of this contention may be obtained from an examination of the accepting houses' relative decline since 1973, as measured by the fall in their share of currency deposits. Following the oil crisis and the financial instability of 1974-1975, the large inflow of petro-dollars went to the larger commercial banks. If they had maintained their share of deposits they would have stood at £11 billion at the end of 1976 instead of £6.3 billion. Thus, the aggregate deposits of the accepting houses as a proportion of total deposits held by banks have declined from 5.8% in 1973 to 3.1% at the end of 1976.
Following the lead of Sir Kenneth Keith of Hill Samuel, a growing number of merchant banks are now apparently reconciled to the need for financial backing from, if not ownership by, external groups. Two of the reasons for this stem directly from the arguments developed above. First, the merchant banks require the funds to compete effectively for euromarket business; and secondly the funds have been essential to achieve much greater size quickly in order to facilitate the development of more effective international coverage. The third reason is also a product of the recent adverse climate, in which a shift of power took place between the merchant banks and the clearing banks. This is developed in the next section but it should be noted at this stage, that coincidental with the difficulties encountered in syndicating international loans was increasing competition from the clearing banks and international investment banks for corporate finance services which the merchant banks had previously dominated. Moreover, with the economic recession and decline in share prices the relatively brief period of hectic merger and acquisition activity ended and the flow of capital issue business virtually halted. The loss of fee income from these sources at a time when it was particularly needed and the consideration, that their 'monopoly' in corporate finance expertise was endangered, confirmed the need for increased resource backing.

The size problem has been tackled in different ways by the accepting houses. Some banks, anticipating the need for growth, undertook a series of inter-merchant bank mergers or received injections of capital from international financial groups. The latter has been most acceptable recently, for with depressed stock market valuations and the reluctance of family interests (which still control a number of merchant banks) to sell out, minority interests achieve the desired effect of increasing capital funds without unduly diluting existing shareholders' equity. There have been several examples of merchant banks seeking external support most of which has come from overseas. A parallel development involving three of the largest accepting houses has been the divestiture of interests in associated
banks (actually London-based consortia) to foreign banks. The measures taken to restructure and increase capital bases are collated in Table 8.2.

### Table 8.2: Changes in Capital Structure/Minority Shareholdings in U.K. Merchant Banks: 1974-1977

<table>
<thead>
<tr>
<th>Year</th>
<th>Merchant Bank</th>
<th>Minority Shareholder</th>
<th>Details</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>1975</td>
<td>Edward Gates</td>
<td>First Arabian Corporation</td>
<td>Acquisition of 25% equity stake, with option to purchase further 15% within three years</td>
<td></td>
</tr>
<tr>
<td>1975</td>
<td>Hambros</td>
<td>Prudential Insurance (U.S.A.)</td>
<td>Market purchase of 9.5% of equity; also injection of £25 m by subscribing for subordinated loan stock issue</td>
<td>Proceeds of loan utilised for expansion of overseas and euro-currency banking business</td>
</tr>
<tr>
<td>1975</td>
<td>Grindlays (parent of Brandts)</td>
<td>Citibank</td>
<td>Injection of £5 m equity finance raising its stake from 40% to 49% and increasing Grindlays' share capital by 17.5%. Lloyds Bank also arranged two 5-year subordinated loans to raise further £27.5 m</td>
<td>Necessitated by bad loan provisions of Brandts, amounting to £25 m for 18 months to June 1975 almost wholly against property advances. May 1975, Brandts obliged to leave Accepting Houses Committee; Grindlays assumed closer management control and to reflect this, subsidiary re-named Grindlay Brandts.</td>
</tr>
<tr>
<td>1976</td>
<td>Fraser Ansbacher</td>
<td>Lissauer Group</td>
<td>Injection of £4 m divided between new equity (£1.8 m), convertible loan stock (£1.2 m) and £1 m additional long-term investment. Lissauer's equity stake = 25%</td>
<td>Funds intended to provide base for international expansion</td>
</tr>
<tr>
<td>1977</td>
<td>Arbuthnot Latham</td>
<td>Banca Nazionale del Lavoro; Agnelli Family (Fiat); Bronfman Family (Seagram Whisky)</td>
<td>Each invited to take equity stakes</td>
<td></td>
</tr>
</tbody>
</table>
The trend towards close relationships with large financial groups is especially pronounced in the case of members of the Accepting Houses Committee. Since 1973, when the Bank of England relaxed its restrictive ownership regulations, the majority of houses have undergone far-reaching changes in the structure of their control. An indication of the resulting pattern of ownership is detailed in Table 8.3. This lists those banks which are now part of an independent financial group and those parents have received finance from external minority shareholders. The number of totally independent groups has now been reduced to seven. From among these, a few can be expected to forge new links over the next few years. It seems likely that this process will accelerate if share prices rise substantially and families which have extensive interests in the banks, become more willing to sell.

<table>
<thead>
<tr>
<th>Accepting House</th>
<th>Quoted Nature of Parent</th>
<th>Nature of Parent</th>
<th>Unquoted Company</th>
<th>Major External Shareholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latham Arbuthnot</td>
<td>Independent Group</td>
<td>Holding Company</td>
<td>Unquoted Company</td>
<td>I.C.F.C. (10.9%); Camp</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(Netherlands) (6.6%); Phil-</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>adelphia International Inv-</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>estment Corporation (4.5%);</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Toronto Dominion Bank (3.5%)</td>
</tr>
<tr>
<td>Japhet Gibbs</td>
<td>Charterhouse Group</td>
<td></td>
<td></td>
<td>Prudential Assurance (8%)</td>
</tr>
<tr>
<td>J. Annes Mahon</td>
<td>Antony Gibbs Holdings</td>
<td></td>
<td></td>
<td>Hong Kong &amp; Shanghai Bank</td>
</tr>
<tr>
<td>Hambros Bank</td>
<td></td>
<td></td>
<td></td>
<td>(40%)</td>
</tr>
<tr>
<td>Baring Brothers</td>
<td></td>
<td></td>
<td></td>
<td>Prudential Insurance Co. of</td>
</tr>
<tr>
<td>N. M. Rothschild</td>
<td></td>
<td></td>
<td></td>
<td>America (11.7%)</td>
</tr>
<tr>
<td>Warburg &amp; Friedlander</td>
<td></td>
<td></td>
<td></td>
<td>J. P. Morgan (35%); Willis</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Faber (22%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Compagnie Financiere de Paris</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>(25% of S.G. Warburg)</td>
</tr>
</tbody>
</table>

: Except where stated, the parent company owns 100% of the accepting house;

Of the 7 other members of the Accepting Houses Committee, Hill Samuel, Kleinwort Benson and J. Henry Schroder Mogg all belong to large financial groups with diverse interests and an independent stock exchange quotation. The same is true of Brown Shipley and Rea Brothers, although these banks are much smaller and their parent companies less diversified. Baring Brothers and N.M. Rothschild are unquoted private companies. In each of the 7 cases, banking contributes the greatest proportion of total disclosed profits, and family or directors have extensive interests in the ownership of the parent.
The development of London as a leading financial centre has been based on the multiplicity and specialisation of financial intermediaries. However, the structural, technological and environmental changes in the financial service industries have pointed recently towards the concentration of financial business in a smaller number of larger multi-product financial institutions. Acquisitions such as that by Barclays Bank of Mercantile Credit and the minority stakes taken by foreign groups in the accepting houses tend to confirm this trend. Recent pressures have indeed favoured the view that the future of the City lies in the Continental concept of 'universal banking' in which a wide range of services is provided by a single large institution. There is certainly evidence that, on an international scale, the functions of the specialists are increasingly being taken over by the big banks which have the large resources needed to support lending activities. The events of the past couple of years seem to have accelerated this trend. Depositors' caution has meant that funds have been attracted to the larger (and therefore 'safe') institutions of the expense of smaller organisations.

The efforts of the large commercial banks - particularly from North America and the Continent - are having a significant impact on the intermediary activities traditionally undertaken by specialised merchant and investment banks. The indications are, moreover, that foreign commercial banks are increasingly determined to extend their presence. This has been particularly evident in the case of the U.S. commercial banks, several of which have developed international merchant banking subsidiaries and have taken shareholdings in consortium banks.

The merchant banks' market power in the provision of domestic corporate financial services has also been eroded recently. It has long been recognised that this power stemmed from an inter-dependent mixture of expertise and reputation which in turn relied heavily on the calibre of staff employed and the maintenance of an environment conducive to flexibility, initiative and entrepreneurial flair. The major entry barrier to merchant banking
from the point of view of the clearing banks was the latter's own large and stratified organisations which, it was argued, would not easily accommodate a merchant banking facility. The merchant banks' predominance owed a great deal to their innovative behaviour in first encouraging the expansion of the euromarkets and the domestic markets for various corporate financial advisory services and then adopting or developing the expertise to exploit them. The decline in the level of merger and acquisition activity and the virtual disappearance of new issues during 1974-1975 compounded the difficulties experienced in international eurocurrency markets. At the same time, the U.K. clearing banks, in their different ways, have been actively developing merchant banking activities. With the exception of Lloyds Bank, each of the London clearing banks has wholly-owned merchant banking subsidiaries, Barclays and National Westminster which developed in-house facilities - Barclays Merchant Bank and County Bank respectively - recruiting staff from the independent merchant banks. Midland Bank's acquisition of Montagu Trust and the Drayton Corporation, in contrast, provided a well-established merchant banking vehicle with which to enter the market. There seems little doubt that the clearing banks will in time, make extensive use of the close contacts they enjoy with corporate customers and will encroach on areas of activity such as corporate finance advice which the accepting houses have dominated.

This conclusion has inevitably been disputed in the City by the merchant banks which consider that their role as financial entrepreneurs cannot be effectively assumed by the institutionalised organisations of the big banks. The qualities of flexibility and adaptability are still recognised in the financial sector as essential to its further development and continued importance. Thus a strongly entrenched tradition of specialist financial organisations serving individual needs persists. The Bank of England, in particular, has taken a protective view of the elite merchant banks which form the Accepting Houses Committee. The examples shown in Table 8.3 indicate that it no longer objects to the ownership of accepting houses lying within large financial groups. But the Bank has continued to
insist on the independence of merchant banking activities even if accommodated within a big group. Membership of the Committee is a carefully guarded privilege and is achieved only with the agreement of the existing members and the Bank of England's blessing. In return the members are afforded a special status. This is tangible in the sense that bills drawn on accepting houses command the finest rates of discount in the open market; it is also intangible in that a close relationship exists between the Central Bank and the Committee which affords members a special position in the banking hierarchy. This is evident from the unusually close relationships with the Bank, and, because of their status, a tacit understanding that they would not be allowed to fail in any way which would damage the interests and confidence of depositors. Thus when depositors were primarily concerned with ensuring the safety of their funds, as they were from 1974 to 1975, the senior merchant banks largely avoided the indiscriminate withdrawal of deposits experienced by other secondary banks.

The Accepting Houses Committee is a unique feature of the financial system and clearly a very important one both in practical terms for its members and in illustrative terms for observers. Its significance seems likely to preserve for the seventeen merchant banks which it contains a future role, albeit a diminished one, in the structure of banking markets. In order to retain its influence, however, its members must be seen to operate with appropriate prudence for they are cushioned from exhaustive analyses of their financial performance by their privileged ability not to reveal true profits by undisclosed allocations to hidden reserves. Confidence, the all important element in banking, threatened to desert even the accepting houses during the recent crisis. The high premium put on the prudent operation of banks preferably with the ability to absorb losses if they are made, tested the merchant banks in spite of their status. The implication is that banks which threaten to lower the standard of the exclusive club and thereby reduce its influence should be expelled.
The losses incurred by William Brandts on its property lending portfolio, which required £14 million of provisions in 1974-1975, represented just such a contravention. The implicit recognition of this fact led Brandts to resign its membership though - for appearances - the reason given was that Grindlays had to strengthen management control on account of the property exposure.

Thus the probability is that certain functions of the merchant bank, particularly those not utilising capital, will continue to be reflected in the activities of the City's specialists as well as in the development of the big commercial banks. This appears to relegate the independent merchant banks to the role of specialist consultancies exclusively offering advisory services. Recent evidence suggests that this is indeed the case for those banks which cling on to their independence. The most clearly established trend of the last three years has been the gradual absorption of merchant banking functions into larger organisations or, alternatively the forging of links by merchant banks with other financial groups.

A total transformation in the character of the U.K. banking system towards a greatly increased international involvement of banks of a 'generalist' nature has been prevented by the recent development of the consortium banks. Most of the consortium operations were established chiefly to provide a participation in the eurocurrency markets for their shareholders. In the past couple of years, however, several of the consortia have managed to diversify away from their original role as vehicles for medium-term lending, by developing individual styles and specialisations.

A number of trends that have emerged in the recent development of the consortium banks are likely to have a bearing on the future structure of financial markets. This is largely because they illustrate a viable alternative to the apparently inexorable demise of the specialist intermediary. The increasing importance of the consortium banks is based on the recognition
of three factors: first, that in the massive recent expansion of banking in general, the growth of international banking has been predominant; secondly, that a bank's capacity to participate in the eurocurrency markets is greatly enhanced by its own size or by the financial strength of its shareholders; and thirdly, that in the expansion of lending activities which reduced the ratio of equity/total assets to their lowest prudent level, a source of income derived independently of the capital base, was essential to improve profitability.

The prominent consortium banks have apparently recognised each of these factors and have developed into a full international investment and merchant banking role. Instead of acting as participants in large-scale medium-term international lending operations, a number of the consortium banks have deliberately set out to increase the proportion of their profits which are gained from fee income. This arises from activities in managing and arranging the loans and bond issues, and in offering corporate financial advice to their corporate and foreign government clients.

In so doing, the consortia have almost totally displaced the traditional U.K. merchant bank in the international market place. One consequence has been a tendency for the merchant banks to reduce their involvement in consortium operations. They have seen these associates developing into direct competitors for precisely the kind of services which have traditionally been the preserve of the London merchant banks. The consortia have been able to retain small, flexible and innovative executive staffs yet have substantial resource backing to support large-scale lending and underwriting activities. Such resources, as noted, are available to the commercial banking participants in international groups on a scale not generally possible for the merchant banks. Thus, Hambros, Kleinwort Benson, Brown Shipley and Charterhouse Japhet have all drastically reduced or completely relinquished their investments in London based consortia.
The growth of the investment banking, or fee income, aspects of the consortia's business has been coincident, and indeed dependent upon, the rapid expansion of the eurobond market. Since the early 1960's this market has been the focal point for international issues. As the accompanying Figure shows, its growth was subject to a fluctuating pattern until after 1974. In 1975, and 1976, however, the eurobond market expanded sharply with issues in all currencies aggregating $8.6 billion and $4.1 billion respectively. Expansion continued into 1977 with 175 issues in the first half of the year totalling $8.2 billion.

Figure 8.1: Eurobond Issues 1966-1976

Source: Morgan Guaranty
The larger consortium banks, notably Orion and European Banking Company, have consciously planned to develop into leading international investment or merchant banks. Orion's achievement in the field of eurobond issues during 1976 and the first half of 1977 is evidence of its success. During 1976 Orion managed eight public issues of S$325 million, and private placements of $310 million. The aggregate of issues and placements which were managed or co-managed by Orion totalled 46 raising $1.4 billion. This compares with a total of $1.5 billion, over the previous five years. The performance in 1976 confirms the bank as among the leading US and Continental issuing houses active in the international markets.

