G R E S H A M

C O L L E G E

NEW LEARNING FOR A NEW CITY

STARTING POINTS

A Lecture by

PROFESSOR TOM CANNON CIM FinstEX FRSA FCIM
Mercers' School Memorial Professor of Commerce

14 October 1998

GRESHAM COLLEGE

Policy & Objectives

An independently funded educational institution, Gresham College exists

- to continue the free public lectures which have been given for 400 years, and to reinterpret the 'new learning' of Sir Thomas Gresham's day in contemporary terms;
- to engage in study, teaching and research, particularly in those disciplines represented by the Gresham Professors;
- to foster academic consideration of contemporary problems;
- to challenge those who live or work in the City of London to engage in intellectual debate on those subjects in which the City has a proper concern; and to provide a window on the City for learned societies, both national and international.

Gresham College, Barnard's Inn Hall, Holborn, London EC1N 2HH
Tel: 0171 831 0575 Fax: 0171 831 5208
e-mail: enquiries@gresham.ac.uk

Tom Cannon: Mercers' School Memorial Professor of Commerce at Gresham College

New Learning for a New City

Starting Points

New technologies, shifting markets, organisational innovations and new ideas have transformed the City over the last few years. These changes are testing the knowledge, skills and competence of the City's leaders and managers. This is as true in the small, specialist hybrid firm as in the giant international financial institution. New learning and new approaches to learning are essential if the City is to retain or enhance its position in the Global market place.

Nothing New Under the Sun

The decision by Thomas Gresham, 400 hundred years ago, to establish Gresham College – to bring new learning to the City – demonstrates his awareness that the City's prosperity ultimately depends on its ability to incorporate and adapt to new ideas. Each subsequent shift in either the nature of knowledge such as the Scientific Revolution or the Industrial Revolutions has served to reinforce this link. The link between economic transformation and change in financial systems and markets was especially dramatic during the first and second industrial revolutions.

The financial revolution of the mid to late 17th century saw a significant opening up of the flows of international financial markets especially in the provision of capital for public or infrastructural purposes. This process highlighted not only the failures of the ancient regime but the scope for rethinking ways of creating wealth and using capital for growth. The success, for example, of the Rothschilds was based in part of their creation of an international financial market. The family linked their ambitions to the new growth industries. It was no coincidence that Nathan Rothschild's initial base in England was not London but Manchester – home of the new industries that were reshaping the world.

The same era saw the end of Amsterdam's role as the dominant financial centre of Europe. The lead that London had created as a financial centre allowed it to fund first the creation of the infrastructure for industrialisation, then industrialisation itself.

Insert (whatever happended to Genoa)

London was able to achieve this leadership because it came closer to meeting the needs of a society seeking "general progress and general enrichment[1]" than any other. London and Britain had most of the general conditions for development and – perhaps most important – met more of the specific conditions for development, better than any other country.

The general conditions for economic development are;

- Secure rights for private property
- Secure rights for personal liberty
- Enforceable rights of contract
- Stable government
- Government willing to give its citizens a right of redress
- Honest government that is trusted by its citizens
- Moderate, efficient and ungreedy government[2]

Perhaps more important for the specific development of an economy or the sector of an economy that leads is growth, London, met the particular conditions for economic leadership;

- The knowledge of how to operate, manage and build the instruments of production, distribution, recovery (of costs) and retention (of returns to reinvest or distribute to investors)
- The capacity to impart this knowledge to entrants to business or members of the business community and enhance this knowledge
- The selection of people for jobs by competence and merit
- The creation of opportunities for people to act individually or as groups to enhance their and society's wealth within the society and without fear
- An environment in which people can publicly enjoy and employ the fruits of their labour in a more satisfactory way within the society[3]

---

[1] Landes, D. (1998) *The Wealth and Poverty of Nations* London, Little Brown

[2] Landes *ibid* p 218

London met both the general and particular conditions more successfully than any other existing community at the end of the eighteenth and much of the nineteenth century. It was access to knowledge, superior skills and technologies that allowed the City of London to finance much of the first industrial revolution in Europe and the opening up of the new economies especially in North America. The challenge to London occurred when rivals exploited the opportunity they had to leap the gap in knowledge and practice to overtake the current leaders and get an edge[4].

