"RECONFIGURATION OF THE GLOBAL SECURITIES INDUSTRY IN THE 1990's"

by

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Abstract:

This paper traces some of the important changes in the financial sector that have resulted from policy reforms in the 1980s and, based on our analysis of expected policy directions in the three principal market areas, develops a number of conclusions about the direction of the global securities industry during the 1990s. These conclusions hold that most capital market issues, wherever they originate, will be capable of being offered simultaneously to investors worldwide by the middle of the 1990s. Those investors will continue to differ significantly as to their preferences for names of issuers and the form of the issue (e.g., bearer form, as opposed to registered form), and for maturities and currencies, although the latter can be easily and cheaply accommodated through currency swaps and hedging instruments. The development of a global, "seamless" fixed-income securities market may begin to resemble the global, "seamless" market in foreign exchange and certain commodities, which would substantially alter the character of the marketplace and those competing in it. Competitive skills in the foreign exchange markets may indeed become a model for what it takes to succeed as market leaders in the capital markets of the 1990s.

There should thus develop during the 1990s powerful capital market centers in the United States, Europe and Japan that are predominantly regional but nonetheless global in operation. These markets will be extremely competitive, internally and with each other. The three principal hubs will adopt essentially similar principles of market governance: (1) Universal banking will be permitted; (2) Commission rates will be negotiated; (3) Foreign banks and brokers will have equal access to markets with locals; (4) Cross-border investment portfolios will become major factors in securities demand; (5) Similar trading rules, disclosure requirements and settlement procedures will apply; and (6) Competition among securities firms will at a maximum. Indeed, the increased competition and the fundamentally altered nature of the business may drive many of today's aspiring global players out of the game. These firms will instead concentrate on specialized investment management or advisory businesses, or various kinds of local market niches.

Reconfiguration of the Global Securities Industry in the 1990s

by

Roy C. Smith and Ingo Walter *

The continuing rapid growth and changing structure of global securities industry is the result of major shifts in the economic environment, most of which have been brought on by discrete government policy decisions made at the national level or, occasionally, by several governments acting in concert. Such decisions can create or destroy broad ranges of banking and securities market activity, validate or scrap the most carefully laid strategic plans of market participants, and transform those performing on the front lines into instant heroes or fools.

In the immediate post-war period, for example the Bretton Woods system of fixed-exchange rates tied to the dollar and to gold dominated international finance. It required that each country insulate the value of its currency from underlying macroeconomic forces. To do so, virtually all governments maintained some form of capital market controls and all tried to out-wit the "speculator," then considered to be the scourge of responsible market activity.

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* A paper presented at a conference on "Banking and Securities Markets After 1992," International Center for Monetary and Banking Studies, Geneva, 15-16 February 1990. The authors are, respectively, Professor of Finance, Stern School of Business, New York University and Limited Partner, Goldman, Sachs & Co.; and Abraham L. Gitlow Professor of Economics and Finance, Stern School of Business, New York University, and Swiss Bank Corporation Professor of International Management, INSEAD, France.

Early in the 1970s, however, the pressure of macroeconomic linkages on fixed exchange rates created conditions under which the old system was replaced, somewhat apprehensively, by floating-rate structures that largely obviated the need for controls on the volume and direction of capital transactions. The United States gave up its capital controls in 1974, and the United Kingdom did the same in 1979, leading those OECD countries that had not already done so to abandon such controls by the mid-1980s. In turn, these successive policy changes affected the financial playing fields in several countries. These quickly became subject to the influence of foreign investors, some of whom -- like central banks, OPEC investment authorities, and European pension funds -- grew to be major factors in daily financial market activity. Still further policy-originated structural changes followed, which similarly affected financial market operations, albeit in somewhat more targeted ways.

Just as government policy changes have had profound effects on capital markets over at least the past two decades, it is equally clear that future policy shifts will have commensurate influences on financial markets and on the entire financial services industry in the 1990s. Indeed, profound changes should occur in the decade ahead as a result of only those policy directions that have already been signalled, namely, the further deregulation of the financial services sector in Europe, Japan and the United States.

This paper traces some of the important changes in the financial sector that have resulted from policy reforms in the 1980s and, based on our analysis of expected policy directions in

the three principal market areas, develops a number of conclusions about the direction of the global securities industry during the 1990s.

Structural Changes in the 1980s

Perhaps most fundamental for the financial markets of all policy-driven changes was the sudden increase in volatility of both interest rates and exchange rates following the dramatic shift by the U.S. Federal Reserve Board in 1979 to focus on managing monetary aggregates instead of interest rates. Figure 1 illustrates the magnitude of this shift. The Fed's retargeting policy, which was followed by a number of other central banks, allowed substantially free movement of interest rates, which in turn drove exchange rate volatility via interest-arbitrage. The increased volatility forced financial market participants to adapt to a fundamentally different world in which opportunities for trading profits rose dramatically, as did the demand for hedging and other risk reduction products for both issuers and investors. But as risks increased, so did the need for much more sophisticated exposure-tracking and risk-management techniques.

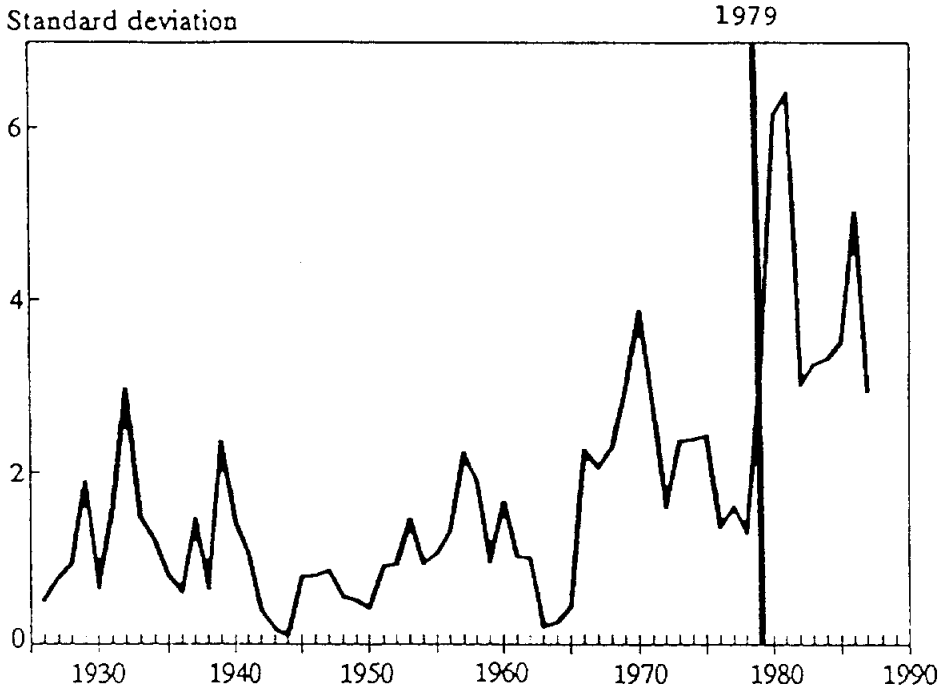
INSERT FIGURE 1 ABOUT HERE

No less significantly, financial flows altered dramatically during the 1980s for reasons originating largely in the real sector of the global economy. The dominant roles in the 1970s of the Middle East oil exporters as lenders, and LDCs as borrowers, was replaced in the 1980s by Japan's massive trade surpluses and domestic savings, and the high U.S. borrowing requirements and

Figure 1

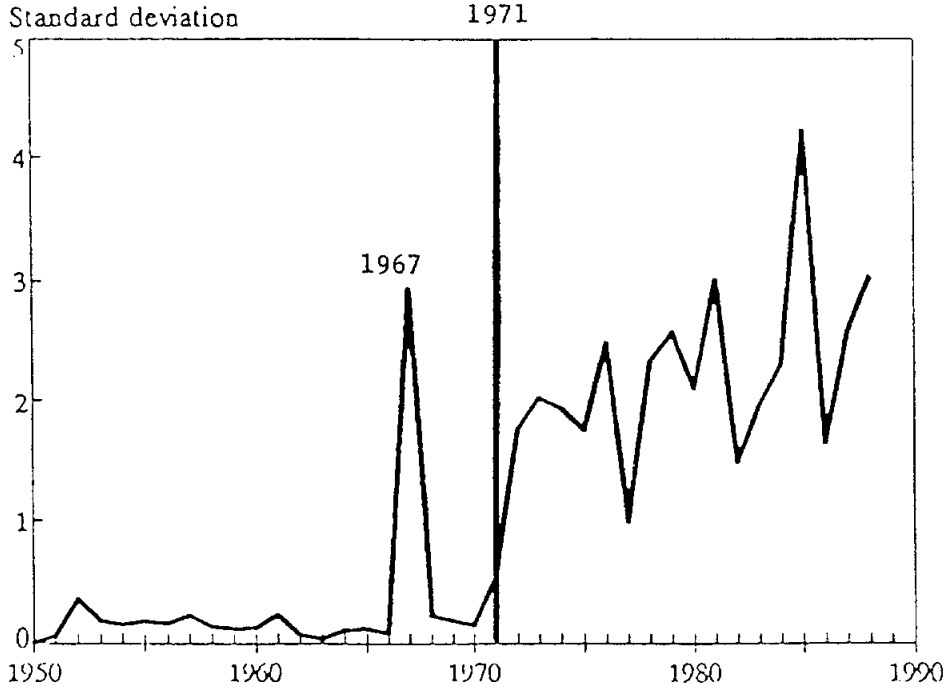
Exchange-rate and interest-rate volatility

Volatility of Treasury bond yields, 1926-87



Note: In this chart, volatility is measured by the annual standard deviation of monthly returns of a 20-year Treasury bond index.