The success of Orion which was nearly matched by that of European Banking Company, has been based on the building-up of a placing power capability, which stems originally from success in the private placement field. It is important to note that the expertise necessary for this is developed independently of the financial backing of shareholders. It also reveals that placing power (roughly defined as the ability to place at least $500,000 of a new issue with investors) has become of greater importance than connections which allow banks to bring customers to the market. Thus the traditional accepting houses which undoubtedly have extensive and entrenched relationships with corporate clients have, with the notable exception of S.G. Warburg, been superceded by a new breed of investment/merchant banks which have considerable international marketing expertise. Some of these are Continental banks, such as Deutsche Bank, Credit Suisse-White Weld and Kredietbank; others are the well established, US investment banks, Kuhn Loeb, Morgan Stanley, and Lehman Brothers for example. The others are being developed within the London consortium banks, notably Orion and European Banking Company which have the ultimate backing of powerful commercial banking groups. S.G. Warburg is the only U.K. merchant bank which became and has remained a pre-eminent force in the euromarkets. Despite competition from commercial banks and its refusal to contribute its own funds to the syndicated credits which it manages, Warburgs is very
successful in the market for syndicated loans. To a large extent, its
success is owed to an early devotion to the euromarkets which dates back
to 1963, when the firm was the lead manager of probably the first eurobond
issue. This concentration has helped Warburgs to create confidence that
their issues are well-placed; ultimately, however, this confidence is
based on its substantial and expanding placing capability.

Notwithstanding the breadth of services offered by merchant and
investment banks, underwriting international bond issues has become a
particularly important aspect of corporate finance work and has made a
significant contribution to fee-earning business. Moreover, the connections
established through a presence in this market add considerable weight to
the banks' entry into allied international, fee-earning corporate finance
business. There has been scope for instance, in the market for advice
in relation to cross-frontier mergers and acquisitions, and capital
reconstructions. Relationships with Middle Eastern states, developed
through the eurobond markets, have been of assistance for example, in
securing a foothold in a market which has been dominated by traditional
merchant banks. There are several notable examples where a consortium
bank has acted for a party undertaking an acquisition. In 1975, Orion Bank
negotiated the sale of Babcock and Wilcox's 25% interest in Deutsche
Babcock to Iran for £31 million. A similar case involving Middle Eastern
investment was the sale of the Dorchester Hotel, also arranged by Orion,
to undisclosed Arab interests. Orion was also appointed by Chase Manhattan
(a major shareholder) to sell its shareholding in Standard Chartered Bank.¹

These examples, whilst interesting in their own right, also clearly
illustrate a significant change in the nature of the financial system.

It seems that in the future development of the international financial
system, there will be a continuing role for the 'specialist' in competition
with the 'generalist'. These 'specialists', however are a different breed
from their conventional merchant banking predecessors. The latter were
small, close-knit organisations depending to a large extent on fee income
earned from advice given to old-established corporate clients. In the
In contemporary financial markets, the advantages of flexibility and small size have been superseded by the need for a strong capital and deposit base, the achievement of which has continually eluded the majority of U.K. merchant banks. The new international merchant and investment banks can combine the necessary qualities of flexibility and expertise with the ability to overcome the shortcomings of the traditional accepting houses.

Whilst the emphasis remains on professional, high calibre and often entrepreneurial executive staff, their parentage and structure are new and reflect the changed nature of international financial markets in which lending capacity and placing power, rather than links with industrial companies, are of paramount importance. To an extent, the consortium banks resemble the continental 'banques d'affaires'. Yet they are unlike them in that they are able to complement their managerial talent with a vast supply of funds provided by powerful shareholding banks. These will not only provide equity capital but can also act as a ready-made syndicate for loans or eurobond issues which are lead managed by their subsidiaries.

8.4 : Regulations

The principles governing the control of modern multinational banking operations do not differ essentially from those that have traditionally guided domestic banks. However, the world's financial markets, particularly those in London, have become so complex in the past twenty years that it is not always easy to judge how these principles should be applied.

Four different reasons for wishing to control bank operations can be distinguished. The oldest and most fundamental of these is to protect depositors, and at one remove shareholders, against the unscrupulous or injudicious use of their funds, which might result in a run on the bank and perhaps ultimately its failure. Underlying general banking prudence is the fiduciary relationship with the customer, in which he entrusts his money to the bank and the bank must both look after it and make good use of it. In recent times central banks have reinforced this banking prudence with their own arrangements for control, inspection or supervision.
In so doing, they have sought not only to protect the depositors in individual banks but also to prevent loss of confidence and disruption spreading through the whole system. History has many cautionary tales of spectacular runs and failures. Those of 1974 are only the latest example.

The second reason for bank control is the desire of national authorities to influence the volume of credit and money in circulation, usually by restraining its increase.

The third reason is related to encouraging competition and discouraging monopoly or controls. The fear is that a strongly established cartel will prevent new entry into banking and that the lack of competition will lead to the exploitation of customers and misallocation of resources.

In the U.K. the emphasis of this type of intervention by the authorities has increased as banking units have grown larger. The Bank of England's Competition and Credit Control regulations of 1971 for example, brought together a number of steps to encourage competition.

One of the forces maintaining competition in modern banking is the internationalization which brings large foreign banks into an increasing number of financial centres. This is especially apparent in London where foreign banks now hold 17% of sterling deposits and 75% of deposits in other currencies. Banks tend to be diversified across a number of markets and whilst controls may persist in specific markets or market segments, the structures of certain other international markets are not oligopolistic. In the markets for syndicated medium-term banks loans and international bond issues, for example, competition is extremely fierce and tends to be between the world's largest and most powerful banks.

The final reason for external control of banking is the desire on the part of governments and other sections of the community to curb the power that banks exercise, consciously or unconsciously, over large sectors of their economies. This often leads to demands for nationalization which have recently been apparent in the U.K.
It is impossible to detail, in a short space, the various methods of regulatory control of banks. It will be more useful to outline the conventional methods, to discuss the ways in which these have been superseded by contemporary banking business and to examine the recent U.K. proposals for banking supervision.

Possibly the most important form of prudential control is that imposed by certain restraints on a bank's balance sheet. There are two types of banking ratios to which banks are usually required to pay particular attention. The first is its liquidity ratio, most naturally expressed as a relationship between liquid assets (or reserve assets) and total deposit liabilities. Its purpose is to guard against the effects of a run on the bank or a sudden change in the availability of deposits, and to guarantee that the bank is able to meet its obligations in the short term. In 1971, the Bank of England introduced a reserve ratio of 12½% for all banks which was intended primarily to serve as a means of regulatory control for purposes of monetary policy. In practice, the prudential ratio being observed by the clearing banks is nearer 20%.

Two features of the modern banking scene have complicated the question of liquidity ratios. One is the very large and widespread increase in the marketable debt of public authorities which tends to provide the banking system with more assets of that description than they would ideally wish to hold. Where this debt is longer than two years, such assets, even though they may be readily realisable in a continuously active market, can carry a considerable risk of capital loss. In these circumstances their value as readily realisable liquid assets has a distinct qualification.
The other qualification is the rapid development of the inter-bank market where most funds have a longer nominal maturity than the retail deposits acquired by the commercial banks, which can in theory be withdrawn at sight or at very short notice. However, these retail deposits have proved to be remarkably stable overall, whilst inter-bank funds have to be rolled over at fluctuating rates of interest and are very sensitive to short-term flows and official monetary measures. Banks which become heavily dependent upon the inter-bank markets for their funds need to be especially careful of the reliability of the repayment on maturity of their matched assets or to carry a higher ratio of truly liquid assets.

The second banking ratio is that which emphasises a bank's capital adequacy and highlights the management of the assets side of the balance sheet. Several problems of definition hinder the universal application of these ratios. The most important of these concerns whether or not capital should include loan stock as well as equity. The former has recently become a favoured way for U.K. banks to increase their capital resources and in several instances, funded debt has taken the form of floating rate notes (F.R.N.s) which have been issued on the international capital market.

Just as some central banks have developed sophisticated liquidity ratios, the Federal Reserve Board in the United States has established differing capital ratios for various types of assets ranging from nil for cash through 10% for loans to 100% for losses. But these, and any other, formulae are no substitute for a qualitative analysis of risk on major loans accompanied by realistic loan provisions. Over-commitment to a single borrower or category of borrowers represents a very real threat and the best way to bear risk is to spread it. In the U.K. secondary banking sector, this lesson was unfortunately learned at considerable cost.
Both liquidity ratios and capital ratios involve relating selected items on one side of the balance sheet with a larger aggregate on the other side. Another approach is to make a detailed comparison of a bank's liabilities with the whole of its assets. This process, known as matching, can take three forms, maturity matching, interest rate matching and currency matching. Matching has been of particular importance in wholesale money markets, in the eurocurrency markets and in the foreign exchange markets.

To summarise, mismatching may be seen as part of the transformation by which the banking system collects short-term deposits and eventually makes loans of several years' maturity. From the individual bank's point of view, each bank must see that it is not left with too large a share of the transformation process, and the other prudential criteria must be needed where matching is, as it often must be, departed from to some carefully controlled extent.

Besides such trends as increasing government intervention and the increase in inflation, the most important complicating development is the trend towards increasing internationalization. In addition to the obvious problems of expanded structure and lengthened chains of command, internationalization has affected bank control and supervision in a number of ways. Thus it is necessary to consider what kind of supervision is appropriate for international banking. What kind of authorities can control contemporary markets in which loans are of much greater size and longer maturity and are composed of many currencies. Uncertainty as to whether foreign bank offshoots were subject to control by the authorities of the parent country or by those of the host country was highlighted by the failure of the Israel British Bank in London in 1974. As a result, the Bank of England obtained the so-called 'letters of comfort' from parents of foreign bank offshoots in the City, including joint parents.
of consortium banks, accepting the ultimate responsibility for them.
Thus the main central banks publicly accepted the obligation to act
as lenders of last resort to the foreign networks of parent banks under
their jurisdiction. There has also been a measure of agreement between
central banks on sharing the task of supervision in such a way that the
central bank in the parent country takes a general view of the parent bank,
including its foreign branches and subsidiaries, while leaving day-to-
day supervision and regulation to the central banks of host countries.

The growth and operation of U.K. banks, including London-based
subsidiaries of foreign-owned banks, has consequently been greatly affected
by the attitude of the Bank of England. Almost alone among central banks
however, the Bank of England has sought to regulate banks under its
supervision as little as possible. Some of the consequences of its
insistence on controlling by suasion rather than by statute have been
examined in previous chapters. The implications of the recent developments
in banking markets can be examined in the context of the Bank's future
control not only of banks' operations, but also of the entire U.K. financial
system. It is clear that any supervision will be operating against a wider
background than simply the problems of the British fringe banks which
provided the main impetus for tightening control over the system. The
problems faced are international in character and the approach to supervision
cannot be parochial. This is obviously recognised by the Bank: frequent
discussion and liaison take place between the U.K. central bank and its
opposite numbers in the E.E.C., and in the wider forum of the monthly
central bankers' meeting in Basle. The world-wide character of the
problems involved, highlighted by the difficulties in the international
banking markets which ran parallel with the U.K.'s own crisis in 1974 and 1975,
has been acknowledged in the establishment of a permanent international
committee to keep a continuing watch on developments.
As a member of the E.E.C., the U.K. is committed to participating in the development of closer harmonisation of banking supervisory practice within the community. The proposed legislation on the licensing and supervision of deposit-taking institutions, set out in the 1976 white paper, will enable the U.K. to meet this obligation, and will represent a major innovation in practice. Yet the proposals retain a peculiarly British character. In common with the flexible and informal approach towards the supervision of the securities markets, the preference of the Bank is quite clearly against creating an excessively formal structure of supervision and against the establishment of rigid criteria for judging the solvency of banks. Its approach retains much of its traditional scope for exercising judgement on an individual bank-by-bank basis. Thus the prudential criteria which are laid down should be described as yardsticks or guidelines rather than categorical imperatives.

The British proposals draw on the practice of a number of other countries. U.S. experience, for example has provided the model for certain aspects of the considerably tighter supervision which is already being exercised by the Bank of England. The Bank, as a result of its efforts in the past few years, is now receiving much more detailed and more frequent information from the banks and deposit-taking institutions within its jurisdiction and has greatly expanded the range of relationships which it examines. They include various aspects of a bank's profit and loss account and a considerable number of ratios relating to capital, deposits, loans, liquid assets, undrawn commitments and standby facilities. The Bank has also been developing analysis which follows a system used in New York assessing, on a points basis, the deviation of the various ratios from a model.

The U.S. system provides the example for the deposit protection fund, which is planned to be part of the new legislation, with the established operation there of the Federal Deposit Insurance Corporation (F.D.I.C.). The main requirement of the European Community though, is to establish a form of prior authorisation of deposit-taking institutions. It is
this which is probably the most radical departure proposed in the legislation from traditional British practice. The new system will establish for the first time a clear definition of a 'bank'; it will be sharply differentiated from other 'deposit-taking institutions' and will enjoy several privileges. In particular, only institutions classified as banks will be exempt from licensing and will be permitted to use the world 'bank' and its derivatives in their titles and advertising.

Until now the control exercised by the Bank has grown by natural evolution rather than by statute. Indeed as the White Paper makes clear, the Bank had no statutory authority to ensure that any institution observed prudent practices in its banking business; it exercised its supervision only with the consent of the supervised. Although the Bank's authority over the banking system has not been in question, the fringe bank crisis associated with the collapse of property prices and the weaknesses of the parallel money markets - both domestic and international - revealed several gaps in the system. The problems lay partly in the ease of entry into banking markets and partly in the diffusion of supervisory activities among a number of authorities of which the Bank was only one. A shortage of manpower, a dearth of statistics and structural deficiencies in the Bank's supervisory department similarly contributed to the failure to identify the hazards at an early stage.

The new system will give the Bank of England responsibility over the whole sector and thus parallels the suggestions made in the previous chapter regarding the supervision of behaviour in the merger market. The main features, the two-tier system of recognitions and the planned deposit protection fund, have also caused the greatest argument.
The criteria for selecting the 'banks' will take into account factors such as the level of capital, the range of business and the reputation and status of the company concerned. It appears that this category will, in the event, be virtually synonymous with the list of banks which already quite clearly have banking status.\textsuperscript{3} These are the banks which have traditionally had a close relationship with the Bank of England and it seems that the character of the supervision to which they are subjected will change very little. For the other institutions, however, the position will be different. Whilst the same flexible and discretionary system of supervision will apply to the 'non-banks', the implication of the division is that these other deposit-takers will be classed as second class institutions thus reducing the possibility of progression to higher degrees of banking status, which has been one of the characteristics of the past systems particularly favoured by the Bank. The proposed mode of recognition also appears to discriminate against new entrants and the minimum capital requirements which are yet to be defined and established may represent an effective barrier to entry to new institutions which have obviously not had the time to build up reserves from retained earnings. On these grounds a gradual approach to licensing, recognising new entrants as special cases, could be advocated.

The deposit protection fund has been the main topic of controversy among the banks, and particularly the clearing banks. It is inevitable that these will provide the greatest part of any funds involved. Their complaints that they would be contributing funds to a rescue fund which they themselves would not need seem, with some qualification, to be justified. Certainly such a requirement might be considered to be merely formalizing their existing contribution to the 'lifeboat' support operations which the Bank of England and the clearing banks are determined to wind down.
In this context the process does indeed seem inequitable; in effect, the prudent which were necessarily levied to support the excesses of the fringe banks on a short-term basis, would be paying for the follies and proven dishonesty of some of these institutions permanently. However, such a view fails to take into account the inter-dependence of the banking system. As the lifeboat operation illustrated, a crisis of confidence affecting even a single bank can quickly encompass many others irrespective of their own policies and management. As Revell correctly asserts, the justification of deposit insurance is:

"... that it serves to prevent the event that it is insured against: if all deposits are insured, there is no incentive for anybody to start a 'run on the bank' at the first sign of trouble, and the troubles of one bank need not spread around the whole banking system and cause a general loss of confidence."

The size of each bank's contribution remains to be decided, although a flat premium for all deposits is envisaged, in line with the practice of the F.D.I.C. This suffers from the shortcoming that it takes some time for the fund to reach a suitable level although this could be overcome by lump sum payments. Such an approach is less palatable to the banks, however, because it would have an immediate impact on their profitability.

