PART

GLOBALIZATION OF FINANCIAL MARKETS

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CHAPTER 1

INTEGRATION OF WORLD FINANCIAL MARKETS: PAST, PRESENT, AND FUTURE

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1.1 INTRODUCTION. Financial people know in their bones that their profession goes back a long way. Its frequent association with "the world's oldest profession" may simply be because it is almost as old. After all, the essential technology of finance is simple, requiring little more than arithmetic and minimal literacy, and the environment in which it applies is universal—that is, any situation that involves money, property, or credit, all of which are commodities that have been in demand since humankind's earliest days.

These financial commodities have been put to use to facilitate trade, commerce, and investment and to accommodate the accumulation, preservation, and distribution of wealth by states, corporations, and individuals. Financial transactions can occur in an almost infinite variety, yet they always require the services of banks, whether acting as principal or as agent, and financial markets in which they can operate. Banks have predominantly been local institutions throughout their history, but many have sought international expansion to follow clients abroad or to offer services not available in other countries.

Banks have a long history: a history rich in product diversity, international scope, and continuous change and adaptation. Generally, change has been required to adjust

to shifting economic and regulatory conditions, which have on many occasions been drastic. On such occasions banks have collapsed, only to be replaced by others eager to try their hand in this traditionally dangerous but profitable business. New competitors have continually appeared on the scene, especially during periods of rapid economic growth, opportunity, and comparatively light governmental interference. Competitive changes have forced adaptations, too, and in general have improved the level and efficiency of services offered to clients, thereby increasing transactional volume. The one constant in the long history of banking is, perhaps, the sight of new stars rising and old ones setting. Some of the older ones have been able to transform themselves into players capable of competing with the newly powerful houses, but many have not. Thus, the banking industry has much natural similarity to continuous economic restructuring in general.

It is doubtful, however, that there has ever been a time in the long history of banking that the pace of restructuring has been greater than the present. Banking and securities markets during the 1980s and 1990s in particular have been affected by a convergence of several exceptionally powerful forces—deregulation and re-regulation, disintermediation, the introduction of new technology and product innovation, cross-border market integration, and greatly increased competition and consolidation—all of which have occurred in a spiraling expansion of demand for financial services across the globe. Bankers today live in interesting—if exhausting and hazardous—times. In this chapter we will have a look at how we got to where we are today, at the characteristics of the wholesale financial services markets in the early twenty-first century, and some of the unresolved issues that will affect the industry's future.

1.2 ROOTS OF MODERN BANKING. Our modern economic and financial heritage begins with the coming of democratic capitalism, around the time of Adam Smith (1776). Under this system, the state does not intervene in economic affairs unnecessarily, removes barriers to competition and subsidies to favored persons to allow competition to develop freely, and, in general, does not prevent or discourage anyone willing to work hard enough—and who also has access to capital—from becoming a capitalist.

A hundred years after Adam Smith, England was at the peak of its power. Politically, it ruled 25% of the Earth's surface and population. The British economy was by far the strongest and most developed in the world. Its traditional competitors were still partly asleep. France was still sorting itself out after a century of political chaos and a war with Prussia that had gone wrong. Germany was just starting to come together politically, but still had a way to go to catch up with the British in industrial terms. The rest of Europe was not all that important economically. There was a potentially serious problem, however, from reckless and often irresponsible competition from America that fancied itself as a rising economic power. Otherwise, the horizon was comparatively free of competitors. British industry and finance were very secure in their respective positions of world leadership in the 1870s.

English financial markets had made it all possible according to Walter Bagehot, the editor at the time of *The Economist*, who published a small book in 1873 titled *Lombard Street,* which described these markets and what made them tick. England's economic glory, he suggested, was based on the supply and accessibility of capital. After all, he pointed out, what would have been the good of inventing a railroad back in Elizabethan times if there was no way to raise the capital to build it? In poor countries there were no financial resources anyway, and in most European countries

money stuck to the aristocrats and the landowners and was unavailable to the market. But in England, Bagehot boasted, there was a place in the City of London—called Lombard Street—where "in all but the rarest of times, money can be always obtained upon good security, or upon decent prospects of probable gain." Such a market, Bagehot continued, was a "luxury which no country has ever enjoyed with even comparable equality before."