Volatility of the dollar/pound exchange rate, 1950-88



Note: In this chart, volatility is measured by the annual standard deviation of monthly percentage changes in the nominal U.S. dollar/pound sterling exchange rate.

Source: Board of Governors, Financial Markets section.

trade deficits. The Japanese role continued to reflect traditional government policy "guidance" regarding household savings and to some extent international trade activity. The changed U.S. role ultimately reflected domestic consumption-biased tax and expenditure policies, which lasted well beyond the monetary tightness of the early 1980s.

A third element affecting financial activities in the 1980s involved a major transformation of social and economic policies in Europe, as a number of countries substituted greater reliance on free-market solutions to problems of economic growth -- particularly capital formation and productivity-enhancement -- as against traditional socialist-oriented reliance on direct and indirect government involvement. One important result of this shift for the banking and securities industry was the sale, beginning in 1981, of government-owned industrial properties to the general public through "privatization" share issues in Britain, France, Japan, Canada, Germany, and several other countries. These new issues of securities were offered principally to domestic investors, but often international investor groups were also targeted. From 1981 until 1989, nearly $100 billion of such issues were sold. In the United Kingdom alone, proceeds from privatization efforts totalled about $40 billion during the 1980s. Newly-conceived jointly owned infrastructure projects, such as the $6 billion Eurotunnel consortium, increasingly were financed in the private sector as well.

With the apparent effectiveness of free-market economic

policies came renewed confidence in and impetus for regional economic integration in Europe, as reflected by the 1985 EC decision to pursue a "single market" based on principles of harmonization and deregulation. The Canada - U.S. free trade arrangement, while much more limited in scope, followed in 1988 and was accelerated in 1989. The objectives specified for these regional-market initiatives were to become effective in the early 1990s. While damaging to some degree long-standing global trade policy tenets, such as multilateralism and non-discrimination, what might be termed "achievable regionalism" promised significant and relatively immediate economic gains -- albeit at the cost of a certain degree of national political sovereignty.

Fourth, policies resulting in substantial deregulation in a number of national financial markets (which subsequently spread to others) led to dramatic increases in competition among and between banks and securities dealers, and provided more liberal access to markets for foreign borrowers and financial intermediaries in most of the OECD countries. Starting perhaps with the 1975 New York Stock Exchange introduction of negotiated securities commission rates on 1 May 1975 ("Mayday"), there followed liberalization of restrictive pricing, trading practices and market access rules in Britain following "Big Bang" (announced in 1983 and implemented in 1986), in Japan after the "Ad Hoc Agreement" (1982), in Canada after the "Little Bang" (1984), in Australia (1984), France (1988-89) and to a significantly lesser degree in Germany, Switzerland and several other countries. Governments in one industrial country after another sought a better balance between the efficiency of its

financial markets and the stability of its banking system, with almost all of the movement favoring more efficient capital markets. At the same time, in the United States and Japan a good deal of erosion of regulations separating banking and securities activities (the Glass-Steagall provisions of the Banking Act of 1933 in the United States and Article 65 of the 1948 Securities and Exchange Law in Japan) had occurred by the end of the 1980s.

A fifth factor was the rapid increase in cross-border private-sector investment flows, which appeared in the form of increasingly globalized portfolio allocations of money market instruments as well as fixed-income and equity securities. Large institutional investors became aware of international opportunities, and gradually enhanced their competence to manage international investment portfolios after many years of primarily domestic focus. Issuers of securities seized the opportunity to do business with new pools of potential investors, especially those offering more attractive pricing arrangements than home-country investors. The linking of issuers and investors internationally took on a wholly new meaning, and occurred in much greater volume than ever before.

In the search for properly structured financial regulatory systems, Europe threatened to leapfrog the United States' archaic and highly-fragmented approach. Following Big Bang, Britain developed a comprehensive new program for financial services regulation (the 1987 Financial Services Act), which both increased the scope and enforcement powers of statutory regulators -- at the expense of traditional self-regulatory

bodies -- and encompassed within its grasp most international financial activities conducted by firms operating in the United Kingdom. Since enactment of the Financial Services Act, a great deal of effort has gone into fine-tuning, perfecting, and simplifying financial market regulation in that country.

The EC Commission also developed a comprehensive program for banking regulation based on the single market (the 1989 Second Banking Directive), and announced proposals for the uniform regulation of securities firms (the 1989 Draft Investment Services Directive). Furthermore, the central banks of the EC countries -- together with those of the United States, Switzerland and Japan) accepted a common method of banking supervision (1985) as well as common standards for measuring and regulating bank capital adequacy (1987-89). These policies were designed to increase confidence in the capacity of the rapidly evolving financial system to do its job, and the fairness with which issuing and investing customers are treated. Among the loose ends has been a set of capital adequacy standards for securities firms consistent with those adopted for banks, as well as a coherent global framework for conduct-of-business rules in securities markets.

Securities Markets Consequences

These factors resulted in a policy-driven expansion of world financial markets in the 1980s such as had never before occurred. The rapidly increasing volumes of trading activity -- and business opportunities for market participants -- induced rapid product innovation, process development and technological change

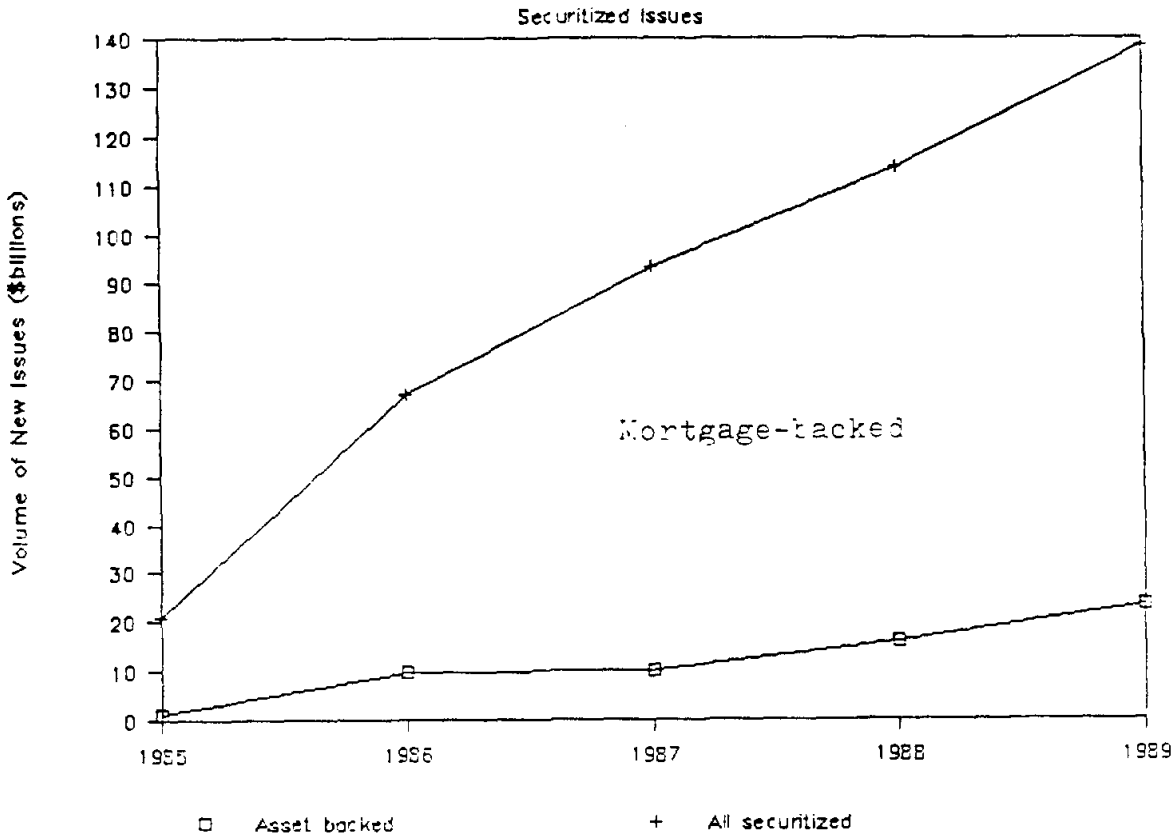
as individual firms altered strategies and tactics to increase the competitiveness of the services they offered.