There are a number of other important issues which will have to be resolved before the legislation is finalised. They include the critical level of the minimum capital requirement for deposit-taking institutions and the definitions of capital to be used; and the exact powers which will be given to the Bank to exercise sanctions over the institutions under its purview. Inevitably, the new system will impose a greater degree of formality into the U.K. banking supervision arrangements. But the Bank's aim remains to operate as informally as possible within the system. With the recognised banks at least, it seems certain to try to retain the personal nature of its interest, placing importance on knowledge of who is running the bank as well as on a flow of information about how it is being run. To a considerable extent, therefore, the U.K. will retain the special character of its self-regulatory supervisory arrangements which
It remains to assess the role of the Bank of England as overseer in the context of the wider subject of informal and flexible self-regulation of the City's activities. Flexibility remains the keynote of the envisaged supervision. An immediate reaction is that this accords closely with the evolution of the banking system; informality has characterised many aspects of the development of banks' operations. This is well illustrated by the position in respect of mergers and acquisitions by banks. In the past, the Bank's unwritten policy has often been detected only when a change in philosophy is announced; this was particularly the case regarding the control of ownership of the accepting houses which was relaxed in 1973. There is no indication that this method of regulation will change and it appears that the Bank will make its assessment on the merits of a particular amalgamation on a similar basis to that employed in conducting its general supervisory functions. That is on a mixture of financial information and its view of a bank's management. It will continue to make informal suggestions - "nods and winks" - which banks will continue to implement.

The link between the Bank's control over the operation of the banking system and that exercised over the behaviour of those institutions (including banks) which are involved in the securities markets lies most clearly in the similar philosophy which underpins both their operations. The Bank's role, however, is often confused, principally because it is ill-explained and poorly understood. The Bank is of course in an invidious position. For on the one hand it must regulate the institutions in the private sector; whilst on the other, it must act as their spokesman. Its knowledge and experience of City markets puts it in a position to understand and advise on the consequences of official action as they affect the operations of the City and international confidence. There must remain doubts, however, as to whether the Bank could act as the authority under which the supervision of all aspects of the City's activities is assembled. For not only is the status of the Bank one of continuing mystery to the
public at large, but recently its role has become a subject of increasing
debate in the financial and political arenas. A clearer definition of
the role of the Bank may have to await the Report of the Wilson Committee's
inquiry and perhaps, any further debate as to how Parliament and Government
should manage the money supply in future.

It must also be true that the question of credibility will not be
effectively resolved until the second strand in the debate, namely that
on the role and organization of the securities market (including the
activities of the Takeover Panel) is carried nearer a conclusion. This
seems certain to have an important bearing on Wilson's recommendations
regarding 'the changes required in existing arrangements for the supervision
of financial institutions'.

Several questions remain at issue. One concerns the part that the
securities market has to play in the economy and the extent to which it is
considered desirable for the state to direct the community's savings.
The resolution of this will in turn be affected by the change in the
composition of share ownership. Imperfections in the structure of the
securities market are highlighted by the steady but gradual shift in share
ownership towards institutional investors. This concentration has been
the result of inflationary pressures which have forced individuals to
liquidate capital and a change in attitudes towards profit, risk, and leisure
which has led individuals to invest through professionally-managed funds.
This is only one aspect of the discussion however.

This decade has seen the establishment of London as a major international
financial centre. It has also seen however, the rise and fall of the
entire domestic secondary banking sector. The collapse required a major
rescue operation, co-ordinated by the Bank of England. The Bank still finds
itself caught in the uneasy balance between being a conventional central
bank and the traditional spokesman of the private financial sector.
There has been little serious discussion about the way in which the rescue operation should change the way in which the affairs of the City are conducted. There is a growing body questioning the traditional, self-administered, non-statutory basis on which the City has always been governed.

It is to questions such as these that future research should be addressed.
NOTES

1: This information was derived from discussion with executives of Orion Bank Limited.


3: Those already holding authorised status under the Exchange Control Act, those with exemption from certain requirements of the Protection of Depositors' Act and those which have permission under Schedule 8 to maintain hidden reserves.

APPENDICES
### APPENDIX 1

**Acquisitions by Banks 1966 - 1973**

<table>
<thead>
<tr>
<th>Acquiring Bank</th>
<th>Acquired Company</th>
<th>Consideration</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1966</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank of Ireland &amp; National Commercial Bank of Scotland</td>
<td>National Bank</td>
<td>£16,950</td>
</tr>
<tr>
<td>Lloyds Bank</td>
<td>National Bank of New Zealand</td>
<td>£8,900</td>
</tr>
<tr>
<td><strong>1967</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank of London and South America</td>
<td>Linway Trust</td>
<td>£1,288</td>
</tr>
<tr>
<td>Lloyds Bank</td>
<td>Lewis's Bank</td>
<td>£1,500</td>
</tr>
<tr>
<td><strong>1968</strong></td>
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<tr>
<td>National &amp; Commercial Banking Group</td>
<td>Royal Bank of Scotland/National Commercial Bank of Scotland</td>
<td>£48,720</td>
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<tr>
<td>Hill Samuel</td>
<td>Lambert Brothers</td>
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<td>Keyser Ullmann</td>
<td>Hocroft Trust</td>
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<tr>
<td>National Westminster Bank</td>
<td>National Provincial Bank/Westminster Bank</td>
<td>£177,499</td>
</tr>
<tr>
<td><strong>1969</strong></td>
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<td>Barclays Bank</td>
<td>Martins Bank</td>
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<tr>
<td>Hill Samuel</td>
<td>Noble Lowndes Annuities</td>
<td>£13,000</td>
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<td>Australia &amp; New Zealand Banking Group</td>
<td>Australia &amp; New Zealand Bank/English Scottish &amp; Australian Bank</td>
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<td>Bank of Scotland</td>
<td>British Linen Bank</td>
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<td>Kleinwort Benson</td>
<td>European Market Investment Trust</td>
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<td>Hambros Bank</td>
<td>Hereditaments</td>
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<td>Arbuthnot Latham</td>
<td>Culloden Investment Trust</td>
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<tr>
<td>Kleinwort Benson</td>
<td>Gov, Wilson &amp; Stanton</td>
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<tr>
<td>Schroder Wagg</td>
<td>Whittaker Ellis</td>
<td>£1,266</td>
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<tr>
<td><strong>1970</strong></td>
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<td>Standard &amp; Chartered Banking Group</td>
<td>Chartered Bank/Standard Bank</td>
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<td>National Westminster Bank</td>
<td>Lombard Banking</td>
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<td>Bank of London &amp; South America</td>
<td>Bank of London &amp; Montreal</td>
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<td>Hambros Bank</td>
<td>British Empire Investment Trust</td>
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<td>Samuel Montagu</td>
<td>Stronghold Insurance</td>
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<tr>
<td>Keyser Ullmann</td>
<td>R.S. Coll</td>
<td>£1,000</td>
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<td><strong>1971</strong></td>
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<td>Bank of London &amp; South America</td>
<td>Lloyds Bank Europe</td>
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<td>Mercantile Credit</td>
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<td>Hill Samuel</td>
<td>L. Hammond</td>
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<td>Keyser Ullmann</td>
<td>Central &amp; District Properties</td>
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<td>Wallace Bros.</td>
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<td>Midland Bank</td>
<td>Thos. Cook &amp; Son</td>
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<td>Keyser Ullmann</td>
<td>Dalton Barton Securities</td>
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<td>National &amp; Grindlays</td>
<td>Gillespie Bros.</td>
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<td>Wm. Brandts</td>
<td>Spey Investments</td>
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<tr>
<td><strong>1972</strong></td>
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<tr>
<td>Edward Bates</td>
<td>Welfare Insurance</td>
<td>£5,534</td>
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<td>Standard &amp; Chartered Banking Group</td>
<td>Mocatta &amp; Goldsmid</td>
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<tr>
<td>Arbuthnot Latham</td>
<td>A.J. Collins &amp; Sons</td>
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<tr>
<td><strong>1973</strong></td>
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<tr>
<td>Standard &amp; Chartered Banking Group</td>
<td>East &amp; West Investment Trust</td>
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<td>Arbuthnot Latham</td>
<td>Montagu Trust</td>
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<td>Midland Bank</td>
<td>Skipton Automation</td>
<td>£4,700</td>
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<td>Bankers Trust International</td>
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<tr>
<td>1972</td>
<td>Keyser Ullmann</td>
<td>Hodge Group</td>
</tr>
<tr>
<td>------------</td>
<td>-----------------------------</td>
<td>-------------------------</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Dominion Lincoln Assurance</td>
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<tr>
<td></td>
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<td>R.H. Manson</td>
</tr>
<tr>
<td></td>
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<td>International Life Insurance</td>
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## APPENDIX 2

### Acquisitions by Insurance Companies 1966 - 1973

<table>
<thead>
<tr>
<th>Acquiring Insurance Company</th>
<th>Acquired Company</th>
<th>Consideration (£m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966</td>
<td></td>
<td></td>
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<tr>
<td>Robert Bradford</td>
<td>Fred Fishwick</td>
<td>0.068</td>
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<tr>
<td>Allied Insurance Brokers</td>
<td>M. Ranson Witt</td>
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<td>Staplegreen Insurance Holdings</td>
<td>Gardner Mountain</td>
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<td>Hogg Robinson - Caple Cure</td>
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<td>Fenchurch Insurance Holdings</td>
<td>B. Wigmore</td>
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<td>Eagle Star</td>
<td>Home &amp; Overseas Insurance</td>
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<td>Alexander Howden Underwriting</td>
<td>L.C.J. Davies</td>
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<tr>
<td>Alexander Howden Underwriting</td>
<td>F.A. North</td>
<td>0.060</td>
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<tr>
<td>1967</td>
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<tr>
<td>Robert Bradford</td>
<td>National Motor &amp; Accident</td>
<td>0.578</td>
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<td>G &amp; J. Miller</td>
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<td>W.E. Found</td>
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<td>Dominion Buildings</td>
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## Links of U.K. Banks with insurance undertakings 1973/1974

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<tr>
<th>Bank</th>
<th>Insurance Participations</th>
<th>Equity Interest</th>
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<td>Arbuthnot Latham</td>
<td>Arbuthnot Insurance Services</td>
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<tr>
<td></td>
<td>A.J. Collins &amp; Co.</td>
<td>100%</td>
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<tr>
<td>Barclays Bank</td>
<td>Barclays Life Assurance</td>
<td>100%</td>
</tr>
<tr>
<td>Edward Bates</td>
<td>Edward Bates Insurance Brokers</td>
<td>100%</td>
</tr>
<tr>
<td>Grindlay Brandts</td>
<td>Brandts Insurance Holdings</td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td>A.L. Sturge</td>
<td>33 1/3%</td>
</tr>
<tr>
<td>Brown Shipley</td>
<td>Crawford, Beck &amp; Amos</td>
<td>100%</td>
</tr>
<tr>
<td>Charterhouse Group</td>
<td>Glanvill Enthoven &amp; Co.</td>
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<tr>
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<td>Sun Life Charterhouse Unit Assurance</td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td>Charterhouse Japhet Life Assurance</td>
<td>100%</td>
</tr>
<tr>
<td>Fraser Ansbacher</td>
<td>C.E. Heath &amp; Co.</td>
<td>20%</td>
</tr>
<tr>
<td>Anthony Gibbs Holdings</td>
<td>Antony Gibbs &amp; Sons (Ins)</td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td>Antony Gibbs Insurance Co.</td>
<td>100%</td>
</tr>
<tr>
<td>Guiness Gibbs Holdings</td>
<td>Fenchurch Insurance</td>
<td>100%</td>
</tr>
<tr>
<td>Hambros</td>
<td>Berkeley (Ins.)</td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td>Hambros Life Assurance</td>
<td>55%</td>
</tr>
<tr>
<td></td>
<td>Unitholders Provident Assurance</td>
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</tr>
<tr>
<td>Hill Samuel</td>
<td>Hill Samuel Insurance &amp; Shipping Holdings</td>
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<tr>
<td></td>
<td>Hill Samuel Life Assurance</td>
<td>100%</td>
</tr>
<tr>
<td>Keyser Ullmann</td>
<td>Cannon Assurance</td>
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</tr>
<tr>
<td>Kleinwort Benson</td>
<td>Kleinwort Sons &amp; Co.</td>
<td>100%</td>
</tr>
<tr>
<td>Lloyds Bank International</td>
<td>F.E. Wright &amp; Co.</td>
<td>94%</td>
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<tr>
<td>Midland Bank</td>
<td>Bland Payne Holdings</td>
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<td>National Westminster Bank</td>
<td>Commercial Union Assurance</td>
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<td>Commercial Union Assurance (Unit Trusts)</td>
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<td>Welfare Insurance Co.</td>
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<td>Rea Bros.</td>
<td>Rea Bros. (Ins)</td>
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</tr>
<tr>
<td></td>
<td>Rea Bros. (Life Loans and Pensions)</td>
<td>100%</td>
</tr>
<tr>
<td></td>
<td>Rea Bros (Underwriting Agencies)</td>
<td>100%</td>
</tr>
<tr>
<td>Schroders</td>
<td>Schroder Life Group</td>
<td>100%</td>
</tr>
<tr>
<td>Singer &amp; Friedlander</td>
<td>C.T. Bowring</td>
<td>N.A.</td>
</tr>
<tr>
<td>Standard &amp; Chartered</td>
<td>Hodge Life Assurance</td>
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<td>Banking Group</td>
<td>Hodge General &amp; Mercantile</td>
<td>100%</td>
</tr>
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<td></td>
<td>Standard &amp; Chartered Insurance Brokers</td>
<td>50%</td>
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<tr>
<td>S.G. Warburg</td>
<td>Matthews Wrighton Holdings</td>
<td>27.1%</td>
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</table>
APPENDIX 4

Banks or Bank-Connected Companies Authorised to carry on one or more classes of insurance business in Great Britain. End - 1973

* Antony Gibbs Insurance
* Barclays Life Assurance
* Charterhouse Japhet Life Insurance
* Citibank Assurance
* Hambro Life Assurance
* Hill Samuel Life Assurance
* Hodge General & Mercantile Insurance
* Hodge Life Assurance
* Pearl Montagu Assurance
* Schroder Assurance
* Schroder Equity Assurance
* Schroder Life Assurance
* Schroder Pensions
Slater, Walker Insurance
Sun Life Charterhouse Unit Assurance
TSB Unit Trust Managers

*Added to list since end-1970.

Notes: (1) All authorised to carry out ordinary long-term insurance except Hodge General & Mercantile Insurance; this company, together with Slater, Walker Insurance, authorised to carry on a wide range of other business.

(2) The total number of authorised insurers at end-1973 was 785, the number authorised to write ordinary long-term insurance was 262.