The second industrial revolution was preceded and accompanied by a financial revolution. This saw the mobilisation of capital on an unprecedented level to support industrial development especially those industries that could benefit from increased concentration in either the means of production or distribution. The growth of firms like Standard Oil, US Steel, New York Central Railway, General Electric and International Harvester would have been impossible without a banking and financial system capable of financing their development. Rockefeller could not have built his pipelines without access to capital on previously unheard of amount. The great consolidations such as US Steel required similar efforts at mobilising capital. The financial community itself was transformed in the same process;

"In 1850 America had 250 stock exchanges but no single financial centre stood out. New York jostled with Boston, Baltimore, Philadelphia and others for supremacy. Fifty years later New York emerged as the dominant exchange and single financial centre of national important. The turning point was the introduction of the telegraph, followed by the tickertape, which transformed the New York Stock Exchange from a regional market into a national one[5]."

This link between the transformation of financial and industrial markets was vividly illustrated in the life of Thomas Edison. His first invention was an improved ticker-tape which helped New York brokers to keep in touch with their markets – no wonder first he and now General Electric have had sustained support from Wall Street. New York's increasing "knowledge edge" partly explains its domestic and international leadership. Determination to retain this edge, partly explains the strength of the links that were created between the dominant financial communities and the leading centres of business and management education and research.

---

[3] Adapted from Landes *ibid* p217

[4] Gerschenkron, A. (1951) Economic *Backwardness in Historical Perspective : A Book of Essays* Cambridge, MA. Harvard University Press

[5] *The Economist* May 9th 1998

Fickle Futures

Financial centres like the City are facing similar changes today. The pressure for change include new technologies, globalisation of markets, new forms and flows of capital and institutional reform. Little wonder that the 1998 Economist Review of Financial Centres used the word "revolution" ten times to describe the nature of the changes facing the financial community. These changes are testing the capabilities of leading financial centres to retain their position in the face of global competition while adjusting to another fundamental shift in the patter of finance. Just as the first industrial revolution was rooted in the provision of capital for public or infrastructural purposes and the second in the mobilisation of capital on an unprecedented level to support industrial development, the third is rooted in the distribution of capital for enterprise and consumption. In effect, the focus of the first was the public institution especially government, the second the corporation, the third is the individual. It is the capacity to mobilise for distribution not concentration that will determine the success of financial centres.

The great centres such as the City of London are threatened not only by rival centres such as Frankfurt but by those questioning the need for centres at all;

"Younger American Exchanges such as Nasdaq, cannot be said to be based anywhere in particular. Nor can its mew online brokers, such as E*Trade, whose services are directly available through any computer hooked up to the Internet ... "in the mid-to-late 1980s, everything was in London," says Philippe Bordenave of Banque Nationale de Paris (BNP). "It was very important to be in London so you could have physical contact with the foreign exchange brokers. The British brokers ran the business.

Those brokers are no longer so important. Two computer systems-Reuters' 2000 series and EBS, an electronic broker owned by 14 big foreign exchange banks-now probably handle around 60% on London's 'spot' market, where currencies are bought and sold for immediate delivery. This electronic market is extraordinarily efficient. For part of the trading day, when London and New York dealers are at work at the same time, dollars, D-marks and yen can be bought and sold for each other at exactly the same price - in traders' jargon, without a bid-offer-spread. (For comparison, watch how much you lose on this spread next time you change money at an airport bureau de change). [6]"

The growth of e-commerce illustrates not only the potential impact of these changes on business-to-business transactions but the specific threat to those failing to rethink the fundamentals of their business in the light of these challenges. Business to business transactions are already the largest activity on the internet (see fig 1). The rate of increase in these transactions is accelerating especially in the financial sector. At present, however, Europe seems to be

---

[6] *The Economist* May 9th 1998

operating at significant disadvantage to the USA. PC penetration rates are far lower in the four major European markets; UK (19.3%), Germany (23.3%), France (15.1%) and Italy (9.2%) than in the USA (36.2%). Perhaps more importantly, high relative telecommunications costs as a result of slow deregulation mean that the European internet user pays 30 times more for usage than in the USA. Cost and other barriers mean that "there is a huge difference in business attitudes (in the USA and Europe) toward e-commerce ... What the Americans see as a huge opportunity, the Europeans see as a huge problem" (Sue Griffith, head of Internet strategy at Cable and Wireless).