Product innovation involved the creation of new financial instruments (e.g., zero coupon bonds, futures, options, swaps, caps) along with the ability to replicate certain instruments by packaging existing ones differently (warrant-linked bonds, synthetic securities) or to highlight only a single financial attribute by unbundling an existing instrument (stripped bonds). [See Levich, 1988] The innovation effort also found ways to convert illiquid financial assets on the books of banks or insurance companies into marketable securities backed by specific asset pools such as real estate mortgages, automobile loans and credit card receivables (securitization). Figure 2 illustrates the growth of securitized transactions in the United States from 1985 to 1989.

INSERT FIGURE 2 ABOUT HERE

Process development encompassed contract design (e.g., interest rate and currency swap and various types of options and futures contracts), electronic methods for trading and settling transactions over-the-counter and across borders, methods for efficient margin calculation and contract pricing, and passive, or index-based, portfolio investment and arbitrage techniques (program trading), along with many other comparable innovations. Together, they greatly enhanced the efficiency, volume and scope of intermarket securities trading, especially in equity securities -- although some have argued that they have also increased market volatility and therefore need to be subject to

Figure 2



Securitized issues include real estate mortgage-backed securities and all other asset-backed securities, in billions of dollars of new issues.

Source: Goldman, Sachs & Co., IDD data bank

greater control.

Technological change in the banking and securities industry, primarily in telecommunications and information processing, made possible or facilitated the creation of the many new product and process innovations, and substantially increased the geographic, time-zone and customer coverage provided by firms in the securities industry.

Given the macroeconomic, regulatory and technological developments in the environment, it was inevitable that world financial markets too would go through dramatic structural changes during the 1980s. These included the rapid expansion of the Eurobond markets and related offshore markets such as Euronotes and Eurocommercial paper, as well as gradual growth in access for foreign bond issuers to domestic capital markets, as shown in Figure 3.

INSERT FIGURE 3 ABOUT HERE

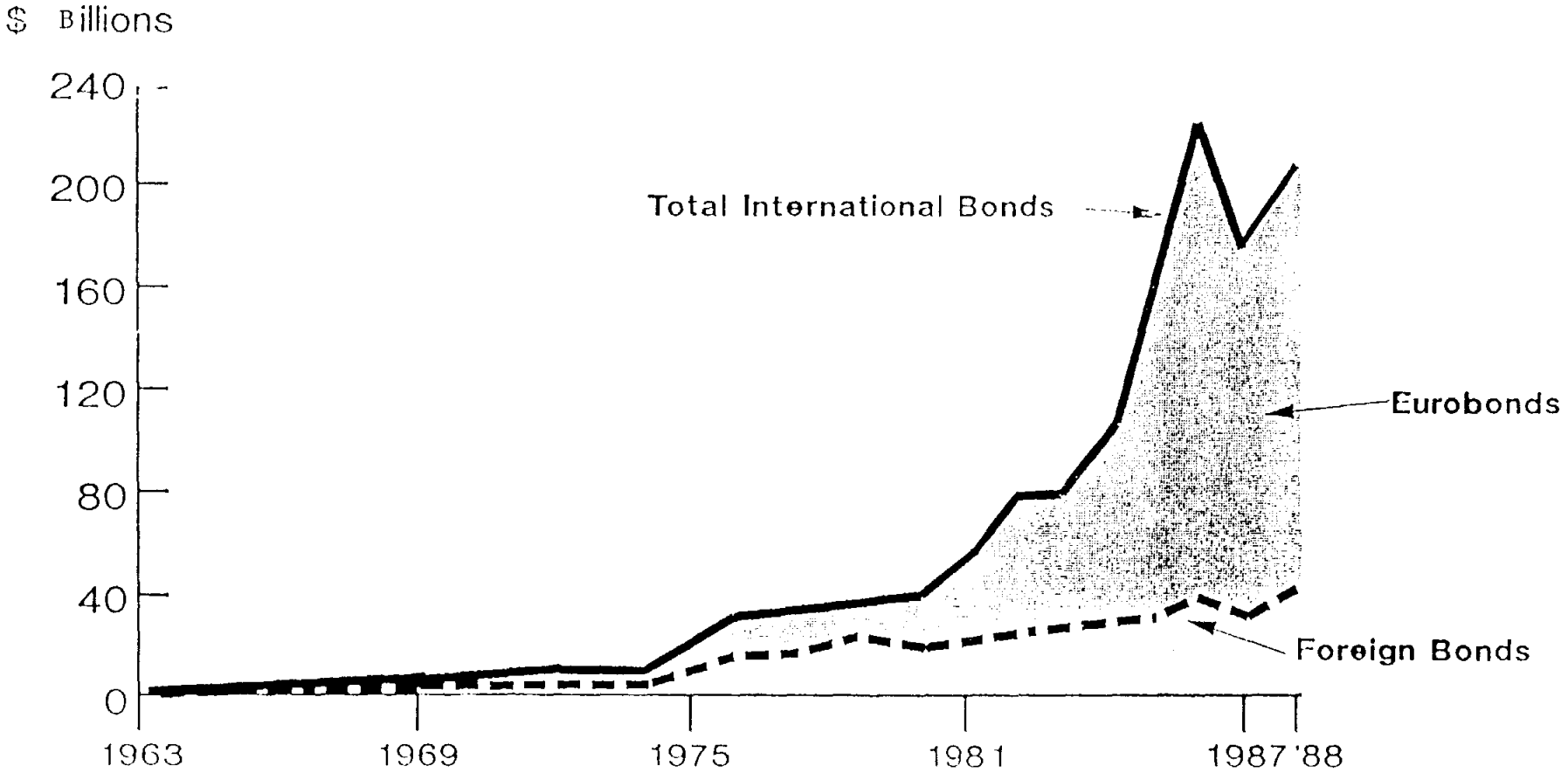
Extensive use of derivative securities (futures and options contracts) as hedging devices in various markets and currencies developed concurrently. Figure 4 illustrates the growth in futures and options trading in major markets worldwide. At the same time, the decline in the value of the dollar in the second half of the 1980s and the growing liquidity of non-dollar markets led to the creation of an extensive fixed-income market in Eurocurrencies other than the dollar and in ECUs, as shown in Table 1.

INSERT FIGURE 4 AND TABLE 1 ABOUT HERE

Figure 3

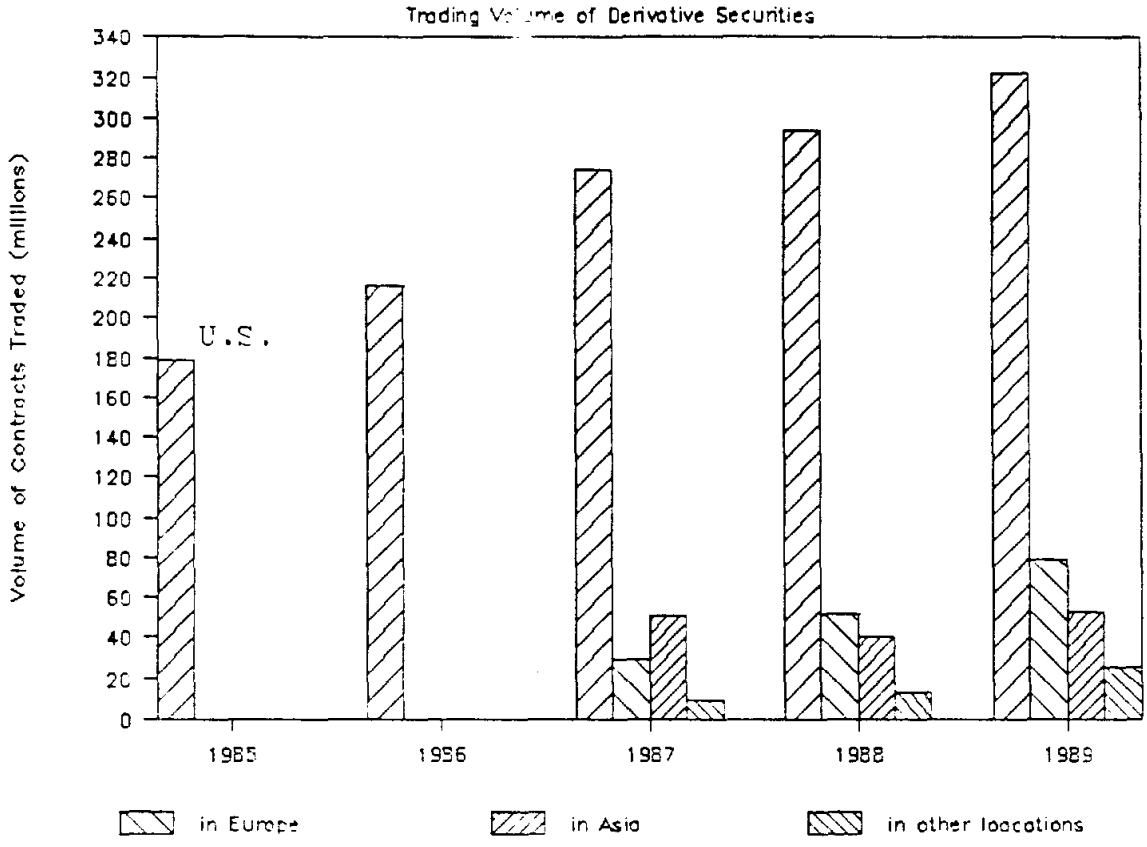
International Bond Markets

1963-1988



Source: Morgan Guaranty Trust Co.