However, the real power in the market, Bagehot went on to suggest, is its ability to offer the benefits of leverage to those working their way up in the system, whose goal is to displace those at the top. "In every district," Bagehot explained, "small traders have arisen who discount their bills largely, and with the capital so borrowed, harass and press upon, if they do not eradicate, the old capitalist." The new trader has "obviously an immense advantage in the struggle of trade":

> If a merchant has £50,000 all his own, to gain 10% on it he must make £5,000 a year, and must charge for his goods accordingly; but if another has only £10,000 and borrows £40,000 by discounts (no extreme instance in our modern trade), he has the same capital of £50,000 to use, and can sell much cheaper. If the rate at which he borrows be 5%, he will have to pay £2,000 a year [in interest]; and if, like the old trader he makes £5,000 a year, he will still, after paying his interest, obtain £3,000 a year, or 30% on his own £10,000. As most merchants are content with much less than 30%, he will be able, if he wishes, to forego some of that profit, lower the price of the commodity, and drive the old-fashioned trader—the man who trades on his own capital—out of the market.

Thus, the ambitious "new man," with little to lose and access to credit through the market, can earn a greater return on his money than a risk-averse capitalist who borrows little or nothing. The higher return enables the new man to undercut the other man's prices and take business from him. True, the new man may lose on the venture, and be taken out of the game, but there is always another new man on his way up who is eager to replace him. As the richer man has a lot to lose, he risks it less, and thus is always in the game, continually defending himself against one newcomer or another until finally he packs it in, retires to the country, and invests in government securities instead.

"This increasingly democratic structure of English commerce," Bagehot continued, "is very unpopular in many quarters." On one hand, he says, "it prevents the long duration of great families of merchant princes . . . who are pushed out by the dirty crowd of little men."

> On the other hand, these unattractive democratic defects are compensated for by one great excellence: no other country was ever so little "sleepy," no other was ever so prompt to seize new advantages. A country dependent mainly on great 'merchant princes' will never be so prompt; there commerce perpetually slips more and more into a commerce of routine. A man of large wealth, however intelligent, always thinks, "I have a great income, and I want to keep it. If things go on as they are, I shall keep it, but if they change I *may* not keep it." Consequently he considers every change of circumstance a bore, and thinks of such changes as little as he can. But a new man, who has his way to make in the world, knows that such changes are his opportunities; he is always on the lookout for them, and always heeds them when he finds them. The rough and vulgar structure of English commerce is the secret of its life . . .[1]

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[1] Walter Bagehot, *Lombard Street, A Description of the Money Market* (London: Henry S. King & Co., 1873), 1–20.

In 1902, a young American named Bernard Baruch took Bagehot's essay to heart and made himself the first of many millions in a Wall Street investment pool, buying control of a railroad on borrowed money. The United States had come of age financially around the turn of the century, and Wall Street would soon displace Lombard Street as the world's center of finance.

(a) The Rise of the Americans. Early in the century, J.P. Morgan organized the United States Steel Corporation, having acquired Carnegie Steel and other companies in a transaction valued at $1.5 billion—an amount worth perhaps $30 billion today. This was the largest financial deal ever done, not surpassed until the RJR–Nabisco leveraged buyout transaction in 1989, and it occurred in 1902 during the first of six merger booms to take place in the United States during the twentieth century and first years of the twenty-first century. Each of these booms was powered by different factors. But in each, rising stock markets and easy access to credit were major contributors.

By the early 1900s New York was beginning to emerge as the world's leading financial center. True, many American companies (especially railroads) still raised capital by selling their securities to investors in Europe—they also sold them to American investors. These investors, looking for places to put their newly acquired wealth, also bought European securities; perhaps thinking they were safer and more reliable investments than those of American companies. By the early years of the twentieth century it was commonplace to find European, Latin American, and some Asian issues in the New York market. This comparatively high level of market integration proved especially beneficial when World War I came—both sides in the conflict sought funds from the United States, both by issuing new securities and by selling existing holdings, though the Allied Powers raised by far the larger amounts.