### APPENDIX 5

Accepting Houses' links with portfolio/fund management April 1977

<table>
<thead>
<tr>
<th>Accepting House</th>
<th>Unit Trust-Managed</th>
<th>Investment Trusts Managed</th>
<th>Pension Funds Managed</th>
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<td>No.</td>
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<td>-------</td>
<td>-------</td>
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<tr>
<td>Arbuthnot Latham</td>
<td>13</td>
<td>17</td>
<td>3</td>
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<tr>
<td>Baring Bros.</td>
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<td>3</td>
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<td>1</td>
<td>1</td>
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<tr>
<td>Charterhouse Japhet</td>
<td>4</td>
<td>5</td>
<td>1</td>
</tr>
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<td>Antony Gibbs</td>
<td>2</td>
<td>1</td>
<td>1</td>
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<tr>
<td>Guinness Mahon</td>
<td>19</td>
<td>200</td>
<td>4</td>
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<td>Hambros Bank</td>
<td>8</td>
<td>100</td>
<td>2</td>
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<tr>
<td>Hill Samuel</td>
<td>19</td>
<td>200</td>
<td>4</td>
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<tr>
<td>Kleinwort Benson¹</td>
<td>1</td>
<td>2</td>
<td>8</td>
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<tr>
<td>Lazardś</td>
<td>5</td>
<td>40</td>
<td>2</td>
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<tr>
<td>Samuel Montagu</td>
<td>11</td>
<td>255</td>
<td>11</td>
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<tr>
<td>Morgan Grenfell</td>
<td>6</td>
<td>350</td>
<td>6</td>
</tr>
<tr>
<td>N.M. Rothschild²</td>
<td>4</td>
<td>23</td>
<td>2</td>
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<tr>
<td>Schroder Wagg³</td>
<td>7</td>
<td>50</td>
<td>5</td>
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<td>Singer &amp; Friedlander</td>
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<td>5</td>
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<tr>
<td>S.G. Warburg⁴</td>
<td>2</td>
<td>4</td>
<td>1</td>
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</table>

1. Also holds 37.5% interest in M & G Group - 22 Trusts, value £300 million
2. Also jointly owns Rothschild & Lowndes Management - 1 Trust, value £10 million
3. Jointly manages Trustee Savings Banks - 2 Trusts, value £45 million
4. Investment adviser to Metropolitan Exempt Fund, value £3 million.
## APPENDIX 6

### Insurance companies' interest in investment trusts

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<th>Insurance company</th>
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<th>% held</th>
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<tr>
<td>Eagle Star</td>
<td>Philip Hill</td>
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<tr>
<td></td>
<td>Drayton Commercial</td>
<td>11.0</td>
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<tr>
<td>Equity and Law</td>
<td>Winterbottom</td>
<td>17.5</td>
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<tr>
<td>Guardian Royal Exchange</td>
<td>London Trust</td>
<td>14.7</td>
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<tr>
<td>Legal and General</td>
<td>Westpool</td>
<td>11.9</td>
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<tr>
<td>Pearl Assurance</td>
<td>Electric and General</td>
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<td></td>
<td>City and International</td>
<td>13.4</td>
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<tr>
<td></td>
<td>London and Holyrood</td>
<td>14.5</td>
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<tr>
<td></td>
<td>Charter</td>
<td>15.0</td>
</tr>
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<td></td>
<td>Romney</td>
<td>11.3</td>
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<tr>
<td></td>
<td>Trans-Oceanic</td>
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<td></td>
<td>Broadstone</td>
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**APPENDIX 7**

**STOCK EXCHANGE TURNOVER, EMPLOYMENT AND FAILURES 1966 - 1974**

### A. Turnover, Number of Bargains Marked

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<th>Year</th>
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<td>21,590</td>
<td>4.1</td>
</tr>
<tr>
<td>1967</td>
<td>35,956</td>
<td>5.0</td>
</tr>
<tr>
<td>1968</td>
<td>31,976</td>
<td>6.5</td>
</tr>
<tr>
<td>1969</td>
<td>30,390</td>
<td>5.8</td>
</tr>
<tr>
<td>1970</td>
<td>38,767</td>
<td></td>
</tr>
<tr>
<td>1971</td>
<td>64,192</td>
<td>6.6</td>
</tr>
<tr>
<td>1972</td>
<td>56,383</td>
<td>8.0</td>
</tr>
<tr>
<td>1973</td>
<td>55,769</td>
<td>6.0</td>
</tr>
<tr>
<td>1974</td>
<td>56,752</td>
<td>5.0</td>
</tr>
</tbody>
</table>

Source: The Stock Exchange Fact Book (various copies)

Note: From April 1973 figures shown are for the amalgamated Stock Exchange.

### B. Number of Firms and Partners; Employment

<table>
<thead>
<tr>
<th>Year Comm.</th>
<th>Brokers</th>
<th>Jobbers</th>
<th>Employment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1966</td>
<td>247</td>
<td>1,827</td>
<td>53</td>
</tr>
<tr>
<td>1967</td>
<td>225</td>
<td>1,727</td>
<td>45</td>
</tr>
<tr>
<td>1968</td>
<td>198</td>
<td>1,701</td>
<td>36</td>
</tr>
<tr>
<td>1969</td>
<td>195</td>
<td>1,772</td>
<td>33</td>
</tr>
<tr>
<td>1970</td>
<td>192</td>
<td>1,810</td>
<td>51</td>
</tr>
<tr>
<td>1971</td>
<td>176</td>
<td>1,773</td>
<td>27</td>
</tr>
<tr>
<td>1972</td>
<td>168</td>
<td>1,755</td>
<td>26</td>
</tr>
<tr>
<td>1973</td>
<td>168</td>
<td>1,774</td>
<td>21</td>
</tr>
<tr>
<td>1974</td>
<td>355</td>
<td>2,623</td>
<td>24</td>
</tr>
<tr>
<td>1975</td>
<td>284</td>
<td>2,129</td>
<td>21</td>
</tr>
</tbody>
</table>

Source: The Stock Exchange Fact Book March 31 1975

Note: From April 1973 figures shown are for the amalgamated Stock Exchange.

### C. Failures 1973 - 1974

<table>
<thead>
<tr>
<th></th>
<th>est. total</th>
<th>paid</th>
<th>est. outstanding</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>$1000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>J.H. Summerveld &amp; Co.</td>
<td>285</td>
<td>243</td>
<td>42</td>
</tr>
<tr>
<td>James O'Connor &amp; Co.</td>
<td>1475</td>
<td>1209</td>
<td>266</td>
</tr>
<tr>
<td>Mitton, Butler, Priest &amp; Co.</td>
<td>550</td>
<td>130</td>
<td>420</td>
</tr>
<tr>
<td>Chapman &amp; Row</td>
<td>1280</td>
<td>400</td>
<td>790</td>
</tr>
<tr>
<td>Davey &amp; Candy</td>
<td>115</td>
<td>33</td>
<td>82</td>
</tr>
<tr>
<td>Tustain &amp; 1 Estrange</td>
<td>500</td>
<td>206</td>
<td>294</td>
</tr>
</tbody>
</table>

APPENDIX 8

Clearing Banks' International Representation: Direct Links

National Westminster

Through:

International Westminster Bank (100%)

Main branch - London
Belgium - 3
France - 6
Germany - 1
Nassau - 1

RoyWest Banking Corporation (40%)

Nassau

Van Lanschot's Beleggings-Compagnie BV (25%)
Netherlands

Union Financiere Bancaire SA (20%)
France

Credit du Nord et Union Parisienne (5%)
France

Creditwest SpA (31%)
Italy

Handelsbank in Zurich (55%)
Switzerland

LLOYDS

Through:

Lloyds Bank International (100%)

Europe - 43 offices
Latin America - 124
Bahamas - 1
US - 2
Asia - 2

International wholesale banking
Banking and trustee services
Owns F van Lanschot the 7th largest commercial bank in Holland (1973)
Holding company controlling Credit du Nord et Union Parisienne, Paribas Group and Banque Worms (1973)
Commercial banking (1973)
Re-styled Banco Milanese di Credito commercial banking; 5 branches in Milan (1972 from Credito Italiano)
Privately-owned; commercial banking and investment banking (1975 from Nestle Alimentana SA).

International banking
Lloyds First Western Corporation (99.9%)

California (US) - 94

Acquired First Western Bank & Trust Co. (1974) which was re-named Lloyds Bank California.

National Bank of New Zealand (100%)

New Zealand - 203

Retail Banking (1966)

National and Grindlays Holdings (41%)

N & G Holdings own 51% of National and Grindlays Bank

British Overseas Bank

BARCLAYS

At 30th September 1974 the offices of Barclays International and its subsidiaries numbered some 1700 in nearly 70 countries, thus:

Barclays National Bank (84.89%) and Barclays Bank of Swaziland (60%)

Southern Africa - 880+ branches

Swaziland - 16

Barclays Bank of Nigeria, Barclays Bank of Ghana, Barclays Bank of Sierra Leone

(51.67%) (100%) (75%)

West Africa - 90 - 54 - 14

Barclays Bank of Uganda, Barclays Bank of Zambia, Barclays Bank SZARL

(51%) (100%) (100%)

Central and East Africa

- 5 - 43 - 2

Barclays Bank of Jamaica (100%) and Barclays Bank of Trinidad & Tobago

Caribbean - 50+ - 33 (73.33%)

Barclays Bank of California (100%) and Barclays Bank of New York (99.8)

USA - 40 - 25

Barclays Discount Bank (100%)

Israel - 50

Barclays Bank SA

France - 22

Notes: In addition commercial banking: Banca Barclays Castellini SpA (Italy); Barclays Kol & Co. NV (Holland) also stockbroking; Societe Bancaire Barclays (Suisse); Intercredit SA (Belgium);

Also finance companies in Cyprus, Malta, Jamaica, Bahamas, Barbados, Trinidad & Tobago, Leeward & Windward Islands, Cayman Islands,

Miscellaneous: Barclays National Merchant Bank; Barclays Insurance Brokers South Africa; Barclays Overseas Development Corp. Banco Popular
Antiliano NV, Barclays Canada; Tozer Kemsley & Milbourn Holdings.
APPENDIX 9

Merchant Banks' International Representation:

Direct Links

Arbuthnot Latham

Through its shareholders, Philadelphia National Bank, Chartered Bank and Toronto Dominion Bank.

Also Directly:

- Luxembourg: Concord International S.A. (25%)
- Singapore: Chartered Merchant Bankers (45%)
  : Chartered Unit Trust Management (28%)
- Malaysia: Chartered Merchant Bankers Malaysia Berhad (18%)
- Thailand: Multicredit Corporation of Thailand (10%)
- Hong Kong: Arbuthnot Securities (Hong Kong) Ltd. (100%)
- Australia: Arbuthnot Latham Australia Property Ltd. (100%)
- Kenya: East African Acceptances (22%)
- Middle East: Oryx Investments (21%)

Baring Brothers

- France: Baring Bros S.A. (100%)
- Switzerland: Lobarco S.A. (50%)
- Canada: Dominion Securities Corp. Harris & Partners (10%)
- Argentine: Industrias Reconquista S.A. (n/a)
- Brazil: Banco Finesa de Investimento S.A. (n/a)
- Australia: Outwich (Australia) Property Ltd. (100%)
- South Africa: Outwich Ltd. (50%)
- Lebanon: Outwich S.A. (50%)

Charterhouse Japhet

Through branch office and subsidiaries and associated companies of Charterhouse Group: Paris; Geneva; Dusseldorf; Johannesburg; Sydney; Toronto; New York; Houston.

Guinness Mahon

- Overseas subsidiaries and affiliates:
  - Switzerland: Guinness Mahon (Zurich) A.G.
  - Singapore: Lewis & Peat, Merchant Bank
  - Bermuda: Lewis & Peat (Bermuda) Ltd.
  - Cayman Islands: Guinness Mahon Cayman Trust
  - Ireland: Guinness & Mahon
  - EEC: Finacor S.A. (50%)
Overseas subsidiaries and affiliates:

**Hambros**

Bahamas : Bahamas International Trust Co. (14%)
Bermuda : International Trust Co. of Bermuda (10%)
Brazil : Cia Metropolitana de Credito Financiamento e Investimentos (20%)
Canada : Hambro Canada (1972) Ltd. (48%)
Cayman Islands : Cayman International Trust Co. (14%)
Cyprus : Hambro (Cyprus) (52%)
Dubai : Dubai Bank (10%)
Hongkong : Pembros (30%)
Lebanon : Investment and Financial Bank S.A.L. (8%)
Malta : Investment Bank of Malta (40%)
Netherlands : Ship Mortgage International N.V. (25%)
Norway : Bohn & Co. (20%)
Sierra Leone : Bentworth Finance (30%)
Switzerland : Bank Ruegg (30%)

**Hill Samuel**

Germany : Hill Samuel & Co. O.H.G.
Spain : Banco de Financiacion Industrial
Switzerland : Bank von Ernst & Cie.
U.S.A. : Hill Samuel Inc.
Brazil : Banco Uniao de Investimento S.A.
Bahamas : Bank of Nova Scotia Trust Co.
South Africa : Hill Samuel Group S.A. (77%)
Rhodesia : Merchant Bank of Central Africa
Nigeria : Nigerian Acceptances
Australia : Hill Samuel Australia (83%)

**Kleinwort Benson**

Overseas subsidiaries and affiliates:

Belgium : Kleinwort Benson (Europe)
Austria : Centrofin (14%)
Switzerland : Kleinwort Benson (Geneva) (92%)
U.S.A. : Kleinwort Benson Inc.
              : Sharps, Pixley Inc.
Cayman Islands : Arawak Trust Co. (20%)
South Africa : J.L. Clark & Co. (33%)
Hongkong : Kleinwort Benson
            : Asia & Euro-American Capital Corp (11%)
Singapore : Asian & Euro-American Merchant Bank (11%)

**Lazard Bros**

Relationship (no shareholding links) with Lazard Freres & Cie (Paris); Lazard Freres & Co. (New York); Mediobanca (Italy); Iran Industrial Mining & Development Bank (Iran)
Morgan Grenfell

Associated with:

U.S.A. : Morgan Guaranty
France : Campagnie Financiere de Suez
Canada : Dominion Securities Corp. Harris & Partners (10%)
Ireland : Investment Bank of Ireland
Netherlands : Bank Mees en Hope
Hongkong : Indo-Suez & Morgan Grenfell (Singapore)
: MWP Incentives
: Tokai Kyowa Morgan Grenfell

Rea Bros

Netherlands : Amsterdamse Crediet-en Handelsbank N.V.

N. M. Rothschild

France : Banque Rothschild
Luxembourg : Bank Oppenheim Pierson International S.A.
Switzerland : Rothschild Bank A.G.
U.S.A. : New York Securities Corp.
Hongkong : N.M. Rothschild & Sons (HK)
Malaysia : Bumiputra Merchant Bankers Berhad
Rhodesia : Merchant Bank of Central Africa

Samuel Montagu

Switzerland : Guyerzeller Zurmont Bank A.G.
Ireland : Northern Bank Finance Corp.

Schroder Wagg

France : Societee Privee de Gestion Financiere S.A. (14%)
Switzerland : J. Henry Schroder Bank A.G. (100%)
Spain : Corporacion Espanola de Financiacion Internacional S.A. (25%)
U.S.A. : Schroders Inc. (100%)
: J. Henry Schroder Banking Corp (100%)
: Schroder Trust (99.6%)
: Schroder Noess & Thomas Division (100%)
: Schroder Capital Corp. (100%)
: Schroder Real Estate
Canada : J. Henry Schroder & Co. (100%)
Bermuda : Schroders (Bermuda) (100%)
: Merchants Finance (100%)
: Property Holdings International (50%)
: Schroder International Trust (40%)
Australia : Darling & Co. (50%)
Brazil : J. Henry Schroder do Brasil (Consultores) S/C (50%)
: Schroder Monteiro Aronha Distribuidora de Titulos e Valores Mobiliarios S.A. (25%)
Bahamas : J. Henry Schroder Banking Corp.
Cayman Islands : J. Henry Schroder Banking Corp.
Singer & Friedlander

Malta : Singer & Friedlander (Malta)
Switzerland : Singer & Friedlander A.G.
Iran : Interfinance & Investment Corp (49%)

S. G. Warburg

France : Paribas *
Germany : Effectenbank-Warburg A.G. (29%)
           : M. M. Warburg-Brinckmann Wirtz
Switzerland : Banque de Gestion Financiere (99%)
           : Banque de Paris et des Pays-bas (Suisse)
Belgium : Banque de Paris et des Pays-bas Belgique S.A. *
Netherlands : Banque de Paris et des Pays-bas N.V. *

* Through Paribas-Warburg S.A.
APPENDIX 10

U.K. Banks' shareholdings in consortium banks

ANGLO-ROMANIAN BANK LTD.

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Romanian Bank for Foreign Trade</td>
<td>50</td>
<td>Romania</td>
</tr>
<tr>
<td>Barclays Bank</td>
<td>30</td>
<td>U.K.</td>
</tr>
<tr>
<td>Manufacturers Hanover International</td>
<td>20</td>
<td>U.S.A.</td>
</tr>
</tbody>
</table>

ATLANTIC INTERNATIONAL BANK LTD.