Figure 4



Derivative securities include exchange-traded futures and options, stated in millions of contracts traded. Data do not include over-the-counter traded futures and options.

Data for Europe, Asia and other locations not available for 1985 and 1986

Source: Futures Industry Association.

Table 1

Underwriting New Issues of Securities

Volume of nondomestic European capital market issues of all European corporations by currency of issue. 1985-1988 (million dollars of proceeds at current exchange rates)

	European currencies	ECUs	Other currencies	European currencies and ECUs as a percentage of the total
1985	12.707	3.004	24,764	38.8
1986	33.982	2.531	33,773	51.9
1987	36.984	2.681	11,339	77.8
1988	46.567	5.489	17,937	74.4

Source: Securities Data Co.

Volume of nondomestic European capital market issues of non-financial European corporations by currency of issue. 1985-1988 (million dollars of proceeds at current exchange rates)

	Issues in dollars	Issues in another currencies	Total issues	Dollar issues as a percentage if total issues
1985	4,846	9,593	14,439	33.57
1986	12,286	26,140	38,426	31.97
1987	3,242	20,207	23,449	13.83
1988	5,067	33,280	38,347	13.21

Source: Securities Data Co.

No less rapid was the development of markets in currency and interest rate swaps -- linking fixed-rate bond markets in different currencies, as well as fixed-rate and floating-rate financial markets in the same and in different currencies (Table 2) -- followed by the subsequent development of markets for forward swaps, swap options, and caps and floors. [BIS, 1986]

INSERT TABLE 2 ABOUT HERE

These market innovations have resulted in a substantial increase in the extent to which financial integration has occurred, especially in debt instruments, around the world. Interest rate and currency swaps in particular create effective linkages between long and short term instruments and between instruments denominated in different currencies. Today's sophisticated corporate borrower (or institutional investor) usually has a choice of four or five finely-priced alternatives to his home-country capital market.

The development of extensive activity in international equity securities and in new methods for distributing equity issues internationally is illustrated in Figure 5 for the 1984-89 period. This increased activity accompanied massive growth in cross-border portfolio investments on the part of pension funds and other institutional investors from almost all countries. Although these investments were especially concentrated in government debt securities, to a lesser degree they occurred in corporate equities as well. The increased cross-border investment activity of the 1980s reflected a growing international awareness

Table 2

Estimate Volume of Swaps
($ billions)

Type of Swap	1982	1983	1984	1985	1986	1987	1988
Currency	3	5	19	50	100	150	175
Interest Rate	2	30	90	175	190	388	568
Total	5	35	109	225	290	538	743

Sources: International Swap Dealers Assn., Bank of England, Salomon Brothers, The Economist

of the benefits of diversification, the increasingly free access to attractive investments abroad, and growing availability of appropriate investor services in various foreign markets. Table 3 indicates the shift in foreign holdings of private-sector pension funds during the 1980-1990 period.

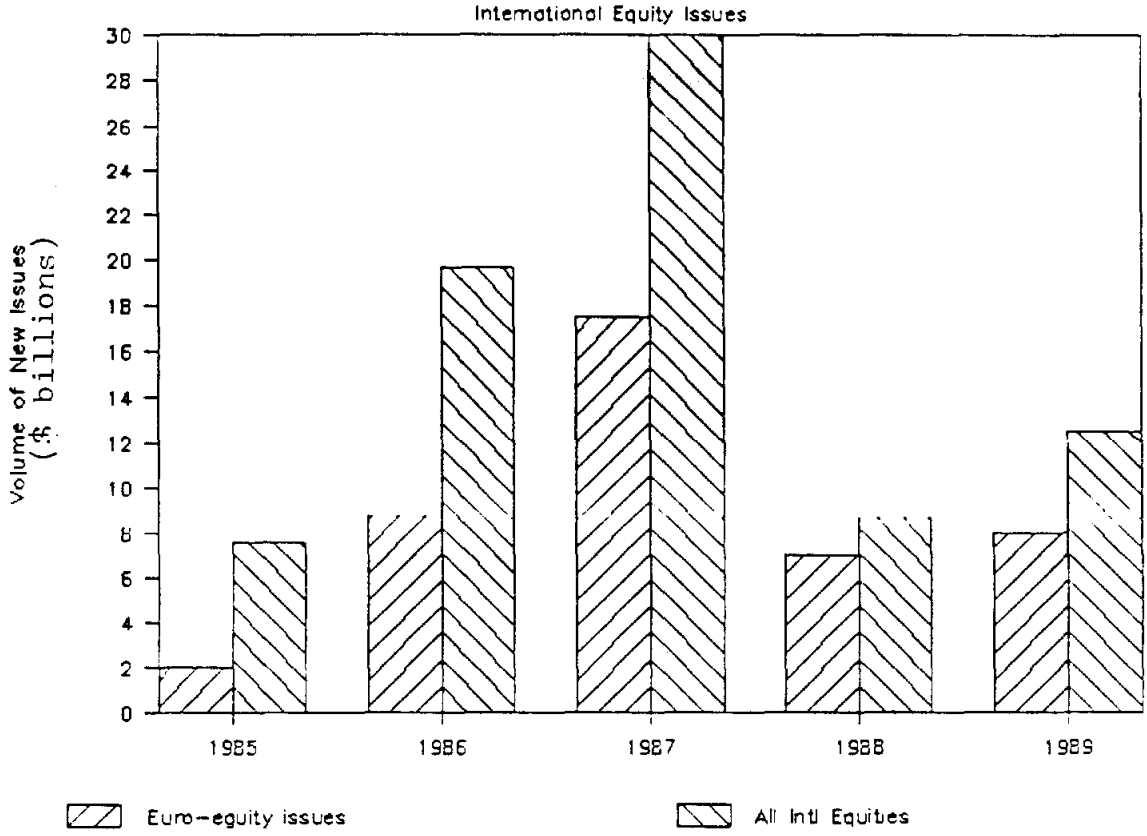
INSERT FIGURE 5 AND TABLE 3 ABOUT HERE

Finally, there has been rapid growth in the number and volume of cross-border merger and acquisition transactions during the 1982-89 period, as shown in Table 4. The data show international merger (and financial restructuring) activity in three categories during 1982-88: (a) Activity in the United States involving U.S. companies only, representing by far the largest share of this activity; (b) U.S. cross-border transactions, in which foreign acquisitions of U.S. companies has been approximately 5.5 times the value of acquisition of foreign companies by U.S. companies, and about 15 percent of overall U.S. merger and acquisition activity during 1982-1989; and (c) Non-U.S. acquisitions of non-U.S. companies, the smallest of the three categories but the fastest-growing one.

INSERT TABLE 4 ABOUT HERE

In response to such developments, large and frequent users of financial markets have changed the methods by which they obtain capital. They have extended their financial relationships to encompass multiple banks and securities firms, looking for the best ideas and the lowest bids, rather than relying

Figure 5



All international equity issues include foreign equity issues and Euro-equity issues

Source: Goldman, Sachs & Co., IDD, IFR data banks

Table 3

Foreign Investment of Private-Sector Pension Assets

($ millions)

Country	1980		1985		1992* (projected)	
United States	$3,300	1%	$27,000	3%	$150,000	9%
Great Britain	9,700	9%	40,100	18%	135,000	25%
Japan	400	1%	7,600	8%	88,000	20%
Netherlands	1,500	4%	5,400	9%	30,000	12%
Canada	2,000	7%	4,100	8%	20,000	10%
Switzerland	1,300	4%	1,700	4%	12,000	8%
Australia	0	0%	800	8%	10,000	20%
Hong Kong	1,200	60%	2,400	60%	9,000	65%
Germany	500	2%	1,000	3%	9,000	6%
Ireland	300	20%	700	20%	2,000	20%
Belgium	275	25%	800	30%	1,800	35%
France	75	1%	200	2%	600	3%
New Zealand	0	0%	0	0%	400	8%
Rest of World	100	2%	600	3%	1,200	10%
Total	$20,650		$92,100		$469,000	

* Expressed in 1987 dollars. Assumes no change in foreign investment restrictions.

Source: InterSec Research Corp., March 1988.