Fig 1

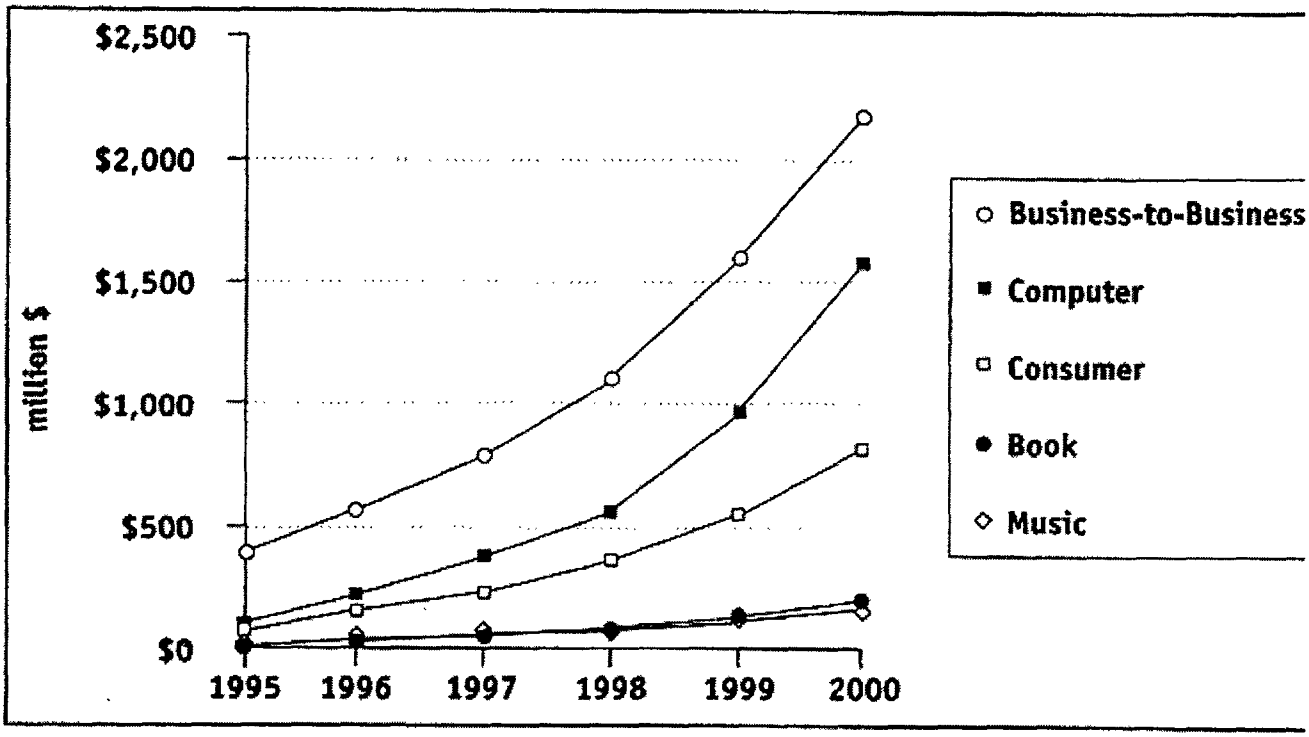

Figure 5-5 Electronic Marketplace Sales Growth by Category, 1995–2000
Source: Cowles/Simba Information; (800) 307-2529.

In the financial and related communities "the problems are intensified because companies' hesitation to embrace e-business is making it difficult for banks to justify the huge investments they must now make to prepare for the mass business-to-business and business-to-consumer markets they know are coming ... Many banks, however, are not clear about exactly what they should be doing. Stephan Mueller (Dresdner Bank) says 'We know for sure what we don't want ... we don't want e-commerce to eat away at our margins[7].'"

---

7 IBM *E-Business ... is Europe Ready?* London, 1998

Roger Alexander of Barclays acknowledges the problems; "we have to ask ourselves some serious questions. Does our role change? Are there any opportunties that have been created? Any risks?[8]" For some, the nature of the risk is clear "Non-banks are a major threat to our business," says Roberto Dadda of Banca Intesa. "They can conduct business with the customer without us ... and confine us to the part of the transaction that involves clearing ... and that is the job that doesn't raise our position in the value chain[9]."