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banco di Napoli</td>
<td>12.5</td>
<td>Italy</td>
</tr>
<tr>
<td>Banque de Neuflize, Schlumberger, Mallet</td>
<td>12.5</td>
<td>France</td>
</tr>
<tr>
<td>Charterhouse Japhet</td>
<td>12.5</td>
<td>U.K.</td>
</tr>
<tr>
<td>First Pennsylvania Banking Trust Co.</td>
<td>12.5</td>
<td>U.S.A.</td>
</tr>
<tr>
<td>F van Lanschot Bankers</td>
<td>12.5</td>
<td>Netherlands</td>
</tr>
<tr>
<td>Manufacturers National Bank of Detroit</td>
<td>12.5</td>
<td>U.S.A.</td>
</tr>
<tr>
<td>National Shawmut Bank of Boston</td>
<td>12.5</td>
<td>U.S.A.</td>
</tr>
<tr>
<td>United California Bank</td>
<td>12.5</td>
<td>U.S.A.</td>
</tr>
</tbody>
</table>

Principal areas of business
Medium and short-term eurocurrency and sterling financing. Corporate Finance.

AUSTRALIAN FINANCE AND INVESTMENT CO. LTD.

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banque Worms et Cie</td>
<td>5</td>
<td>France</td>
</tr>
<tr>
<td>Central Merchant Bank of South Africa</td>
<td>20</td>
<td>South Africa</td>
</tr>
<tr>
<td>Hambros Bank Ltd.</td>
<td>40</td>
<td>U.K.</td>
</tr>
<tr>
<td>Philadelphia National Bank</td>
<td>20</td>
<td>U.S.A.</td>
</tr>
</tbody>
</table>

Subsidiaries and affiliates

AFIC Acceptances Pty Ltd.
AFIC Investment Services Ltd.
AFIC Nominees Pty Ltd.
Australian Finance and Securities Ltd. Group
Arinyah Holdings Pty Ltd.
Arinyah Properties Pty Ltd.
Cagoda Pty Ltd.
Peerless Investments Ltd.

Principal areas of business
Comprehensive range of merchant banking services including property finance negotiations; capital raising; mergers and acquisitions; industrial research and investigation; and term loans and leasing.
AUSTRALIAN UNITED CORPORATION LTD

Shareholders | Percentage | Country
---|---|---
Bank of New South Wales | 11.6 | Australia
European Australian Associates | 10.6 | U.K. and Germany
Industrial Bank of Japan | 4 | Japan
JP Morgan (Morgan Guaranty) | 21 | U.S.A.
Morgan Grenfell | 10.6 | U.K.
Others

Principal areas of business
Merchant Banking.

BANQUE DE LA SOCIETE FINANCIERE EUROPEENNE

Shareholders | Percentage | Country
---|---|---
Algemene Bank Nederland | 12.6 | Netherlands
Banca Nazionale del Lavoro | 12.6 | Italy
Bank of America | 12.6 | U.S.A.
Banque de Bruxelles | 12.6 | Belgium
Barclays Bank Ltd. | 12.6 | U.K.
Dresdner Bank | 12.6 | Germany
Groupe BNP | 12.6 | France
Sumitomo Bank | 12.6 | Japan

Principal areas of business
Medium and short term eurocurrency financing.

BANQUE EUROPEENNE DE CREDIT

Shareholders | Percentage | Country
---|---|---
Amsterdamsche-Rotterdamsche Bank N.V. | 13.12 | Netherlands
Banca Commerciale Italiana | 13.12 | Italy
Creditanstalt-Bankverein | 13.12 | Austria
Deutsche Bank A.G. | 13.12 | Germany
Midland Bank Ltd. | 13.12 | U.K.
Samuel Montagu & Co. Ltd. | 8.14 | U.K.
Societe Generale | 13.12 | France
Societe Generale de Banque S.A. | 13.12 | Belgium

Principal areas of business
Medium and short term eurocurrency financing.

BROWN HARRIMAN AND INTERNATIONAL BANKS LTD.

Shareholders | Percentage | Country
---|---|---
Brown Bros Harriman & Co. | 22 | U.S.A.
First National Bank of Minneapolis | 10 | U.S.A.
Pittsburgh National Bank | 10 | U.S.A.
Prudential Assurance | 18 | U.K.
The Inter-Alpha Group of European Banks: | 40 | Italy
Banco Ambrosiano | | Germany
Berliner Handelsgesellschaft-Frankfurter Bank | | France
Credit Commercial de France | | Belgium
Kredietbank | | Netherlands
Nederlandsche Middenstandsbank | | U.K.
Williams and Glyn's | | 

Principal Areas of business
Loans, deposits and foreign exchange, short and medium term credits, international corporate finance, Eurobond market.
COMMERCIAL CONTINENTAL LTD.

Shareholders                                             Percentage  Country
Commercial Banking Company of Sydney Ltd.                33          Australia
Continental Illinois National Bank & Trust Co.          19.26        U.S.A.
Credit Commercial de France S.A.                        5.48        France
Crown Agents of Overseas Governments & Administrations  5          U.K.
Mutual Life and Citizens Assurance Co. Ltd.             18          Australia
Sanwa Bank Ltd.                                          19.26        Japan

Subsidiary
Lease Industrial Finance Ltd.

Affiliate
Commercial Continental (Securities) Ltd.

Principal areas of business
Medium-term finance; trade and accommodation bill facilities; corporate advice.

DEVELOPMENT FINANCE CORPORATION LTD.

Shareholders                                             Percentage  Country
Bank of Adelaide                                          n/a         Australia
Canadian Imperial Bank of Commerce                        n/a         Canada
Commercial Banking Company of Sydney Ltd.                 n/a         Australia
Cie Lambert pour l'Industrie et la Finance S.A.           n/a         Belgium
Dai-Ichi Kangyo Bank Ltd.                                 n/a         Japan
Hill Samuel & Co. Ltd.                                    n/a         U.K.
Manufacturers Hanover International Finance Corporation  n/a         U.S.A.
Normura Securities Co. Ltd.                               n/a         Japan

Subsidiaries
Australian Fixed Trusts Group of Companies
Canada Australia Investment Co. Ltd.
Delfin Corporate Services Ltd.
Delfin Discount Co. Ltd.
Delfin Industrial Finance Ltd.
Delfin Investment Services Ltd.
DFC (International) Ltd.
Development Finance Corporation (Underwriting) Ltd.
**EURO-PACIFIC FINANCE CORPORATION LTD.**

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amsterdamsche-Rotterdamsche Bank N.V.</td>
<td>8</td>
<td>Netherlands</td>
</tr>
<tr>
<td>Commercial Bank of Australia Ltd.</td>
<td>25</td>
<td>Australia</td>
</tr>
<tr>
<td>Deutsche Bank A.G.</td>
<td>8</td>
<td>Germany</td>
</tr>
<tr>
<td>Fuji Bank Ltd.</td>
<td>15</td>
<td>Japan</td>
</tr>
<tr>
<td>Midland Bank Ltd.</td>
<td>15.5</td>
<td>U.K.</td>
</tr>
<tr>
<td>Societe Generale de Banque S.A.</td>
<td>8</td>
<td>Belgium</td>
</tr>
<tr>
<td>Societe Generale (France)</td>
<td>8</td>
<td>France</td>
</tr>
<tr>
<td>United California Bank</td>
<td>12.5</td>
<td>U.S.A.</td>
</tr>
</tbody>
</table>

**Principal areas of business**

Merchant Banking.

**EUROPAISCH ASIATISCHE BANK AG-EUROPEAN ASIAN BANK**

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amsterdamsche-Rotterdamsche Bank N.V.</td>
<td>n/a</td>
<td>Netherlands</td>
</tr>
<tr>
<td>Banca Commerciale Italiana</td>
<td>n/a</td>
<td>Italy</td>
</tr>
<tr>
<td>Creditanstalt-Bankverein</td>
<td>n/a</td>
<td>Austria</td>
</tr>
<tr>
<td>Deutsche Bank A.G.</td>
<td>n/a</td>
<td>Germany</td>
</tr>
<tr>
<td>Midland Bank Ltd.</td>
<td>n/a</td>
<td>U.K.</td>
</tr>
<tr>
<td>Societe Generale S.A.</td>
<td>n/a</td>
<td>France</td>
</tr>
<tr>
<td>Societe Generale de Banque S.A.</td>
<td>n/a</td>
<td>Belgium</td>
</tr>
</tbody>
</table>

**EUROPEAN-AMERICAN BANKING CORPORATION,**

**EUROPEAN-AMERICAN BANK AND TRUST COMPANY.**

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amsterdamsche-Rotterdamsche Bank N.V.</td>
<td>n/a</td>
<td>Netherlands</td>
</tr>
<tr>
<td>Creditanstalt-Bankverein</td>
<td>n/a</td>
<td>Austria</td>
</tr>
<tr>
<td>Deutsche Bank A.G.</td>
<td>n/a</td>
<td>Germany</td>
</tr>
<tr>
<td>Midland Bank Ltd.</td>
<td>n/a</td>
<td>U.K.</td>
</tr>
<tr>
<td>Societe Generale S.A.</td>
<td>n/a</td>
<td>France</td>
</tr>
<tr>
<td>Societe Generale de Banque</td>
<td>n/a</td>
<td>Belgium</td>
</tr>
</tbody>
</table>

**Subsidiary**

European-American Finance (Bermuda) Ltd.

**Principal areas of business**

European-American Banking Corporation specialises in international banking and finance while European-American Bank and Trust Co. is a full service commercial bank specialising in financial services for American and European customers.
### EUROPEAN BANKING CO. LTD.

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amsterdamsche-Rotterdamsche Bank</td>
<td>14.3</td>
<td>Netherlands</td>
</tr>
<tr>
<td>Banca Commerciale Italiana</td>
<td>14.3</td>
<td>Italy</td>
</tr>
<tr>
<td>Creditanstalt Bankverein</td>
<td>14.3</td>
<td>Austria</td>
</tr>
<tr>
<td>Deutsche Bank</td>
<td>14.3</td>
<td>Germany</td>
</tr>
<tr>
<td>Midland Bank</td>
<td>14.3</td>
<td>U.K.</td>
</tr>
<tr>
<td>Societe Generale de Banque</td>
<td>14.3</td>
<td>Belgium</td>
</tr>
<tr>
<td>Societe Generale</td>
<td>14.3</td>
<td>France</td>
</tr>
</tbody>
</table>

### EUROPEAN BRAZILIAN BANK LTD.

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banco do Brasil</td>
<td>35</td>
<td>Brazil</td>
</tr>
<tr>
<td>Bank of America Ltd.</td>
<td>17.5</td>
<td>U.K.</td>
</tr>
<tr>
<td>Banque Ameribas S.A.</td>
<td>17.5</td>
<td>Luxembourg</td>
</tr>
<tr>
<td>Deutsche Bank A.G.</td>
<td>15</td>
<td>Germany</td>
</tr>
<tr>
<td>Union Bank of Switzerland</td>
<td>15</td>
<td>Switzerland</td>
</tr>
</tbody>
</table>

**Principal areas of business**

Merchant banking dealing in eurocurrency, comanagement and underwriting, and placing of Latin American securities issues and other normal banking services.

### FIRST NEW ZEALAND INTERNATIONAL LTD.

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank of New Zealand</td>
<td>40</td>
<td>New Zealand</td>
</tr>
<tr>
<td>New Zealand Insurance Co. Ltd.</td>
<td>20</td>
<td>New Zealand</td>
</tr>
<tr>
<td>Development Finance Corporation Ltd.</td>
<td>25</td>
<td>Australia</td>
</tr>
<tr>
<td>Morgan Grenfell and Co. Ltd.</td>
<td>5</td>
<td>U.K.</td>
</tr>
<tr>
<td>Morgan Guaranty Trust Co. of New York</td>
<td>5</td>
<td>U.S.A.</td>
</tr>
<tr>
<td>S. G. Warburg &amp; Co. Ltd.</td>
<td>5</td>
<td>U.K.</td>
</tr>
</tbody>
</table>

**Affiliates and subsidiaries**

- Delfin Discount Co. (NZ) Ltd.
- Dominion Units Ltd.
- First New Zealand Deposits Ltd.
- First New Zealand Nominees Ltd.
- First New Zealand RDC Ltd.
- Security Units Ltd.
- Tasman Development Corporation Ltd.

**Principal area of business**

Merchant banking.
INTERNATIONAL ENERGY BANK

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank of Scotland</td>
<td>15</td>
<td>U.K.</td>
</tr>
<tr>
<td>Banque Worms</td>
<td>10</td>
<td>France</td>
</tr>
<tr>
<td>Barclays Bank International</td>
<td>15</td>
<td>U.K.</td>
</tr>
<tr>
<td>Canadian Imperial Bank of Commerce</td>
<td>15</td>
<td>Canada</td>
</tr>
<tr>
<td>Republic National Bank of Dallas</td>
<td>15</td>
<td>U.S.A.</td>
</tr>
<tr>
<td>Societe Financiere Europeenne</td>
<td>30</td>
<td>France</td>
</tr>
</tbody>
</table>

INTERNATIONAL PACIFIC CORPORATION LTD.

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Charter Consolidated Ltd.</td>
<td>27.3</td>
<td>Australia</td>
</tr>
<tr>
<td>Commercial Bank of Australia Ltd.</td>
<td>11.8</td>
<td>Australia</td>
</tr>
<tr>
<td>Hordern, Utz and Bode</td>
<td>24.5</td>
<td>Australia</td>
</tr>
<tr>
<td>N. M. Rothschild and Sons Ltd.</td>
<td>27.3</td>
<td>U.K.</td>
</tr>
</tbody>
</table>

The other 9.1% is held by the management.

Subsidiaries

- International Pacific Property Management Pty Ltd.
- Syngenetic Management Pty Ltd.
- Syngenetic Mining Pty Ltd.
- Westralian Rutile Pty Ltd.

Principal areas of business

Banking services - acceptance credits, advances, loans, money market operations. Corporate finance services - all aspects including underwriting, mergers, acquisitions. Investment management services - investment of funds of institutions, pension funds, businesses and individuals.

INTERUNION-BANQUE

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banque Belge pour l'Industrie</td>
<td>4.82</td>
<td>Belgium</td>
</tr>
<tr>
<td>Banque Commerciale de Bale</td>
<td>2.63</td>
<td>Switzerland</td>
</tr>
<tr>
<td>Banque de Bruxelles</td>
<td>9.70</td>
<td>Belgium</td>
</tr>
<tr>
<td>Banque de l'Union Europeenne Industrielle et Financiere*</td>
<td></td>
<td>France</td>
</tr>
<tr>
<td>Bayerische Vereinsbank</td>
<td>9.70</td>
<td>Germany</td>
</tr>
<tr>
<td>Centrale Finanziaria Generale</td>
<td>4.73</td>
<td>Italy</td>
</tr>
<tr>
<td>Compagnie Financiere de l'Union Europeenne*</td>
<td></td>
<td>France</td>
</tr>
<tr>
<td>Hambros Bank</td>
<td>4.84</td>
<td>U.K.</td>
</tr>
<tr>
<td>Marine Midlands Banks Inc.</td>
<td>19.40</td>
<td>U.S.A.</td>
</tr>
<tr>
<td>Royal Bank of Canada International Ltd.</td>
<td>9.70</td>
<td>Nassau</td>
</tr>
<tr>
<td>Societe Financiere Desmarais pour l'Industrie et le Commerce</td>
<td>9.70</td>
<td>France</td>
</tr>
<tr>
<td>Tokai Bank Ltd.</td>
<td>5.26</td>
<td>Japan</td>
</tr>
</tbody>
</table>

* They hold 19.52% together.

Subsidiaries and affiliates

- Interunion Antilles N.V. 90 controlled Curacao

Principal areas of business

Eurocurrency short, medium and long-term lending. Foreign exchange and trading in deposits, eurobond issue department.
IRAN OVERSEAS INVESTMENT BANK LTD.