Table 4

Volume of completed international mergers and acquisitions, 1982–1988

	Domestic USA[a]		Cross-border (US)[b,c]						Outside USA[d]	
			Buyer from USA		Seller from USA		Total cross-border			
Year	No.	Value[e]	No.	Value[e]	No.	Value[e]	No.	Value[e]	No.	Value[e]
1982	879	52,260	32	866	52	2,985	84	3,851	71	5,629
1983	1396	81,080	57	2,920	79	6,564	136	9,484	163	21,848
1984	1690	143,915	47	2,720	104	17,138	151	19,858	168	18,023
1985	1689	199,616	50	2,201	83	7,061	133	9,262	298	42,188
1986	1828	195,489	57	2,871	176	31,837	233	34,708	294	45,846
1987	1595	169,697	79	14,474	194	47,336	273	61,810	566	104,941
1988	1120	160,038	48	5,035	221	59,683	269	64,718	578	55,515
Total, 1982–8	10197	1,002,095	370	31,087	909	172,604	1279	203,691	2138	293,990

[a] Completed mergers, tender–mergers, tender offers, purchases of stakes, divestitures and LBOs in US companies by US companies.

[b] Completed mergers, tender–mergers, tender offers, purchases of stakes, divestitures and LBOs in which either the buyer or the seller is a US company and the counterpart is a non-US company.

[c] Transactions involving divestitures are recorded by the nationality of the division being bought or sold.

[d] Completed mergers, tender–mergers, tender offers, purchases of stakes, divestitures and LBOs in which both participants are non-US companies.

[e] Million dollars of purchase price at current exchange rates.

Sources: Goldman Sachs & Co. and Securities Data Co.

exclusively on one or two preferred financial institutions within traditional banking relationship structures. Such clients have become extremely knowledgeable and sophisticated in their use of global financial markets.

Changed Competitive Conditions

The financial markets have become exceedingly competitive as they have proceeded through three revolutions simultaneously: (a) Deregulation, product innovation and restructuring in domestic banking and securities sectors, which has increased the volume of transactions but substantially lowered fees and commissions; (b) Geographic interpenetration by firms into each-others' markets, in which domestic clients in most banks' home countries are solicited by powerful foreign institutions; and (c) Disintermediation and functional interpenetration by securities firms and banks into each-others' activities in foreign and domestic markets.

The developments of the 1980s favored some financial institutions and disfavored others as the markets became still more integrated and open to new competitors -- rewarding the innovative, adaptive, low-cost producers, and those with capital to commit to transactions on their clients' behalf. Market conditions during most of the 1980s were favorable, and therefore protected exceptionally aggressive behavior on the part of particular competitors. More recently, difficult market conditions have emerged, following the worldwide stock market crash in October 1987 and the wind-down of a decade of extensive activity in mergers, acquisitions, and highly leveraged corporate

restructurings in the United States. Credit conditions tightened, and many leveraged acquisitions found themselves drifting towards bankruptcy, which prompted a collapse in the junk bond market beginning in late 1989, possibly accelerated by the significant stock market decline on October 13, 1989.

Business conditions thus became more difficult in the late 1980s, with many financial services firms losing money -- sometimes in their domestic operations but almost always (with only a few exceptions) in their international operations. Meantime, costs proved to be difficult to contain for many banks and securities firms, and layoffs became commonplace. The compression of opportunities for profitability and growth (at least for a period) cooled the spirits of many who might otherwise have expected to be included on lists of top international securities firms of the 1990s.

Since the market adjustments during the 1988-1989 period in the United States and in Europe, a distinction has emerged between three kinds of competitors in securities markets: (a) Truly global firms which intend to operate aggressively to serve the world's largest clients in both domestic and international markets; (b) Major national firms which hope to concentrate on maintaining a healthy (but understandably modest) share of domestic business but forego the substantial expenditures needed to build up and develop relationships with the largest issuers and investors, which would require commensurate international capabilities; and (c) Niche players, mainly smaller firms that concentrate in a few specialized services which may be carried out domestically or internationally.

Each type of competitor has a useful role to perform in the overall scheme of the financial marketplace. Once committed to one of these roles, however, it is difficult to change to another. Prior to 1980, there were few, if any, truly global banks or securities firms, so the process of strategic competitor segmentation into one of the three categories has been a consequence of the market developments of the 1980s. Perhaps only the strongest, most confident firms will step forward and attempt to become truly global players. Nevertheless, such firms will number among them aspirants from Europe, the United States, and Japan.

Financial Markets and the Securities Industry in the 1990s

The evolution of financial markets and securities firms in the 1990s can be discussed in terms of prospective changes in the world's three principal regional marketplaces. Many of the changes that will occur in these markets are unforeseeable, just as the oil price rise which so affected financial markets in the 1970s was unforeseeable at the beginning of that decade, or as the impact of Reaganomics or the changing role of Japan was unforeseeable at the beginning of the 1980s. Some changes, however, can be expected based on an understanding of policy-making trends and the capabilities of the markets. Other things being equal (which they almost never are) and after making two important assumptions about the future, certain developments do seem to be on the horizon.

Europe. Two assumptions about the forces driving the securities industry in Europe are critical: (a) That the European

experiment in retreating from extensive government involvement in industry and commerce will prove to be successful, and that governments will indeed continue to withdraw from influencing microeconomic outcomes through interventionist policies; and (b) That the EC 1992 initiatives are regarded as successful and to occur within the broad context of liberal international trade pursued in the Uruguay Round of negotiations under the auspices of the GATT, meaning that a significant resurgence of protectionism in trade or investment does not make itself felt in the 1990s.

European financial and industrial deregulation associated with the EC 1992 initiatives will help sustain a long overdue industrial restructuring in Europe, through mergers, corporate recapitalizations, leveraged management buyouts and other free-market responses. [Walter and Smith, 1990] Based on the duration and intensity of corporate restructuring activities in the United States during the decade of the 1980s, a European restructuring -- occasioned by many of the same factors that powered the U.S. restructuring, plus the extra push of governmental disengagement from industry and the EC single-market initiatives -- would appear to be inevitable. Indeed, based on the volume of intra-European industrial restructuring that has already occurred, there is ample evidence that the process is already well underway, that it will last for a number of years, and will involve all sectors of industry and finance. Assuming Eastern Europe's political and economic changes maintain direction and momentum, further and perhaps more extensive and entirely

different restructuring patterns may be in the offing.

The European industrial restructuring will require impressive amounts of financing. This should be available primarily, if not entirely, from European sources. European corporations should no longer find it necessary to arrange their capital financings in non-European currencies or in non-European markets. This conclusion may appear to be in conflict with international bond market data, which show the new issue volume of European issuers to have declined to levels below the $104 billion volume achieved in 1987 -- see Table 5.

INSERT TABLE 5 HERE

The reason for our more optimistic forecast is that European corporations (especially non-financial corporations) obtain by far the largest portion of their capital market financing requirements from domestic securities markets and from banks. Domestic financial markets in Europe have benefited from increased transaction volumes, greater liquidity, and more competition over the past years -- see Table 6 -- although the percentage of such financings arranged by non-financial (i.e., industrial) borrowers is lower than in either the United States or Japan per unit of GNP. With the elimination of all barriers to cross-border transactions scheduled to go into effect for both issuers and investors (as well as financial intermediaries) in the coming years, it can be expected that a large, single European capital market will emerge. This new intra-European market will reflect the consolidation of previously separate domestic markets, serviced mainly by local banking institutions,

Table 5

Eurobonds and European Foreign Bond Issues
By European Issuers 1985-1989
($ billions)

	1985	1986	1987	1988	1989
Eurobond Issues	61870	84019	56589	87568	85918
Foreign Bond Issues	29223	20562	17204	20232	13580
Total	91093	104581	73793	107800	99498

Source: Goldman, Sachs & Co., IDD.
Foreign bonds includes all non-US, non-Euro offerings outside domestic market of issuers.

with the Eurobond and European "foreign bond" market structures.

INSERT TABLE 6 HERE

In essence, the new market will derive from the integration of financial competition in Europe. Under the EC Second Banking Directive a German bank, for example, may open branches or buy local banks in France and in Italy to take advantage of the 1992 single market initiatives. In Germany, however, the bank will itself be subject to new competition for the business of its traditional clients from German branches of French and Italian banks. The German bank may propose an ordinary, traditional "Hausbank" financing for an old customer, only to discover that better terms under a somewhat more imaginative structure are being offered by a German branch of a foreign bank, or by a US investment bank operating out of London. The German bank may match the terms to keep the client's business. The financing could become a capital market operation, because the cheapest financing for borrowers tends to emanate from the issuance of securities rather than from bank loans, especially in those situations in which the rates have to be sharpened to fully competitive levels. The German bank then would go to the market for the necessary funds, perhaps using the domestic bond market structure and prospectus, if this is convenient. If it is not -- e.g., if it involves translating the prospectus into all EC languages, as has been proposed -- the bank could instead offer a Eurobond structure, even though the ultimate investors may in either case be the same -- partly local nationals who know the

Table 6

Volume of Corporate Sector Capital Market Financing
By Regional Corporations in their Respective Home Markets
1988
($ billions of preceeds at average exchange rates)

	USA			Europe			Japan		
	Financial	Non Financial	Total	Financial	Non Financial	Total	Financial	Non Financial	Total
Equities	28.8	13.6	42.4	9.5	42.3	63.0	25.1	40.8	65.9
Bonds	141.1	221.9	363	155.2	26.3	181.4	287.7	137.9	425.6
Total	169.9	235.5	405.4	164.7	68.6	244.4	312.8	178.7	491.5
GNP (1 time)			4.88			5.27			2.9
Financing per dollar of GNP	$0.03	$0.05	$0.08	$0.03	$0.01	$0.05	$0.11	$0.06	$0.17