After World War I, America's prosperity continued while Europe's did not. Banks had a busy time, raising money for corporations, foreign governments, and investment companies and making large loans to investors buying securities. Banks were then "universal." That is, they were free to participate in commercial banking (lending) and investment banking, which at the time meant the underwriting, distribution, and trading of securities in financial markets. Many of the larger banks were also involved in a substantial amount of international business. There was trade to finance all over the world, especially in such mineral-rich areas as Latin America and Australia. There were new securities issues (underwritings) to perform for foreign clients, which in the years before the 1929 crash aggregated around 25% of all business done. There were correspondent banking and custodial (safekeeping) relationships with overseas counterparts and a variety of overseas financial services to perform for individuals, both with respect to foreigners doing business in the United States and the activities abroad of Americans.

The stock market crash in 1929 was a global event—markets crashed everywhere, all at the same time, and the volume of foreign selling orders was high. The Great Depression followed, and the banks were blamed for it, although the evidence has never been strong to connect the speculative activities of the banks during the 1920s with either the crash or the subsequent depression of the 1930s. Nonetheless, there were three prominent results from these events that had great effect on American banking. The first was the passage of the Banking Act of 1933 that provided for the Federal Deposit Insurance system and the Glass–Steagall provisions that completely separated commercial banking and securities activities. Second was the depression it-

self, which led in the end to World War II and a 30-year period in which banking was confined to basic, slow-growing deposit taking and loan making within a limited local market only. And third was the rising importance of the government in deciding financial matters, especially during the post-war recovery period. As a consequence, there was comparatively little for banks or securities firms to do from the early 1930s until the early 1960s.

By then, world trade had resumed its vigorous expansion and U.S. banks, following the lead of First National City Bank (subsequently Citicorp, now part of Citigroup), resumed their activities abroad. The successful recovery of the economies of Western Europe and Japan led to pressures on the fixed-rate foreign exchange system set up in 1944. The Eurodollar market emerged from a surplus of U.S. currency available outside the country; then the Eurobond market followed and the reattraction of banks and investment banks to international capital market transactions.

(b) Global Banking Reemerges. Next came the 1971 collapse of the fixed exchange rate system in which the dollar was tied to gold and other currencies were tied to the dollar. Floating exchange rates set by the market replaced this system, obviating the need for government capital controls. In turn, this led to widespread removal of restrictions on capital flows between countries, and the beginnings of the global financial system that we have today.

This system, which is based on markets setting prices and determining the flow of capital around the world, has drawn many new players—both users and providers of banking and capital market services. Competition among these players for funds, and the business of providing them, has greatly increased both the stakes and the risks of the banking and securities businesses. But the volume and size of transactions increased steadily through the 1970s and 1980s.

The effects of competitive capitalism have been seen and appreciated during the past decades as they have not been since 1929. The 1980s witnessed further rounds of deregulation and privatization of government-owned enterprises, indicating that governments of industrial countries around the world found private-sector solutions to problems of economic growth and development preferable to state-operated, semi-socialist programs. Massive deregulation of financial markets occurred in the United Kingdom and several other countries. The Single Market Act and Economic and Monetary Union initiatives of the European Union (EU) promised stimulating effects on European business and finance. Deregulation in Japan has (rather more gradually) freed vast sums of capital to seek investment overseas and to create active global securities markets in Tokyo.

Most large businesses are now effectively global, dealing with customers, suppliers, manufacturing, and information centers all over the world. Many corporations are repositioning themselves strategically because of changes in their industry and in traditional markets and among their competitors. In Europe, for example, most sizeable firms must consider themselves as at least continental players, not just national players. The European market, in aggregate, is as large as the market for goods and services in the United States; indeed, it is larger if you include Eastern Europe. No important competitor in any industry can afford not to be active in such a market, but neither can it neglect the markets in the United States. And all competitors seem interested in the emerging markets for goods and services that are developing in India, China, South Asia, and Latin America since these regions began to adopt market economies in a capitalistic form. Global companies have thus become active in world

markets as never before, and as a result have become major consumers of international financial services of many types: for capital raising, mergers and acquisitions, and foreign direct investments; for foreign exchange and commodity brokerage; and for investment and tax advice. Governments and financial institutions also have become major users of these financial services for the investment of reserves, the issuance of debt securities, the privatization of state-owned enterprises, the sale of deposits and other bank liabilities, mutual funds, and a variety of investment and hedging services.