Shareholders | Percentage | Country
---|---|---
Bank Melli Iran | 10 | Iran
Bank of America | 10 | U.S.A.
Bank of Tokyo | 10 | Japan
Barclays Bank International | 10 | U.K.
Deutsche Bank | 10 | Germany
Industrial and Mining Development Bank of Iran | 10 | Iran
Industrial Bank of Japan | 10 | Japan
Manufacturers Hanover Trust | 10 | U.S.A.
Midland Bank Ltd. | 10 | U.K.
Societe Generale | 10 | France

LIBRA BANK

Shareholders | Percentage | Country
---|---|---
Chase Manhattan Bank | n/a | U.S.A.
National Westminster Bank | n/a | U.K.
Royal Bank of Canada | n/a | Canada
Credito Italiano | n/a | Italy
Mitsubishi Bank | n/a | Japan
Westdeutsche Landesbank | n/a | Germany
Swiss Bank Corporation | n/a | Switzerland
Banco Espirito Santo e Comercial de Lisboa | n/a | Portugal

Principal areas of business

International financing in Latin American markets. The bank engages in: short, medium and long-term eurocurrency loan transactions; management; underwriting and placement of debt and equity securities for clients; syndication of major loan transactions; transacting business in the short-term eurocurrency deposit markets; financial counselling.

LONDON INTERSTATE BANK LTD.

Shareholders | Percentage | Country
---|---|---
First National Bank of Atlanta | 16.13 | U.S.A.
First Western Bank and Trust Co. | 16.13 | U.S.A.
Indiana National Bank | 16.13 | U.S.A.
Keyser Ullmann | 16.13 | U.K.
Maryland National Bank | 16.13 | U.S.A.
Mercantile Trust Company NA, St. Louis | 16.13 | U.S.A.

Principal area of business

Conducts an international banking business providing finance for the short and medium-term in sterling and foreign currencies for commercial and industrial companies, financial institutions, governments, government agencies and corporations.
LONDON MULTINATIONAL BANK LTD.

Shareholders

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Baring Brothers Ltd.</td>
<td>20</td>
<td>U.K.</td>
</tr>
<tr>
<td>Chemical Bank</td>
<td>30</td>
<td>U.S.A.</td>
</tr>
<tr>
<td>Credit Suisse</td>
<td>30</td>
<td>Switzerland</td>
</tr>
<tr>
<td>Northern Trust Company Chicago</td>
<td>20</td>
<td>U.S.A.</td>
</tr>
</tbody>
</table>

Principal area of business

Multinational merchant banking.

MANUFACTURERS HANOVER LTD.

Shareholders

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturers Hanover Trust</td>
<td>75</td>
<td>U.S.A.</td>
</tr>
<tr>
<td>N. M. Rothschild and Sons</td>
<td>10</td>
<td>U.K.</td>
</tr>
<tr>
<td>Riunione Adriatica di Sicurtà</td>
<td>10</td>
<td>Italy</td>
</tr>
<tr>
<td>Long Term Credit Bank of Japan</td>
<td>5</td>
<td>Japan</td>
</tr>
</tbody>
</table>

Principal areas of business

Principal business is the arranging of medium and long-term finance for governments, government agencies and major international corporations, in the eurocurrency markets and through the management, underwriting and distribution of issues in the international capital market and the private placement of securities with investors. It also provides financial advisory services to international companies and governmental agencies in the examination, implementation and financing of major projects; arranges finance for shipping; acts as advisers to clients in the timing, methods and amounts of financing in different countries and currencies; participates in the underwriting and distribution of issues in the international capital market managed by others; manages fixed interest portfolios which also involves the purchase, sale and custody of securities; and makes loans and places funds for its own account.

MARTIN CORPORATION GROUP LTD.

Shareholders

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Baring Brothers and Co. Ltd.</td>
<td>20</td>
<td>U.K.</td>
</tr>
<tr>
<td>United Dominions Trust Ltd.</td>
<td>40</td>
<td>U.K.</td>
</tr>
<tr>
<td>Wells Fargo Bank NA</td>
<td>40</td>
<td>U.S.A.</td>
</tr>
</tbody>
</table>

Subsidiaries and affiliates

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Martin Corporation Ltd.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Martin Nominees Ltd.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Principal areas of business

Merchant banking (complete range of facilities) and money market operations.
MBC INTERNATIONAL LTD.

Shareholders

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank of America</td>
<td>25</td>
<td>U.S.A.</td>
</tr>
<tr>
<td>Dai-Ichi Kangyo Bank Ltd.</td>
<td>10</td>
<td>Japan</td>
</tr>
<tr>
<td>Antony Gibbs and Sons Ltd.</td>
<td>26.8</td>
<td>U.K.</td>
</tr>
<tr>
<td>Kleinwort Benson Ltd.</td>
<td>26.8</td>
<td>U.K.</td>
</tr>
<tr>
<td>Rothmans</td>
<td>11.4</td>
<td>Australia</td>
</tr>
</tbody>
</table>

Subsidiaries and affiliates

MBC Investments Ltd.
MBC Nominees Proprietary Ltd.

Principal area of business

Merchant banking.

MERRILL LYNCH-BROWN SHIPLEY BANK LTD (NOW MERRILL LYNCH INTERNATIONAL)

Shareholders

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brown Shipley Holdings</td>
<td>5</td>
<td>U.K.</td>
</tr>
<tr>
<td>Merrill Lynch Holdings</td>
<td>95</td>
<td>U.S.A.</td>
</tr>
</tbody>
</table>

MIDLAND AND INTERNATIONAL BANKS LTD.

Shareholders

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Midland Bank Ltd.</td>
<td>45</td>
<td>U.K.</td>
</tr>
<tr>
<td>Commercial Bank of Australia Ltd.</td>
<td>10</td>
<td>Australia</td>
</tr>
<tr>
<td>Standard Bank Ltd.</td>
<td>19</td>
<td>U.K.</td>
</tr>
<tr>
<td>Toronto Dominion Bank</td>
<td>26</td>
<td>Canada</td>
</tr>
</tbody>
</table>

Principal areas of business

Formed in 1964 to undertake international financial business. Most business is within the medium-term field. Active in medium-term eurocurrency market and issues negotiable certificate of deposit in both dollars and sterling.

ORION BANK LIMITED

Shareholders

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chase Manhattan Overseas Banking Corp.</td>
<td>20</td>
<td>U.S.A.</td>
</tr>
<tr>
<td>Credito Italiano SpA</td>
<td>10</td>
<td>Italy</td>
</tr>
<tr>
<td>Mitsubishi Bank Ltd.</td>
<td>10</td>
<td>Japan</td>
</tr>
<tr>
<td>National Westminster Bank Ltd.</td>
<td>20</td>
<td>U.K.</td>
</tr>
<tr>
<td>Royal Bank of Canada</td>
<td>20</td>
<td>Canada</td>
</tr>
<tr>
<td>Westdeutsche Landesbank Girozentrale</td>
<td>20</td>
<td>Germany</td>
</tr>
</tbody>
</table>

Subsidiaries and affiliates

Orion Multinational Services Ltd.
Orion Termbank Ltd.
Orion Leasing Holdings Ltd.

Principal areas of business

An international investment and issue bank.
ORION MULTINATIONAL SERVICES LTD.

Shareholders Percentage Country
Chase Manhattan Overseas Banking Corp. 16.66 U. S. A.
Credito Italiano SpA 16.66 Italy
Mitsubishi Bank Ltd. 16.66 Japan
National Westminster Bank Ltd. 16.66 U. K.
Royal Bank of Canada 16.66 Canada
Westdeutsche Landesbank Girozentrale 16.66 Germany

Subsidiaries and affiliates
Orion Termbank Ltd.
Orion Bank Ltd.
Orion Leasing Holdings Ltd.

Principal areas of business
A planning and marketing coordination organisation for the Orion Banking Group.

PHILIPS-FIRST CITY-BRANDT'S LTD.

Shareholders Percentage Country
First National City Bank 20 U. S. A.
Merrill Lynch Pierce Fenner and Smith 20 U. S. A.
William Brandt's Sons and Co. Ltd. 10 U. K.
National Mutual Life 20 Australia
Philips, Kitchen and Co. 20 Australia
Wallace H. Smith and Co. 10 Australia

Subsidiaries and affiliates
PFCB Management Pty Ltd.
PFCB Nominees Pty Ltd.
Springbridge Pty Ltd.

Principal areas of business
Merchant banking, underwriting, corporate finance advice and investment management.

SCHRODERS AND CHARTERED LTD.

Shareholders Percentage Country
Chartered Bank 40 U. K.
Sir Elly Kadoorie Continuation Ltd. 20 Hong Kong
J. Henry Schroder Wagg and Co. 40 U. K.

Principal areas of business
Management of new issues, underwriting of local and international issues, capital reorganisations, capital raising through rights issues, placings and quotations, introductions and underwriting of issues of foreign corporations, mergers and acquisitions, investment and management of institutional funds, primary distributors and underwriters of eurobonds and Asian dollar bonds, loan syndication, general financial advice.
SOCIETE FINANCIERE EUROPEENNE

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algemene Bank Nederland N.V.</td>
<td>12.5</td>
<td>Netherlands</td>
</tr>
<tr>
<td>Banca Nazionale del Lavoro</td>
<td>n/a</td>
<td>Italy</td>
</tr>
<tr>
<td>Bank of America NT and SA</td>
<td>n/a</td>
<td>U.S.A.</td>
</tr>
<tr>
<td>Banque de Bruxelles SA</td>
<td>n/a</td>
<td>Belgium</td>
</tr>
<tr>
<td>Banque Nationale de Paris</td>
<td>n/a</td>
<td>France</td>
</tr>
<tr>
<td>Barclays Bank International Ltd.</td>
<td>n/a</td>
<td>U.K.</td>
</tr>
<tr>
<td>Dresdner Bank AG</td>
<td>n/a</td>
<td>Germany</td>
</tr>
<tr>
<td>Sumitomo Bank Ltd.</td>
<td>n/a</td>
<td>Japan</td>
</tr>
</tbody>
</table>

BANQUE DE LA SOCIETE FINANCIERE EUROPEENNE

Societe Financiere Europeenne, Luxembourg, has a 52% participation and each of its participants own 6% of Societe Financiere Europeenne, Paris.

Principal areas of business

Medium and long-term loans; mergers and acquisitions; equity participations; underwriting.

TRICONTINENTAL CORPORATION LTD.

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gillett Bros Discount Co. Ltd.</td>
<td>9.17</td>
<td>U.K.</td>
</tr>
<tr>
<td>Incentive AB *</td>
<td>3.83</td>
<td>Sweden</td>
</tr>
<tr>
<td>Mitsui Bank Ltd.</td>
<td>12.00</td>
<td>Japan</td>
</tr>
<tr>
<td>Security Pacific National Bank</td>
<td>24.00</td>
<td>U.S.A.</td>
</tr>
</tbody>
</table>

* Associated with Skandinaviska Enskilda Banken.

The Ian Potter Foundation, Australian United Investment Co. Ltd., Commercial Union Assurance Co. of Australia Ltd., and Consolidated Press Holdings Ltd. and Sir Ian Potter are also major shareholders in a total of 570 shareholdes.

Subsidiaries

Inverary Pty Ltd. (investment company)
Milfay Pty Ltd. (leasing company)
Portview Management Pty Ltd. (portfolio managers)
Portview Nominees Pty Ltd. (nominee company)
Tricontinental Leasing Ltd. (leasing company)
Vite Pty Ltd. (investment company)

Principal areas of business

Corporate finance; leasing - money market operations; investments - portfolio management.
UBAF LTD.

Shareholders

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Union de Banques Arabes et Francaises</td>
<td>50</td>
<td>France</td>
</tr>
<tr>
<td>Midland Bank Ltd.</td>
<td>25</td>
<td>U.K.</td>
</tr>
<tr>
<td>Libyan Arab Foreign Bank</td>
<td>25</td>
<td>Libya</td>
</tr>
</tbody>
</table>

Subsidiaries and affiliates

UBAE Luxembourg-Frankfurt
UBAE Rome
UBAN Hong Kong - Tokyo

Principal area of business

Medium-term eurocurrency finance.

UNITED INTERNATIONAL BANK LTD.

Shareholders

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banco de Bilbao</td>
<td>n/a</td>
<td>Spain</td>
</tr>
<tr>
<td>Bank Mees and Hope</td>
<td>n/a</td>
<td>Netherlands</td>
</tr>
<tr>
<td>Bank of Nova Scotia</td>
<td>n/a</td>
<td>Canada</td>
</tr>
<tr>
<td>Banque Francaise du Commerce Exterieur</td>
<td>n/a</td>
<td>France</td>
</tr>
<tr>
<td>Bayerische Hypotheken-und Wechselbank</td>
<td>n/a</td>
<td>Germany</td>
</tr>
<tr>
<td>Credit du Nord</td>
<td>n/a</td>
<td>France</td>
</tr>
<tr>
<td>Crocker National Bank</td>
<td>n/a</td>
<td>U.S.A.</td>
</tr>
<tr>
<td>Privatbanken i Kjobenhavn</td>
<td>n/a</td>
<td>Denmark</td>
</tr>
<tr>
<td>Sveriges Kreditbank</td>
<td>n/a</td>
<td>Sweden</td>
</tr>
<tr>
<td>Williams and Glyn's</td>
<td>n/a</td>
<td>U.K.</td>
</tr>
</tbody>
</table>

Principal areas of business

The bank accepts deposits of substantial amounts for varying periods at market rates in both sterling and eurocurrencies. It also issues negotiable sterling and dollar certificate of deposit. The bank has granted loans in the interbank market and medium-term loans to major institutions throughout the world. It has developed an active foreign exchange dealing department.

WESTERN AMERICAN BANK (EUROPE) LTD.

Shareholders

<table>
<thead>
<tr>
<th>Shareholder</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank of Tokyo Ltd.</td>
<td>22.5</td>
<td>Japan</td>
</tr>
<tr>
<td>Hambros Bank Ltd.</td>
<td>10.0</td>
<td>U.K.</td>
</tr>
<tr>
<td>National Bank of Detroit</td>
<td>22.5</td>
<td>U.S.A.</td>
</tr>
<tr>
<td>Security Pacific National Bank</td>
<td>22.5</td>
<td>U.S.A.</td>
</tr>
<tr>
<td>Wells Fargo Bank</td>
<td>22.5</td>
<td>U.S.A.</td>
</tr>
</tbody>
</table>

Subsidiaries and affiliates

Western American Bank (Luxembourg) SA
Western American Eurodeal Ltd., London
Western American Eurodeal (Continental) AG, Zug.

Principal area of business

International merchant banking.
WESTRALIAN INTERNATIONAL LTD.

<table>
<thead>
<tr>
<th>Shareholders</th>
<th>Percentage</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alexanders Discount Co. Ltd.</td>
<td>4.2</td>
<td>U.K.</td>
</tr>
<tr>
<td>Commissioners of the Rural and Industries Bank of Western Australia</td>
<td>18.3</td>
<td>Australia</td>
</tr>
<tr>
<td>Credit Lyonnais</td>
<td>20.0</td>
<td>France</td>
</tr>
<tr>
<td>Crown Agents for Overseas Governments and Administrations</td>
<td>35.0</td>
<td>U.K.</td>
</tr>
<tr>
<td>Mutual Life and Citizens' Assurance Company Ltd.</td>
<td>18.3</td>
<td>Australia</td>
</tr>
<tr>
<td>Wallace Brothers Sassoon Bank Ltd.</td>
<td>4.2</td>
<td>U.K.</td>
</tr>
</tbody>
</table>

Subsidiaries and affiliates

Westint Nominees Pty Ltd.
WIL Acceptances Pty Ltd.