Notes:

Source: OECD Financial Statistics Monthly Domestic Markets December 1989 (earlier months where not updated).
Equities include public and private enterprise issues (lines A.1.a+b for non-financial; lines A.1.c for financial).
Non-financial corporate bonds include public issues for private and public non-financial corporations plus private placements where reported (lines B.1.1 c+d+private placements)
Financial corporate bonds are taken from line B.1.1.e (or lines B.1.1.e.1 + e.2).
Because the US 1989 equities' breakdown into financial and non-financial corporations is only given for first 2 quarters the breakdown given above was estimated from proportions evident in those quarters:

Total	22.7	NF	7.3

Issues by domestic firms outside of their home country are excluded.
European figures are aggregated from Germany, France, Greece, Italy, Norway, Netherlands, U.K., Switzerland, Finland, Spain, Belgium, Portugal and Luxembourg as follows:

issuer well, partly other Europeans who will be offered the new paper through the bank's branches throughout the EEC. Some French investors may subscribe to a German domestic issue, just as they might to a Eurobond issue, and German investors may subscribe just as they might to a private placement. Before long, all such issues will be structured to find the most receptive investors, wherever they may be located in Europe.

This kind of hypothetical market operation could result in sales outside Europe as well -- i.e., to Japan or the United States, although such operations may require time-consuming delays for marketing or to obtain the necessary underwriting commitments. For most EC issuers, however, especially those too small to be well known in Japan or the United States, the intra-European market generally will offer the quickest access and the best rates.

The simultaneous activities of financial market competitors throughout Europe -- by banks and securities firms from EC member countries, as well as from Switzerland, Japan and the United States -- will force the markets to conform to the most efficient transactions structure possible. The result should be similar to the introduction of the "bought deal" to the Eurobond market in the early 1980s, which opened all clients to the competitive offerings of capable securities houses with whom no prior relationship existed. Indeed, the competition-enhancing influence of the bought deal was so strong that the SEC took it into account, when proposing and later adopting Rule 415 ("shelf registration") in the United States, which also led to a marked increase in competition for the new issue business involving

corporate debt securities.

The emerging, consolidated European market will be stimulated by comparably free-wheeling competition, pressure for financial innovation and the proliferation of sophisticated financial services. Large European issuers will be the first to benefit from these changes. Firms marketing these services, however, will also attempt to reach beyond large blue-chip companies, to capture as well the business of middle-market companies that previously did not think themselves capable of capital market access.

By the mid-1990s, based on the experience of the Eurobond and U.S. bond markets, the competitive environment of the formerly domestic and now intra-European financial markets could very well have adapted sufficiently to be comparable to that of the United States in the late 1980s.

United States. Changes in the Glass-Steagall provisions and interstate banking restrictions are anticipated early in the 1990s, resulting in still further -- indeed possibly radical -- restructuring of the commercial and investment banking industries. A dozen or so large banks will enter the securities business as important competitors particularly in the underwriting of new issues. These banks, admittedly few in number but including some of the largest money center and regional banking entities, will attempt to introduce universal banking to the United States.

Their strategic move will occur just as the U.S. securities industry is recovering from a substantial overcapacity problem

that developed at the end of the 1980s, which has adversely affected profitability and return on capital ratios for most investment banks and brokers. Many traditional U.S. securities firms, having adjusted to the increased competitive conditions in the New York market following "Mayday", in the Eurobond market following the introduction of the bought deal and in the United States bond market following Rule 415, in the London market following "Big Bang", may decide to reconsider the desirability life as a large, increasingly unwieldy and bureaucratic institution, and opt instead for smaller, more profitable niches that offer the sort of rewards and opportunities that investment bankers as a species have always sought out.

Banks, on the other hand, view investment banking as a vehicle for escaping the large, unwieldy and bureaucratic institutions they have become. They expect that universal banking will be a business they can assimilate -- in the manner of the large German or Swiss banks, for example -- more easily than they could assimilate the business of First Boston or Shearson Lehman Hutton.

The banks will be tested, however, by the unwrapping of two long awaited gifts at the same time -- the de facto or de jure collapse of Glass Steagall <u>and</u> the end of the last remnants of opposition to interstate banking. The challenge will be to manage human and capital resources effectively so that proper strategic moves can be made in one or the other direction. The cost of putting together a first-rate nationwide commercial banking system may considerably exceed the $1 billion or so that many observers think is a prerequisite for a comparable investment

banking commitment. These challenges will arrive at a time when bank capital reserves have been depleted by various charge-offs, bond ratings have been lowered throughout the banking industry, share prices dropped to historic lows, and new standards of bank capital adequacy have been adopted by the Federal Reserve and the other bank regulators.

It seems probable that the dozen or so large U.S. banks that are adept at global money market and foreign exchange dealing will aspire to become the leaders in global markets for all types of debt and financing arrangements -- from bank loans, commercial paper, and tradable notes to long-term bonds, in all of the major currencies -- much as the major European universal banks have traditionally done in their domestic markets. Other banks will decide to leave the heavy traffic lanes and specialize in other activities, including middle-market commercial lending and consumer banking.

Foreign banks operating in the United States will find many of the market developments ideal -- they can continue to attempt to increase their penetration of the traditional commercial banking businesses, or they can enter the international capital market business on a basis in which their ability to place U.S. securities in their home markets or in other foreign markets will become an important competitive advantage.

American bond market operators will be taking advantage of the opportunities presented by SEC Rule 144A, which became effective in January 1990 and offers a safe haven to any issuer (domestic or foreign) offering securities to qualified

institutional investors on an unregistered basis. Whereas Rule 415 permitted qualified issuers to sell securities under a shelf-registration procedure, **Rule 144a** omits registration requirements altogether, thereby greatly simplifying new issue procedures for international issuers unwilling to submit to the trouble and cost of preparing a registration statement. [SEC, 1988]

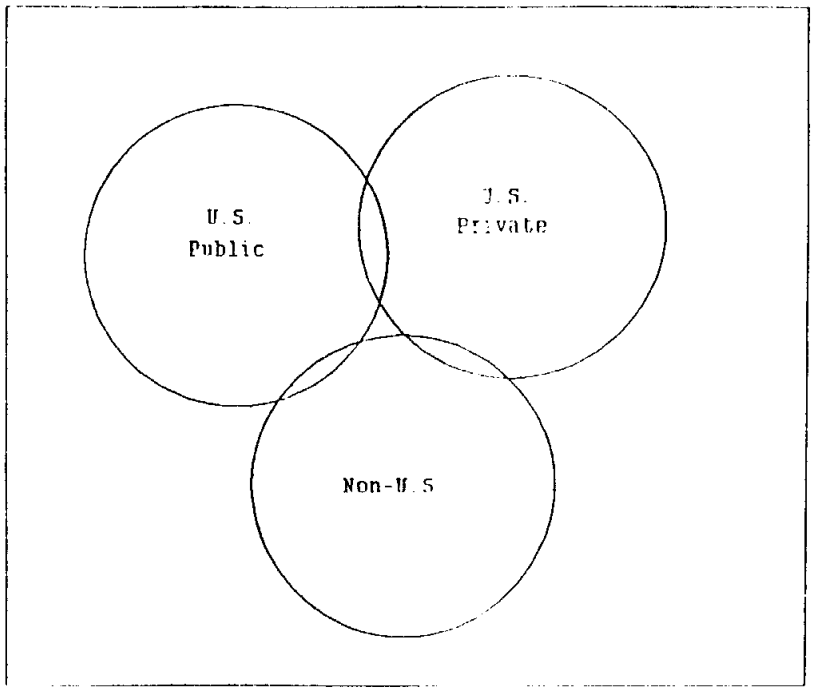
Rule 144A contemplates a substantial increase in the number of non-U.S. debt and equity financings done in the American capital market, many of which will be offered not only to domestic investors but also, simultaneously, to investors in Europe and Japan. Figure 6 illustrates the market-overlaps that are expected as a result of Rule 144A. Issues brought to European and Japanese markets -- whether by U.S. or other corporate issuers -- may also be offered to institutional investors in the United States under Rule 144A. From a regulatory viewpoint, virtually all remaining obstacles to full international market integration are removed with the introduction of Rule 144A. Issuers will always choose the lowest-cost market for the securities they wish to offer, which may or may not be in the United States, regardless of regulatory considerations. Over time, however, pockets within markets will emerge that demand certain types of securities, and these pockets will be filled with offerings from all of the three market centers.