1.3 BANKING TODAY: SURVIVAL OF THE FITTEST. Global banking and capital market services proliferated during the 1980s and 1990s as a result of a great increase in demand from companies, governments, and financial institutions, but also because financial market conditions were buoyant and, on the whole, bullish. Interest rates in the United States declined from about 15% for two-year U.S. Treasury notes to about 5% during the 20-year period, and the Dow Jones Index increased nearly 14-fold, driving prices higher in financial markets all over the world. Indeed, financial assets grew then at a rate approximately twice the rate of the world economy, despite significant and regular setbacks in the markets in 1987, 1990, 1994, 1998, and 2001. Such growth and opportunity in financial services, however, entirely changed the competitive landscape—some services were rendered into commodities, commissions and fees were slashed, banks became bold and aggressive in offering to invest directly in their clients' securities without the formation of a syndicate, traditional banker–client relationships were shattered, and, through all this, a steady run of innovation continued—new products, practices, ideas, and techniques for improving balance sheets and earnings. As a result, many firms were unable to remain competitive, some took on too much risk and failed, and others were taken up in mergers or consolidations. Great banking houses such as Baring Brothers, Chase Manhattan, Dillon Read, Dresdner Bank, First Boston, Industrial Bank of Japan, Kidder Peabody, Kuhn Loeb, Midland Bank, J.P. Morgan, National Westminster Bank, Salomon Brothers, Union Bank of Switzerland, and Yamaichi Securities all disappeared into mergers or liquidation. The 1980–2000 years were a difficult time for many banks, but a time of great opportunity for others. For their clients, however, it was a time of prosperity in which the pendulum of profitability swung from favoring the manufacturers of financial services to their users.

(a) Market Integration in 2000. Market integration has been accelerated by several factors that have occurred during the past 20 years. The end of the need for foreign exchange controls has resulted in a free flow of capital between markets of industrially developed countries. Deregulation has removed barriers that impeded access to markets in different parts of the world, by both issuers and financial service providers. Massive improvements in telecommunications capability has made it possible for information available in one part of the world (such as bond prices) to be simultaneously available in many other places. And advances in financial technology (and the infrastructure to support it), such as swaps and other derivatives, have made it possible to take advantage of many new financing opportunities. For example, in 1997, the U.S. Federal National Mortgage Association (FNMA) issued five-year notes denominated in Australian dollars that were sold in the United States, Europe, Asia, and Australia. These notes were priced at a rate very close to the Australian government bond rate, taking advantage of very strong market conditions in Australia

at the time. FNMA, advised by a Swiss bank (UBS-Warburg), was able to arrange a simultaneous U.S. dollar/Australian dollar currency swap that enabled FNMA to convert its forward payment obligations in Australian dollars into U.S. dollars. Because the terms of the new issue were very attractive to FNMA, and the cost of the swap was also, the borrower was able to secure funds from an entirely new source at an all-in cost somewhat less than (or certainly no greater than) the cost of funds available to it in the New York market. The swap had been a form of arbitrage that linked the Australian and U.S. bond markets and made a global distribution of the new bonds to international investors possible. FNMA had in the past issued its securities in the Eurobond market also, where investors there must "bid" for the paper in competition with U.S. investors. This continuous stream of new issues (which are frequently accompanied by currency or interest rate swaps) that harness the investment demands of institutional investors all over the world has created a highly integrated world market for debt securities.

Bond market investors, after all, see bonds partly as commodities with two distinctive characteristics only—they represent a certain credit quality (defined by bond ratings) and they extend for a certain duration. An AA bond with a maturity of 12 years and fairly standard call provisions will be expected to provide a certain yield to investors. The bond may be packaged with a swap and sold to investors in any number of different currencies. But in all major bond markets the price of such bonds, translated into home market currency through the swap market, will be about the same, thus indicating a high degree of correlation of returns and therefore of market integration.