Principal area of business

Merchant banking.
### APPENDIX 11

**U.S. Banks' shareholdings in London consortium banks**

<table>
<thead>
<tr>
<th>Shareholders (US)</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manufacturers Hanover</td>
<td>(20)</td>
</tr>
<tr>
<td>First Pennsylvania Bk Tst</td>
<td>(12.5)</td>
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<tr>
<td>Manufacturers NB of Detroit</td>
<td>(12.5)</td>
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<tr>
<td>Nat. Shawmut Bk. of Boston</td>
<td>(12.5)</td>
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<tr>
<td>United California Bank</td>
<td>(12.5)</td>
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<tr>
<td>Brown Bros. Harriman</td>
<td>(22)</td>
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<tr>
<td>Pittsburgh National Bank</td>
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<tr>
<td>First Nat. of Minneapolis</td>
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<tr>
<td>Bank of America Intl. Ltd.</td>
<td>(17.5)*</td>
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<tr>
<td>First NB of Chicago</td>
<td>(22)</td>
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<tr>
<td>Irving Tst Co.</td>
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<td>Republic NB of Dallas</td>
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<td>Bank of America</td>
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<td>Manufacturers Hanover</td>
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<tr>
<td>Chase Manhattan</td>
<td>(n/s)</td>
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<td>First NB of Atlanta</td>
<td>(16.13)</td>
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<tr>
<td>First Western Bk &amp; Tst Co.</td>
<td>(16.13)*</td>
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<tr>
<td>Indiana National Bank</td>
<td>(16.13)</td>
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<td>Maryland National Bank</td>
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<td>Mercantile Tst Co. of St Louis</td>
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<tr>
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<td>(30)</td>
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<td>Northern Trust Co. of Chicago</td>
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<tr>
<td>Merrill Lynch</td>
<td>(95)</td>
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<td>Security Pacific Nat. Bk</td>
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<td>Wells Fargo Bank</td>
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<td>Bank of America Intl. Ltd.</td>
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<td><strong>London Consortium Bank</strong></td>
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<td>Anglo-Romanian Bank</td>
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<td>Atlantic International Bank</td>
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<td>Brown Harriman &amp; International Banks</td>
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<td>Eurobraz</td>
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<tr>
<td>Western American Bank</td>
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<tr>
<td>International Mexican Bank</td>
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**Notes:**


° Acquired by Lloyds Bank and withdrawn from consortium

+ Now increased to 25%, since withdrawal of Hambros.
EMBARGO: NOT FOR PUBLICATION UNTIL SATURDAY, SEPTEMBER 23, 1972

September 22, 1972

LORD INCHCAPE'S STATEMENT ON P & O - BOVIS SITUATION

I have already stated my strong opposition to the proposal that P & O should merge with Bovis. I believe that there is a better alternative.

Since my original statement, Mr. A.B. Marshall and Mr. D.D. Brown have independently reached the conclusion that they cannot recommend the terms. They join with me in issuing this statement.

The proposed merger with Bovis is in my view not in the best interests of P & O stockholders for two main reasons:

1. the share of the P & O equity it is proposed should be issued to Bovis shareholders is unfairly biased in Bovis's favour.

2. the whole tenor and timing of the Offer do not reflect the real potential within the P & O Group.

Under the proposed merger terms Bovis shareholders would ultimately receive just over 40% of the increased equity of P & O. In order to contain the interest of the Bovis shareholders in P & O equity at this level, the existing P & O shareholders will have to subscribe £36.7 million cash in respect of warrants to be issued under the proposed capitalisation scheme. (One may in passing question the rationale of the further cash injection into an already cash rich group.)

- more -
LORD INCHCAPE'S STATEMENT - 2

But Bovis would contribute less than 20% of the new Group's combined assets. *

Although on the basis of 1972 forecast earnings Bovis would contribute about half† of the new Group's combined earnings we cannot believe that these earnings, taken together with P & O's forecast earnings for the year to September 30, 1972, represent a fair reflection of the relative earning capacity of the two businesses.

The P & O Board forecast on September 15 profits for the current year of £8 million, but with a further £2 million earned profit from earlier years to be added. During the year the company suffered a dock strike (£1.5 million estimated loss), a severe decline in the Northern Irish traffic, industrial troubles in Falmouth and major reorganisation costs. At a time of depression in international shipping I do not regard this result, which is substantially up on last year, as in any way discouraging. This is not the record of a company in decline.

The new ship programme to the value of some £200 million is now beginning to bring in profits in increasing measure. These ships are designed for the growth markets of world trade throughout the 70s.

Notes: * This would be the case even after assuming a substantial surplus value for the Bovis land bank and Twentieth Century Banking Corporation.
† Assuming earnings for Bovis at £7.8 million for 1972 and assuming P & O earnings for the year to September 30, 1972 to be of the order of £8.0 million.

- more -
P & O has invested substantial resources in such joint ventures as O.C.L. Panocean, Oil exploration in the North Sea, and the transport and marketing of liquefied gas. The earnings to justify these joint venture investments are already beginning to flow and we are convinced that they will contribute increasingly over the years ahead to the profits available for P & O stockholders.

Over the past two years the P & O staff have made great efforts and put through great changes. The benefits of this massive reorganisation are only now beginning to come through.

From all I know of the Eastern trades, and of the Company's Five Year Plan for profit improvement and for expansion into new activities, both in and out of the maritime field, I am confident that P & O is poised for a substantial profit recovery. Indeed in Mr. Geddes' letter he says "Your Directors believe that a more favourable view of the trend of profits in the next few years is justified." This view by the Board as a whole is one with which I strongly concur.

There is moreover a highly significant implication in Mr. Geddes' statement that "between now and the end of 1974 (tax) allowances unutilised against profits of the P & O Group alone are likely to be of the order of £40 million". As this statement could only be made given profit estimates for 1973/74, shareholders should be told how this figure of £40 million was arrived at.

A significant part of P & O's improving profitability will arise from the deployment, at acceptable returns, of the substantial cash flow which will accrue to P & O over the next few years with, in my view a relatively high degree of certainty.
Bovis's recent profit trend has benefited from factors, principally the recent and unprecedented rise in land values, which have been exceptionally favourable to their business. Their Directors have provided no information in the published documents to reassure me that Bovis's future profit trend is likely to be a significant justification for the merger proposals.

With international shipping currently emerging from depressed conditions, it may well be that the proposed merger comes at a time when P&O and Bovis are at diametrically opposite ends of their respective trading cycles.

The relative contributions of assets by two Groups - which will provide the material for future profitability - demonstrate how drastically the terms are biased in Bovis's favour. The relevance of this point is, of course, emphasised by the proportion of P&O's assets that is in the form of property or liquid assets.

The foundations of success lie in assets and management. We have the former and, I believe, much more of the latter than the Offer Documents suggest.

We need a Board confident in itself and its staff, and given appropriate leadership and direction, both of which I am confident will be forthcoming once the Bovis proposal has been rejected by the stockholders, I believe we have the necessary skills and abilities in the executive team on the shipping side. There is also plenty of talent of a high order to be found at all levels of staff and its potential must be released.
Of course, specific skills and qualifications must be sought elsewhere to meet urgent needs e.g. it is essential to bring into the company a property man of high calibre.

Accordingly, we believe that the proposals put to stockholders to merge P & O and Bovis are on terms which quite inadequately reflect the present value and great potential of the P & O Group and should, therefore, in the best interests of P & O stockholders be rejected.

What is the alternative and what should stockholders do?

P & O stockholders should refuse to authorise the increase of capital called for to implement the proposed terms. The Board of P & O should then determine to achieve increased earnings per share which will reflect a more acceptable return on P & O's assets currently estimated at some £300 million (500p per stock unit).

In fulfilment of this objective the Board should:

(i) Reaffirm the company's faith in its own future and restore staff confidence;

(ii) press on with the exploitation of the company's recent investments in new and advanced ships totalling some £200 million.

(iii) wherever possible raise the return earned on the Group properties now valued at some £110 million.
(iv) continue P & O's diversification into non-shipping fields by acquisition and investment and thus balance the Group's economic base, making for this purpose maximum use of the Group's financial standing, its liquid resources, now amounting to some £40 million, the substantial annual cash flow of about £25 million, and the special fiscal advantages enjoyed by a shipping company;

(v) cut out loss making subsidiary service and agency companies and dispose of low yielding investments in companies no longer required for the purposes of the Group's business.

This course of action constitutes a far better resolution of the present position than a merger with Bovis on the terms proposed.

The proposed terms do not do justice to P & O. They have never been and are not today the best opportunity open.

We believe stockholders should vote against the merger Resolutions proposed for the meeting on October 12, 1972.

Lord Inchcape, Mr. A.B. Marshall and Mr. D.D. Brown have considered all statements of fact and opinion contained herein and accept individually and collectively responsibility therefor.

September 22, 1972

Copies of this statement are available from Lord Inchcape's Office, 40 St. Mary Axe, EC3A 8EU

END

Issued by the Earl of Inchcape through Charles Barker City Limited tel: 01-236 3011
Press enquiries: Lord Inchcape office: 01-283 4680
home: Newport (079 982) 212
After hours & Mr. A.B. Marshall Woldingham (905) 2299
weekend. Mr. D.D. Brown Godalming (04868) 6635

GP/AJR
Questions relating to the merger between P & O and Bovis

1. The P & O Board has given no indication of the likely range of P & O profits over the next few years. Shareholders are told that there is a £200m. shipbuilding programme, yet the offer documents give no indication of what profit the Company is likely to derive from its shipping operations. P & O has presumably made internal projections of profits at least up to the end of 1974 in order to arrive at the estimate of £40m. unutilisable capital allowances given in the letter to shareholders. Why haven't shareholders been told how the figure of £40m. was reached?

The internal reorganisation post-McKinsey is apparently only now taking effect. Has this resulted in cost savings? What cost savings are likely to result in the future?

2. The P & O Board has given no real indication of the potential of the P & O properties but says that many of the properties are needed by the Group for the conduct of its business. Conversely, the Chairman of Bovis says in his letter to Bovis shareholders that Bovis expertise can maximise returns on P & O properties. What is the current valuation of those properties that are available for development? On what basis have they been valued? To what extent would it be practicable over a period for P & O's business to be moved to other premises without a material increase in costs, thus freeing more of the existing properties for redevelopment?

3. The P & O Board claim as one rationale for the merger a desire to spread the risk underlying the P & O profit base. As far as properties are concerned, how can this be done other than by developing properties as fixed assets to be held for rental purposes, thus giving a certain rental income which increases with inflation. Is it intended that the development of the P & O properties should be done with this end in view?
4. What steps has the P & O Board taken to find experts capable of exploiting the potential of the P & O properties? Has the Board explored any schemes for a joint venture or other association with a property company to maximise returns on the P & O properties?

5. The offer document incorporates a revaluation of the P & O properties yet nothing is said about the current value of the Group's other assets, in particular the value of its fleet. What is the current value of the P & O fleet? If it is in fact below the book value, then:

   (a) why hasn't the book value been written down out of reserves?
   (b) why hasn't the depreciation charge been reduced with a consequent increase in profits?

6. P & O is known to have ships on order until 1975; further ships may have been ordered. What are the gross capital allowances on these ships? What is the present total of unutilised allowances? Why doesn't the estimate of unutilisable allowances of £40m. go beyond the end of 1974? Has the P & O Board seriously considered schemes for the acceleration of the use of capital allowances? If not, why not?

7. Has the P & O Board explored the possibility of acquiring the other interests in profitable associated companies, the profits of which would then be offsettable against P & O's capital allowance and so become tax free in the hands of P & O?

8. Why is P & O proposing to issue warrants? There is no proper reason for doing so unless it is expected that they will be exercised. Why does the P & O Board think that the Company will need the £36m. that the exercise of the warrants will produce, bearing in mind the existing liquid assets and "the considerable cash flow generated by P & O" referred to by Mr. Sanderson.
9. What is the detailed breakdown of the Bovis profit forecast so that P & O shareholders may know the extent to which Bovis forecast profits are attributable to:-

(a) Housebuilding, and in particular the extent to which housebuilding profits will be derived from profit on the sale of sites as opposed to construction activity?
(b) Property dealing profit, including the sale of completed developments.
(c) Rental income.
(d) Contracting.
(e) Banking.

10. What is the estimated range of Bovis profits in 1973 and 1974 and what proportions are likely to be derived from the separate sources listed in 9?

11. What is the current value of the Bovis land bank and the surplus over cost? Has the land bank been independently valued recently and if so, by whom?

12. What is the current value of the Bovis fixed asset land and buildings? Have they been independently valued recently, and if so, by whom?

13. What is the extent of additional costs resulting from the settlement of the building dispute which cannot be recovered under escalation clauses in existing contracts?

14. Since Bovis first became involved in property development, in addition to contracting and housebuilding, in 1970, what profits have been derived from development activities and to what extent are they represented by (a) dealing profits and (b) rental income?
15. What is the basis for the estimate of the "end value" of £100m. for the Bovis development programme? How much of this is profit? Does Bovis intend to realise this profit, and if so to what extent and over what period? If not, what additional rental income is it estimated will accrue? It is noted that the assumption underlying the profit forecast of the property division for 1972 does not envisage any increase in rental income. Is this correct?
THIS LETTER IS URGENT. YOU SHOULD READ IT WITHOUT DELAY.

P&O and BOVIS

EMBARGO

NOT FOR PUBLICATION, BROADCAST OR USE ON CLUB TAPES BEFORE 00.01 HOURS
- 4 OCT 1972

A LETTER TO STOCKHOLDERS
CONCERNING THE PROPOSED MERGER FROM

ISSUED BY JOHN ADDEY ASSOCIATES

Morgan Grenfell

3rd October, 1972.
To: The holders of the Preferred and Deferred Stock of
The Peninsular and Oriental Steam Navigation Company

Dear Stockholder,

PROPOSED MERGER WITH BOVIS

As a stockholder of P & O you will be aware that your Board has proposed a merger between your Company and Bovis and you will have received an explanatory letter from the Chairman of P & O together with a copy of the formal offer document dated 19th September, 1972.

Following the announcement of the proposal, Morgan Grenfell, as investment advisers responsible to clients holding more than £400,000 Deferred Stock in P & O, examined the proposed terms and concluded that they might not be in the best interests of P & O stockholders. Accordingly we contacted major stockholders and discovered that they too had reservations about the terms.

We decided that Morgan Grenfell, which is independent of both P & O and Bovis and has no advisory position with either company should make its views known publicly so that those who share our feeling of unease over the proposal and the manner in which it has been conceived might have their interests represented.

You will have read that the Earl of Inchcape and two executive directors, Mr. A. B. Marshall and Mr. D. D. Brown dissented from the recommendation of the Board of P & O as they did not accept that the prospects for P & O stockholders were appreciably better from the combined group than from P & O alone. A fourth director, Mr. C. J. Nancarrow, has now withdrawn his recommendation. Morgan Grenfell do not represent these directors, preferring to take a completely independent and objective position seeking to obtain the best outcome for the stockholders of P & O.

Our first step, after having had an opportunity to study the documents carefully, was to hold a meeting of major stockholders, representing some 25 per cent. of the equity of P & O, at our offices on Monday, 25th September, 1972. We believed then that in his communications to his stockholders the Chairman of P & O had not dealt with basic issues fundamental to a realistic assessment of the position, and that there was a seemingly totally unjustifiable attempt by the Board to belittle P & O and cast doubt on its prospects even though this Board had been responsible for its management and policy for many years. This lack of proper information, and the apparent indecent haste with which the proposed merger had been arranged, raised a great number of questions. These were discussed at the meeting and a list of questions (as set out in the Appendix I to this letter), designed to elicit the information in our opinion necessary to reach a rational, informed and unemotional decision, was submitted to P & O’s advisers.

In order to give P & O stockholders proper time to consider the answers we asked that they should be given to stockholders by the morning of Thursday, 28th September. We assumed that the answers could be given from information already available to P & O and its advisers having been already considered by them in formulating the terms.

The response to these questions was a further letter from the Chairman of P & O posted on Friday, 29th September giving certain information which in no way provides the full and frank answers we expected the Board should provide before stockholders could reasonably be expected to take what may be an irrevocable decision on the future of P & O.

Owing to the lack of information concerning P & O we felt it necessary to commission an independent report on the prospects of P & O from James Morrell & Associates, specialists in business forecasting. A copy of this report may be inspected at our offices at the above address.

In their opinion “in the year just ending we expect to see a small improvement in profit margins, which should produce, on unchanged gross revenues, the level of profits forecast by the Chairman. Taking into account the general sober outlook for freight rates and the cost position, we forecast a cyclical improvement in margins to 1974. Profits should also rise as capacity increases. Investment income is expected to rise as cash flow retentions are re-invested, but loan interest payments are likely to increase as outstanding facilities are taken up for the final instalments of the building programme.”