INSERT FIGURE 6 HERE

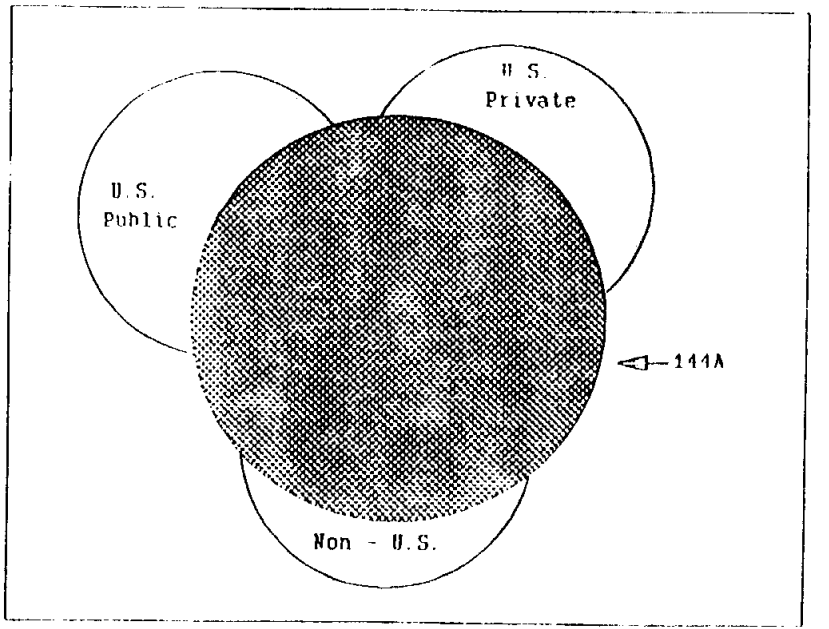
One other way in which Rule 144a may effect market activities is its use by banks to broaden and perfect their

Figure 6

Market Structure Before the Adoption of Rule 144A and Regulation S



Potential Market Structure After the Adoption of Rule 144A



distribution of bank loans. During the 1980s many U.S. banks adopted the practice of "selling down" to other banks their participations in loans. This process could be made more efficient by securitizing the loans by using Rule 144a provisions which would permit liquid markets to develop in the loan/securities, and to extend the group of investors to which they are offered to encompass non-bank financial institutions. Should such practices become widespread, the bank loan market would come to be integrated with the bond market to a substantial extent, thereby facilitating the development of meaningful placing power by banks in the securities field (a strength which most banks currently lack) and raising regulatory questions as to how such loan/securities should be treated for accounting and "firewall", or deposit insurance, purposes.

American equity markets may likewise experience greater international involvement in the 1990s as portfolio investors, especially those from Japan, become more active -- but also as foreign corporations continue to acquire U.S. companies in the face of what may otherwise be a decline in the great U.S. merger boom of the 1980s. This increased foreign investment could raise the pricing structure of the equities market somewhat. By the end of the 1990s Americans may have reduced their concerns over the foreign-ownership issue and many large American companies will be substantially owned by a variety of international investors -- perhaps even comprising a majority of the shareholders -- just as large European companies became increasingly owned by foreign shareholders in the 1970s and

1980s.

U.S. and foreign equity trading may also become integrated on an expanded NASDQ/SEAQ system which could result in a substantial increase of American institutional ownership of foreign equities. This would further concentrate trading power in New York, London and Tokyo as regional "hubs", and ultimately lead toward a greater standardization of accounting, disclosure, regulatory, and settlement procedures, all of which tend to encourage greater international activity.

Japan. Japanese financial markets are likely to experience substantial additional deregulation in the 1990s, which in turn should lead to major changes in the competitive dominance of Japanese business by Japanese banks and brokers.

The basic business of the Japanese banks has changed rapidly -- the surplus cash of Japanese companies has substantially paid down all but the barest minimum of bank debt owed by manufacturing companies. Table 7 shows the dramatic decline of net interest costs as a percentage of Japanese corporate operating profits. The traditional influence and power of the banks over their industrial customers is becoming a thing of the past. Banks continue to have large balance sheets, which are partly inflated by cosmetic loans maintained for the sake of appearances (i.e., lending money which is subsequently redeposited in the same bank), but increasingly loans and other new business are coming from banking transactions outside Japan.

INSERT TABLE 7 HERE

As in the United States, Japanese banks need to find a new

Table 7

Net Financial Costs (Interest Charges) as a Percent of Operating Profits, Tokyo Stock Exchange First-Section Companies, Fiscal 1975-1988E

(parent-company basis)

Year	All Companies	Manufacturing Sector
1975	62.8%	69.0%
1976	39.6	44.4
1977	41.5	42.3
1978	44.7	30.8
1979	36.7	23.9
1980	33.3	30.0
1981	35.5	28.6
1982	35.8	28.0
1983	35.9	24.5
1984	28.6	16.1
1985	27.0	13.3
1986	26.5	11.8
1987	18.9	4.4
1988	0.0	0.9 (0.6)*

* Net Financial receipts -- i.e., investment income -- exceeded interest charges in manufacturing

Source: Tokyo Stock Exchange

domestic business, and banks believe the greatest promise resides in the securities business. Similarly, Japanese brokers want to be able to move into those special lucrative areas that have traditionally been set aside for banks, if possible without giving up their exclusive hold on their extremely profitable securities business. The question of reforming Article 65, however controversial and locked into immovable opposition it may appear, will have to be resolved during the 1990s -- presumably soon after any legislative changes to the U.S. Glass-Steagall Act. Otherwise, the Japanese market will be entirely out of alignment with markets in Europe and the United States. American and European banks and securities firms will use every opportunity (as they have over matters of Tokyo Stock Exchange membership) to force roughly equivalent Japanese deregulation and substantial equality of market access. Failing to do so sets up the question of imposing sanctions under reciprocity procedures.

Repeal of Article 65 will dramatically alter the competitive structure of financial intermediation in Japan. In the United States there are a dozen or so large securities firms preparing to face competition from a handful of large and adequately capitalized banks with the demise of Glass-Steagall. In Japan, four large securities firms face 16 large, very well capitalized City banks (the largest in the world), three long-term credit banks, and a dozen trust banks and cooperative banks with major aspirations in the securities field.

Fixed commission rates in Japan are required by the Tokyo Stock Exchange -- virtually the last such exchange in the world

that does not allow negotiated commissions between customer and broker -- although in recent years there have been a number of increases in institutional discounts from standard rates for large orders. It is inevitable in the 1990s that the Japanese commission structure will collapse, after which competition for securities transactions will -- as in the case of Mayday in the United States, Big Bang in Great Britain and virtually everywhere else negotiated rates were introduced -- will become very bloody indeed. This will be true especially if the big banks are allowed into the game at the same time, as was the case in the United Kingdom.

Japanese brokers have made almost all of their money from domestic brokerage commissions. They are reluctant block traders, offer little else in the way of service beyond taking orders against the latest stock ideas, and are heavily overstaffed for what they do. Profit pressure could be exceedingly tough for these firms for some time, especially if competent, smaller-sized foreign brokers are nicking off their clients with block trading and research services. Several foreign firms operating in Tokyo have been able to demonstrate their ability to do this, and have become very profitable in the process. It is certainly not unthinkable for foreign firms to develop a significant share of securities market business in Japan, assuming a fully level playing field and large commitments of resources.

Japan must also bring its domestic new-issue capital market access conditions into line with those of the United States and Europe. This has not been the case in the past, new securities issues being subject to substantial regulations that limit

market usage to a comparatively small number of blue chip companies, queuing delays, interest rate controls, collateralization requirements, and approval of "commission banks" (City banks acting as trustees for bondholders). Accordingly, most Japanese corporations prefer to utilize the Eurobond market, where none of these obstacles exist, even when the investors in their securities are overwhelmingly Japanese. During 1987-89, for example, in excess of $100 billion of Japanese debt issues with equity purchase warrants attached were offered to Euromarket investors, although most of these securities (perhaps 70-80%) were ultimately sold back to investors in Japan.

The round-tripping of these issues (almost entirely done for the sake of financial arbitrage by the issuers) was necessary to escape confining new issue conditions in the domestic market. The authorities finally began to act in 1989 to bring this business back to Japan by liberalizing the standards to be met by Japanese companies seeking to use the domestic public bond markets, by introducing shelf registration procedures to provide quicker access to markets, and by proposing that securities issued abroad bought predominantly by Japanese investors be registered in Japan. These steps, along with fewer opportunities for gain in financial arbitrage, would substantially curtail the use of the Euromarket for the purposes of Japanese round-tripping. An important result of bringing this market back to Japan, however, would be the continued liberalization of market-access rules, in turn increasing further the volume of corporate new issues in

the Japanese market. Many of these issues, like Rule 144A issues in the United States and Euromarket issues, could be sold on a global basis.

Competitive Evolution in the 1990s

An array of factors will determine the prospective role of firms that intend to compete in the global securities markets of the 1990s. Some of these are related to the home markets of the firms themselves. Others relate to the competitive resources they are able to develop internally or to attract. Still others relate to the clarity of vision shown by management in the search for durable competitive advantage in an industry subject to rapid change. Some of these can be enumerated here.