The City's Edge

Despite their relatively slow response, UK – City based – financial institutions have a major edge in adapting to the new environment. UK banks are relatively high trust organisations. They are, for example, trusted more than their peers in the USA, Germany and France. Only doctors are viewed as more trustworthy as holders of personal information. Banks are seen as organisations that have generally used technology for the benefit of their customers. There are, however, negatives, in these attitudes. One of the newest and most threatening rivals, Supermarkets, is seen as caring far more about their customers than the banks and there is a strong and widespread view that banks could do more to help people sort out their finances. Perhaps the most dramatic shift in attitudes over the last few years highlights the threat to traditional banking. Almost half of UK bank customers would be willing to bank through a supermarket.

The quality of the labour force is a further advantage in this effort to ensure that City of London institutions have the knowledge of how to operate, manage and build the new instruments of production, distribution, recovery (of costs) and retention (of returns to reinvest or distribute to investors). The City remains an institution largely based on the selection of people for jobs by competence and merit. There are, however, questions about its capacity to impart the new knowledge to entrants to business or members of the business community and enhance this knowledge at a pace that is fast enough to cope with a knowledge based industrial revolution based on new technologies and globalisation. Its assets have created a powerful market position. The foreign exchange market highlights the strength of London's position as it shares sixty per cent of global foreign exchange dealing with New York and Tokyo with Singapore, Hong Kong, Zurich, Geneva, Frankfurt, Sydney, Copenhagen, Toronto, Brussels and Amsterdam battling for the rest. But the technologies of the new economy are changing this;

"Technology also makes distance less of a barrier. Networked computers are getting better at piping richer information from further away with greater speed.

---

8 IBM *ibid*

9 IBM *ibid*

This is more helpful in centralising some markets than others. The sort of information that moves prices in the foreign exchange market (chiefly macroeconomic data and political news) is available to everyone at the same time from financial-information vendors such as Reuters and Bloomberg. Government bond markets run on similar sorts of information. Investing in corporate bond markets requires more detailed knowledge about a company's financial condition. Share prices are moved by a thousand and one different bits of information, some of which may first leak out locally ... More advanced technology encourages far flung counterparties to do more trading with each other, too, as the world's payment systems become safer to use. For customers who still want locally tailored products, global, centralised products can be given a local flavour. For example some financial wire services are experimenting with software that adds local idioms to journalist copy written in London or New York. Nevertheless, most big financial products are becoming more global and less local as borrowers and investors become more global too. Investment banks used to split up their international company analysts into country teams, each of which covered a different national market. Now the trend is to split teams by industrial sector. For example Ericsson, a Swedish multinational, is covered by the global telecommunications group, not the Swedish country ...For a start, securitisation - the process used to turn loans into traded bits of paper - removes the need for borrowers to stay close to lenders. Banks must try to judge the probability that they will get back the money they lend to local businessmen: hence the dogged endurance of the bank branch, despite frequent predictions of its demise. But bond lenders do not need to know so much about their borrowers' creditworthiness because specialist credit rating agencies do the job for them[10]."

Success in the "weightless", "service", "boundary-free" economy will rely more on innovation, the ability to absorb ideas and the capacity to set and manage standards than location. These are areas in which it is fair to question the City's current capability.

Moving On

The City currently lacks either a coherent knowledge, competences or skills strategy or the identifiable means of creating and shaping such a strategy. Efforts to frame such a strategy have, so far, concentrated on relatively lower order skills – those designed to deliver existing services better or at lower cost – rather than the higher order knowledge, competence or capability to deliver long term improvements in competitiveness. It is remarkable that the City – the UK's largest "knowledge industry" received relatively little attention in past White Papers on Competitiveness nor does it seem to receive much attention in current Competitiveness thinking.

---

[10] *The Economist* May 9th 1998

In part, this reflects a seeming reluctance on the part of the City, its leadership groups or institutions to take the lead in innovating in new ways of learning. The scope for example to use the internet to deliver higher order knowledge, understanding and skills through a University for Commerce has received little attention. The infrastructure that exists, for example, in enterprises like NatWest, KPMG and BT could transform access to learning within these enterprise and, if extended to clients and suppliers, to a wider community. It is remarkable that relatively closed, manufacturing enterprise like Unipart and Ford have been the pioneers in this area.