“The rise in the level of operations in 1973 is expected to be well above average due to the good increase in world production and trade. This will entail increased operating costs, which in conjunction with the general rise in prices is expected to lead to a 15 per cent. rise in total costs. Thereafter benefits are likely to accrue from the rationalisation programme arising from the implementation of the McKinsey report recommendations.”

“Our forecasts can be summarised as follows:—

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<tr>
<th>Year to 30th September</th>
<th>Net income before tax (£m)</th>
<th>Available for equity (£m)</th>
<th>Earnings per stock unit pence</th>
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<td>1971 Actual</td>
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<td>3.1</td>
<td>5.2</td>
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<td>1972</td>
<td>10.9</td>
<td>8.9</td>
<td>15.3</td>
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<td>1973</td>
<td>15.5</td>
<td>13.5</td>
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<tr>
<td>1974</td>
<td>19.2</td>
<td>17.1</td>
<td>29.3</td>
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It is stressed that this forecast makes no allowance for any change in use or disposal of surplus assets.”
"In addition P & O has property interests substantially in excess of its own operating requirements. The sale of surplus property would release capital for the acquisition of additional industrial equity income. Either surplus assets are re-invested to raise the level of equity earnings or the surplus cash and property assets can be disposed of. In either case we suggest that the additional earnings, or asset surplus, can be valued at £2 per stock unit."

"On this basis, our basic forecast of earnings per stock unit rising to 30p in 1974 plus the more effective use of assets indicate a potential price of £5 by 1974."

In the absence of contrary evidence from the Chairman of P & O we can only reach our decision on the balance of advantages to P & O in the light of independent estimates.

We question whether a housebuilding, construction and property dealing company such as Bovis is the right company with which P & O should merge. We do not believe that the record and potential of Bovis is such as to justify a merger on the terms currently proposed. In our opinion, on the evidence so far presented, the existing potential of P & O is such that this is the wrong time for P & O stockholders to give away nearly 50 per cent. of their company.

A more dynamic Board of Directors should be appointed. We believe that the Earl of Inchcape, as one of the senior directors, would be prepared to be appointed Chairman until a full time executive Chairman of the calibre required could be found. In this way, we believe that the existing potential of P & O will be realised, the whole of which will go to P & O stockholders.

At a further meeting of major stockholders on Thursday, 28th September it was considered that there would no longer be sufficient time for the proper consideration of any new information given by P & O and for serious comment on such information to reach stockholders before we were required to return our proxies in order to vote at the Extraordinary General Meeting convened for 12th October, 1972. Proxies must be returned by 3 p.m. on Tuesday, 10th October which means that many stockholders will need to post their proxies by Friday, 6th October. Accordingly, we were authorised as spokesmen of the meeting to seek an adjournment of the Extraordinary General Meeting. This request was refused by the Board of P & O. We then referred the matter to the Executive of the Panel on Take-overs and Mergers and when they ruled that in their view an adjournment was not necessary we appealed to the full Panel. At a meeting of the full Panel on Monday, 2nd October, the appeal was refused and the Executive ruling upheld. The position now is that stockholders have only three working days from the receipt of this letter to consider questions of vital consequence and to complete their proxy forms.

We believe that stockholders cannot be expected to assent to these merger plans until the proper information has been made available, and proper time given for its consideration, and until stockholders have been given complete satisfaction by the Board of P & O.

The consent of the stockholders of P & O must be obtained for the alteration to the share capital of P & O necessary to implement the merger with Bovis. Resolutions 2 and 3 to be proposed at the Extraordinary General Meeting convened for 12th October, 1972 are for this purpose.

IF YOU SHARE OUR CONCERN ABOUT THE PROPOSED MERGER YOU SHOULD VOTE AGAINST RESOLUTIONS 2 AND 3

Resolution 1 is a Special Resolution altering the voting structure of P & O so as to give every stockholder one vote for every £1 nominal of stock held. This Resolution has no bearing on the proposed merger. The P & O Board have recommended stockholders to implement this change in order to bring the voting structure into conformity with modern practice which we believe is a sensible proposal.

WE SHALL ADVISE OUR CLIENTS TO VOTE FOR RESOLUTION 1

A new proxy form is enclosed with this letter which, by being completed and returned to Morgan Grenfell not later than 12 noon on Tuesday, 10th October, 1972, can be used to replace any proxy form already submitted. In the event that this meeting is postponed and further information provided, you may always reverse this vote by sending in a new proxy form.

IF YOU ARE IN ANY DOUBT AS TO THE IMPLICATIONS OF THIS LETTER AND THE ACTION YOU SHOULD TAKE YOU SHOULD CONSULT YOUR BROKER, BANK MANAGER OR OTHER ADVISER IMMEDIATELY.

Yours faithfully,

For MORGAN GRENFELL & CO. LIMITED,

CATTO,
Director.
QUESTIONS RELATING TO THE MERGER BETWEEN P & O AND BOVIS

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13. What is the extent of additional costs resulting from the settlement of the building dispute which can be recovered under escalation clauses in existing contracts?

14. Since Bovis first became involved in property development, in addition to contracting and housebuilding, in 1970, what profits have been derived from development activities and to what extent are they represented by (a) dealing profits and (b) rental income?

15. What is the basis for the estimate of the “end value” of £100m. for the Bovis development programme? How much of this is profit? Does Bovis intend to realise this profit, and if so to what extent and over what period? If not, what additional rental income is it estimated will accrue? It is noted that the assumption underlying the profit forecast of the property division for 1972 does not envisage any increase in rental income. Is this correct?
STAY INDEPENDENT.
CHOOSE THE BEST ALTERNATIVE,
NOT THE FIRST ALTERNATIVE.

You are being asked by the Board of P & O to make "the most crucial vote in the history of your Company" for a merger with Bovis where:—

1. INADEQUATE INFORMATION HAS BEEN PROVIDED.

2. FOUR DIRECTORS HAVE DISSENTED FROM THE BOARD'S VIEWS.

3. NEARLY 50 PER CENT. OF THE FUTURE GROWTH AND ASSETS OF P & O ARE BEING GIVEN TO BOVIS SHAREHOLDERS IN RETURN FOR JUST OVER 50 PER CENT. OF BOVIS.

4. P & O AT £5 PER STOCK UNIT WOULD BE VALUED AT £300 MILLION. BEFORE THE OFFER BOVIS WAS VALUED AT £97 MILLION.

5. THE NET ASSETS OF P & O ARE £306 MILLION. THE NET ASSETS OF BOVIS ARE £27 MILLION.

6. P & O IS EFFECTIVELY BEING TAKEN OVER BY BOVIS.
APPENDIX II

Assumptions made by James Morrell & Associates in arriving at their assessment dated 2nd October, 1972 of the prospects of P & O:—

1. (a) Demand for shipping is determined by world industrial production which in turn influences world trade.
   
   (b) The world business cycle can be predicted with some exactitude for one or two years ahead and a fair approximation can be made for the complete cycle for four or five years.
   
   (c) The trends over the past decade in P & O's operating ratios (revenue to assets and operating profits to revenue) viewed against the world background will be maintained.

2. P & O will continue its present basic pattern of operation and its concentration in shipping.

3. If unprofitable operations are to be continued steps will be taken to make them profitable.

4. The Group is not likely to be liable for U.K. Corporation Tax in the foreseeable future and the planned changeover to an imputation system of Corporation Tax will have no material effect. Overseas Tax will rise to a moderate extent.

5. The annual depreciation charges will remain at near the same percentage of the written down value of fixed assets.

6. The balance of the capital programme will be financed by further shipbuilding loans at interest rates below the market level.

7. The existing pattern of exchange rates will continue.

8. No allowance has been made for any likely increase in the profitability of interests outside shipping.
APPENDIX 15

A guide to the City Code, Revised April 1976

GENERAL PRINCIPLES

1. Observe the spirit as well as the wording.
2. Code impinges on the freedom of action of parties
3. Shareholders entitled to adequate information and time to decide.
4. Board of offeree company may not take action to deny shareholders the opportunity to decide outcome.
5. A false market in shares must not be allowed.
6. An offeree board should seek outside advice
7. Rights of control must be exercised in good faith
8. All offeree shareholders of the same class must be treated similarly.
9. An offer to shareholders in general shall not be on less favourable terms than a prior offer to selected shareholders.
10. Information shall not be made available to some but all shareholders.
11. Directors must act in their capacity as directors and in the interests of the shareholders as a whole.
12. Documents or advertisements to shareholders must be prepared with the same care as a prospectus.
13. Where control is effected by persons acting in concert, a general offer to all shareholders is required.
14. Financial advisers should ensure that an offeror is, and will remain, in a position to implement its offer.

RULES

The Approach

1. The offer should be put first to the offeree board or its advisers.
2. The identity of the principal must be disclosed at the outset.
3. The offeree board may seek assurances that the offeror has adequate resources.
4. The offeree board must seek independent advice on any offer.

Early Stages

5. Shareholders must be informed immediately that a firm intention to make an offer is notified.
6. An announcement by both parties is preferable.
7. There must be absolute secrecy before an announcement.
8. The identity of the offeror and its existing shareholding must be disclosed.

Board Consideration of an Offer

9. An offer will lapse if it is referred to the Monopolies and Mergers Commission.
10. Offer documents should be posted within 28 days of announcement of the terms.
11. Where offeror buys shares from directors (and associates) of offeree company he must undertake to fulfil any commitment under Rule 34.
12. Information given to one bidder must be furnished equally to other suitors.
Formal Offers, Documents Supporting an Offer or Recommending the Acceptance or Rejection of an Offer

13. Agreements or share dealings between directors/associates of the offeror and offeree companies must be disclosed in offer documents.
14. Any document or advertisement should be drawn with the same care as a prospectus and approved by the whole board. Notices of dissent must also be included.
15. Shareholders must be given all the facts, in ample time to make an informed judgement on the merits.
16. Profits forecasts require especial care from directors, and must be backed by a report on the bases by auditors and a report by financial advisers on the forecasts. Revaluation of assets require an independent professional report.
17. Offeree shareholders must be given details of shareholdings in the two companies of the companies themselves and their directors, and be told whether the offeree directors intend to accept or reject the offer.
18. The availability of adequate cash to satisfy the offer must be independently confirmed.
19. Details must be disclosed regarding directors' service contracts and emoluments.
20. Copies of all documents and announcements must be lodged with the Panel secretariat.

Mechanics and the Formal Offer

21. An offer which could confer voting control may not be declared unconditional unless voting control has been secured.
26. The provisions of the following four rules must be specifically incorporated in the offer document:

22. The offer must be open for at least 21 days and 14 days after revision terms. Unless the offer has become unconditional, an acceptor may withdraw his acceptance after 21 days from the original closing date and the offer must lapse after 60 days.
23. After an offer has become unconditional, it must be left open for at least 14 days, unless shareholders were given 14 days' advance warning.
24. An extension of an offer must be announced by 9.30 a.m. on the working day following the earlier expiry date.
25. The offeror must announce detailed results of an offer the morning after its expiry date, failing which quotation may be suspended and the unconditional declaration will become void.
27. Panel's consent is required for all partial bids.
28. Offers for various classes of shares must, for technical reasons relating to section 209 of the 1948 Companies Act, be worded as separate offers for each class.
29. Suitable arrangements must be made to protect the interests of holders of securities, options or subscription rights convertible into equity capital for which an offer is made.

Dealings

30. No insider trading is allowed from the first stage of an approach. This applies to all those "privy" to the preliminary discussions and includes directors/employees of the companies involved, professional advisers, the spouse and close relatives and related trusts of such persons.
31. The Code does not generally seek to fetter dealings in the market but each morning disclosure must be made of details of shares of each company acquired or sold by the parties or their associates the previous day.
32. If the offeror and/or its associate purchases shares in the market or otherwise during the offer period at a price higher than the bid price, the offeror shall offer a correspondingly higher price to all acceptors.

33. If shares purchased by the offeror, within 12 months prior to the offer period carry 15% or more of the voting rights, then the offer will normally be in cash or accompanied by a cash alternative at not less than the highest price.

34. If shares carrying more than 30% of the voting rights of a company are acquired, or if between 30% and 50% of voting rights are held and additional shares increasing the percentage by more than 2% are acquired, an offer must be extended for the remainder of the shares.

35. If an offer does not become unconditional the offeror may not make an offer for the company within 12 months of the previous offer lapsing or acquire sufficient shares for an offer to be mandatory under Rule 34.

36. Purchases and sales with some shareholders with special conditions are prohibited.

37. Associates of the offeror or offeree should consult the Panel to ensure that their dealings do not unfairly affect the outcome of, or frustrate, a bid.

Changes in the Situation of a company during a bid

38. In a bid situation, the Board of the offeree company may not generally, without the permission of a general meeting, issue fresh shares or options, sell or acquire material assets or enter into contracts otherwise than in the ordinary course of business.

Registration of Transfers

39. Registration of transfers should take place promptly so that shareholders can freely exercise their voting rights; Articles which prescribe a qualification period for voting are undesirable

PRACTICE NOTES

1. Application to private companies, unquoted public companies and foreign companies
2. Publication of information (General Principle 10)
3. Profit Forecasts (Rule 16)
4. Assumptions regarding profit forecast (Rule 16)
5. Asset valuations (Rule 16)
6. Directors' service contracts (Rule 19)
7. Disclosure of dealings (Rule 31)
8. Mandatory offers following acquisition or consolidation of control (Rule 34)
9. Rulings and interpretations of general interest.
APPENDIX 16

A summary of the proposals for the supervision of deposit taking institutions 1976

Recognition as a bank: 'Exacting criteria' covering minimum capital and reserves, type and range of banking services, reputation or status to be determined by the Bank in agreement with the Treasury and to be published, right of appeal to the Treasury against refusal or revocation of recognition, banks to be exempt from licensing.

Licensed institutions: Licence required from the Bank for all deposit-taking institutions that are not banks or otherwise exempt. 'General conditions' to be laid down in legislation and published prudential criteria to be determined by the Bank with the agreement of the Treasury, consultations to be held about the nature of criteria to include minimum capital and reserves, 'honest, trustworthy and suitably qualified' management and in the case of existing institutions, past performance.

Regulation: Bank to examine capital adequacy, liquidity, degree of risk attached to various assets, matching liabilities and assets in sterling and other currencies, deposits from and lending to connected organisations, lending distribution, provisions and profits. When granting or renewing licence Bank to be able to 'attach further conditions' covering appointment of directors or management, injection of extra capital, licence may be revoked or suspended if standards not met, with right to appeal to the Treasury.

Banking names and advertising: Recognised banks, but not licensed institutions, to use the word 'bank' in name, describe themselves as 'banks' or in the business of banking'; the Treasury, in consultation with the Bank under proposed legislation, to issue regulations governing content and form of advertising for deposits.

Deposit Protection Fund: Government propose a 'mandatory deposit protection fund' for banks and licensed institutions, providing cover for sterling deposits up to £10,000 or first £10,000 of larger deposits, to be administered by the Bank.

Branches of overseas deposit-taking institutions: To be licensed or recognised as a bank, prudential supervision, primarily 'by country of origin, no requirement of separate endowment capital in UK, if licensed in UK, and head office in EEC may be entitled to use banking names used in own country.

Legislation: Moneylenders Act and s 123 of Companies Act to be repealed once all the provisions of Consumer Credit Act 1974 in operation; Protection of Depositors Act and s 127 of Companies Act 1967 to be repealed; Income and Corporation Taxes Act 1970 to be amended. Exchange Control Act 1947 to remain; provisions of the Eighth Schedule of the Companies Act 1948 to continue pending review.

Accountability: Parliamentary scrutiny of supervision; criteria for licensing and recognition evolved by Bank and Treasury to be put before Parliament in both original and, as necessary, modified form; Bank to report annually on exercise of supervisory responsibilities to Parliament, report available to Select Committee on Nationalised Industries; Bank to handle individual cases
about which Treasury ministers will not answer questions unless there is an appeal. Appeals to be subject to statutory inquiry as defined in Tribunals and Inquiries Act 1971.