Differential home-country savings and credit-use patterns. Given historically thin U.S. savings patterns relative to those in Europe and Japan, American financial institutions tend to carry an inherent competitive disadvantage in tapping into the savings end of the international flow of funds spectrum (for purposes of funding and retail placement of securities), as compared with European and Japanese players. On the other hand, given an continued strong U.S. spending and anti-savings bias, U.S. institutions have an advantage in retail lending and origination of asset-backed securities, agency securities, and the like, that can be of interest to investors in Europe and Japan, as well as to domestic investors. That is, global flows of funds rooted in saving and spending patterns may give U.S. institutions an inherent comparative advantage at the borrower end of the spectrum and foreign-based institutions at the

savings end of the spectrum.

Capitalization. The BIS risk-based capital accords will do much to level the international playing field with respect to book capital of banks engaged in international securities markets. But many U.S. banks and securities firms continue to be seriously disadvantaged by poor market capitalization. This means that European and especially Japan-based institutions can undertake transactions and make strategic moves easily and quickly that are impossible or difficult for their U.S. competitors. These institutions must, however, be sufficiently motivated and bold to do so, which so far most of them have not been.

Credit standing. With the extinction of AAA-rated U.S. bank holding companies and securities firms, a premier credit rating has become a designation reserved for non-financial corporations and non-U.S. financial institutions. This decline in credit standing is an obvious competitive millstone in terms of funding costs, and one that is increasingly used as a competitive marketing weapon as well. The question here is whether, or how quickly, U.S. institutions can digest the credit problems of the past without taking on any new ones, in order to reclaim credit standing that is on a par with the best of their foreign competitors. Credit standing is thus a decided advantage of Japanese and especially European players.

Financial technologies. Some financial institutions continue to perform much better than others in creating new financial products as well as processes, ranging from new forms of securities repackaging to state-of-the-art applications in

information systems and efficient, accurate transactions processing. This is in large part driven by the extremely competitive character of the domestic financial services industry in the United States, the United Kingdom, and a few other countries. However, the half-life of many financial technologies is short, and may be getting shorter, so that sustained competitive advantage depends on a continued stream of innovations. Unlike some of the other determinants of competitive performance, financial technologies are relatively easy to acquire and apply.

Human resources. American and British financial institutions continue to be relatively attractive to some of the best and brightest professionals domestically and internationally -- helped by a relatively "open" and "inclusive" culture as compared with German or Japanese competitors, for example. This advantage may be more durable than some others. Nevertheless, new financial skills will be required in the international competitive context of the 1990s -- skills that many U.S. institutions do not now have. [Bertrand and Noyelle, 1986]

The pace of change, and the increasing content of international financial innovations and risks unfamiliar to domestic managers will place far higher demands on those performing on the front lines of financial services. The securities sales and trading, new-issue, corporate financial advisory and portfolio management skills required in the emerging EC market, as elsewhere, will continue to place a heavy

responsibility on the banks and securities firms for recruitment, state-of-the-art training, and management development and succession planning. Critical will be the development of truly internationalized "decathlon" players in the sales forces and senior ranks of the firms. And for most banks, there must also be a much more performance-oriented attitude ingrained in the people on the front lines -- including an open, global view that is as opportunistic as it is defensive -- and a willingness to accept new ideas.

Operating costs and risk management. As noted earlier, firms intending to compete in the global markets of the 1990s will have to exert tight control over cost structures. Excess costs due to overmanning and inflated expenses appear to vary widely between banks and securities firms in the three major markets, but in many cases seem to have been driven out of many U.S. and London based commercial and investment banks during the difficult times of the late 1980s. This has not occurred to nearly the same extent in continental Europe. Social legislation and customary employment practices make it more difficult in Japan and parts of Europe to adapt employment costs to changing markets quickly. Moreover, some institutions have a better capacity for managing international and securities market related exposures to risk than their competitors. This is probably a temporary advantage, however. [See also Kallberg and Saunders, 1986]

Size. Empirical evidence from the U.S. banking experience, based mainly on unit-cost data, has generally suggested that economies of scale in financial services flatten-out at size-levels well below some of the larger international competitors

that exist today. [Clark, 1988] Nor is there much evidence that financial institutions with international aspirations suffer significantly from size deficiencies. Recent evidence from Europe, on the other hand, suggests that "economies of super-scale" may be achieved in the case of very large financial institutions (megabanks), such as the universal banking institutions of Germany and Switzerland. So the jury remains out on the question of economies of scale in globalized financial firms. Still, size brings with it the potential for complexity and inertia that can be a serious disadvantage in dynamic financial markets.

Scope. The scope of permissible activities is likewise important, including possible benefits from cross-selling of financial services, spreading fixed infrastructure costs across a broader array of products, and increasing earnings stability. [Panzar and Willig, 1981; Teece, 1985] Residual domestic banking and securities activity-constraints and market-interpenetration barriers (e.g., with respect to the insurance industry) have limited the development of true universal financial institutions in Japan and the United States, but not in Europe. If such benefits are indeed compelling, the relevant regulatory issues may have significant competitive dimensions.

Staying-power. U.S. financial institutions have earned a reputation in some international markets and with some groups of clients as "fair weather bankers" with relatively little tolerance for even temporarily adverse market conditions or financial problems of clients, as compared with their competitors

based in Europe and Japan. They are sometimes regarded as excessively transactions- as opposed to relationship-oriented, taking the relatively short-term view that they can abandon markets or clients in tough times and later regain easy access through competitive products and pricing when things improve. This is resented and derided in some environments, such as continental Europe, to the point where relationship-oriented clients are willing to pay more or accept marginally inferior quality for financial services supplied by institutions that are considered more reliable.

The perceived lack of staying-power may be linked to the competitive nature of the domestic markets of U.S. financial institutions, which throw off few excess returns that could permit financial cross-subsidization. Competitors from countries whose financial markets have been cartelized or highly regulated, with fixed commissions or deposit ceilings, can behave quite differently in this respect. However, as the volume of financial activity and the level of competition increase, so will the clients' expectations that they will have access to a broad array of banking and securities services. Attracted by a better idea or a lower price, even the most relationship-oriented clients may shift in the direction of multiple banking relationships, and thus place relatively less reliance on reliability.

Adaptability. Adaptability may be the most underrated quality in terms of competitive performance in the financial markets of the 1990s, in the EC as in the United States, Japan and elsewhere. To be a significant force in the evolving international securities markets, managements must become

accustomed to the fact that this will always be an inherently unstable business, with profit opportunities appearing and disappearing across the principal business segments. It is also a business prone to tensions between origination, trading, risk-control, and distribution functions. Both of these characteristics will place a premium on senior management commitment, continuity and diplomacy.

In addition to tensions that arise among the various functions in the securities business, even greater potential tensions reside in universal banking. It is yet to be seen whether such institutions -- as opposed to those with a narrower focus, "lighter" infrastructure, more opportunistic behavior, and more direct linkages between individual effort and reward -- can become a major players in international investment banking in particular.

Conclusions

Most capital market issues, wherever they originate, will be capable of being offered simultaneously to investors worldwide by the middle of the 1990s. Those investors will continue to differ significantly as to their preferences for names of issuers and the form of the issue (e.g., bearer form, as opposed to registered form), and for maturities and currencies, although the latter can be easily and cheaply accommodated through currency swaps and hedging instruments. The development of a global, "seamless" fixed-income securities market may begin to resemble the global, "seamless" market in foreign exchange and certain commodities, which would substantially alter the

character of the marketplace and those competing in it. Competitive skills in the foreign exchange markets may indeed become a model for what it takes to succeed as market leaders in the capital markets of the 1990s.

There should thus develop during the 1990s powerful capital market centers in the United States, Europe and Japan that are predominantly regional but nonetheless global in operation. These markets will be extremely competitive, internally and with each other. The three principal hubs will adopt essentially similar principles of market governance: (1) Universal banking will be permitted; (2) Commission rates will be negotiated; (3) Foreign banks and brokers will have equal access to markets with locals; (4) Cross-border investment portfolios will become major factors in securities demand; (5) Similar trading rules, disclosure requirements and settlement procedures will apply; and (6) Competition among securities firms will at a maximum. Indeed, the increased competition and the fundamentally altered nature of the business may drive many of today's aspiring global players out of the game. These firms will instead concentrate on specialized investment management or advisory businesses, or various kinds of local market niches.

Government policies, or course, could once again substantially change this conclusion. Protectionism may undo much of the market integration already achieved. The 1992 initiatives could give way to internal squabbling and foot-dragging, or be derailed by developments in Eastern Europe. Japan or the United States could further delay the deregulation

needed to assure all markets and competitors a level playing-field. Capital controls could be reimposed. Policies affecting savings rates and capital formation, mergers and acquisitions, leveraged transactions, enforcement of securities laws, foreign direct investment, and competition regulation are no less important.

Otherwise, the new market configuration at the end of the 1990s could in many ways resemble the global financial markets of the period prior to World War I, when banks and brokers sorted themselves out in an environment devoid of substantial government interference. Perhaps the world of finance will exit this century much as it entered it -- differences of course residing in enormous technological advance, in the vast increase in the size and competitiveness of the markets, and the improved quality of investor protection and enforcement of rules of conduct.

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