There is a much lesser degree of market integration in the case of equities. Each stock is unique, representing not a fixed income return for a specified time but only the prospect of future dividends for an indefinite time. These prospects are still significantly differentiated by national economic conditions (such as labor and capital costs) and other factors that make DaimlerChrysler different from Ford and Toyota. Stock market returns in different countries are not highly correlated as a result, though with increasing international and cross-border investment these correlations are rising, and within certain regions (such as the eurozone within the EU) equity market correlations are starting to become significant.

The merger and acquisition market (sometimes thought of as the market for corporate control) has also experienced considerable integration since the mid-1980s, when mergers outside the United States first came to be significant. In 1985, for example, 89.4% of all global merger and acquisition transactions occurred within the United States or involved either a U.S. buyer or seller. In 1995 that percentage had decreased to 58.8%, and by 2001 to 48.8%. Indeed, after 1999, more mergers occurred outside the United States than within. For the entire period from 1985 through 2001, $12.8 trillion of global mergers and acquisitions have been completed, of which $5.5 trillion were within the United States, $1.9 trillion involved crossborder deals in which one side was a U.S. company, and $5.3 trillion of completed transactions occurred outside the United States, of which $5.0 trillion occurred within Europe.

The merger market requires a healthy supply of willing parties, an availability of capital to finance the deals, transactional know-how and an environment free of impediments to takeovers in order for deals to be done. For international deals, these requirements must apply globally, which, for the most part, they have. The last set of conditions, freedom from barriers to takeovers, does not exist everywhere—nor does it exist anywhere in completely pure form—but many countries, such as Japan, Ger-

many, and several emerging markets in which cross-shareholdings are considerable, access to corporate control is not always available in the market. Over the years, however, barriers to takeovers have been falling and specific barriers to takeovers by foreign corporations are disappearing quickly.

(b) Competitive Issues. The effects of wide-scale market integration, together with greatly increased demand for sophisticated financial services, put great pressure on banks and investment banks seeking to secure a significant share of this rapidly growing and lucrative market. Chief financial officers (CFOs) quickly learned that there were many possibilities for creative, beneficial financing available to them, but they could not expect to receive all of the best ideas and lowest quotes from just one firm. The days of the so-called traditional, "exclusive" investment banking relationship were numbered. Large companies with undisputed access to capital markets around the world would receive frequent proposals from bankers, and before long they began to deal with several. Competitive biddings for conventional new issues became common; exclusive relationships were abandoned, especially after the Securities and Exchange Commission (SEC) adopted Rule 415 that provided for instant access to markets by issuers using a "shelf registration." "Proprietary" financing ideas, however, were reserved for the bank first submitting the idea, such as the global Australian dollar bond issue proposed to FNMA by UBS-Warburg. Of course, once a proprietary idea was revealed, anyone could copy it, and in such cases the mandates would go to the bank bidding the highest price. Banks now had to compete on the basis of best ideas or highest prices even for their traditional clients' business. To be competitive meant opening offices in London, Tokyo, and other locations; developing very advanced trading skills; and being willing to acquire and manage large positions in securities to accommodate clients. Firms must also be able to collect price information from all over the world and analyze it effectively before a competitor was able to in order to stay competitive with the best players. It was difficult, expensive, and risky to do all of these things, and some firms stumbled along the way. However, for those who succeeded, the enormous increase in transactional volume—in stocks, bonds, derivatives, and mergers—provided adequate room for fees and commissions to be compressed and still leave plenty for those able to land the mandates.

Throughout the last 20 years of the last century, however, there was continuous turmoil in and deregulation of the banking industry that changed that industry profoundly. Rapidly rising interest rates in the 1970s squeezed savings and loan organizations, and certain banks in the United States and Europe accustomed to mortgage lending, to the point of a crisis in the industry. Too many low fixed-interest-rate mortgage loans had been made with money obtained by the bank from the short-term deposit market. To offset the problem, some banks made riskier loans in order to gain higher interest rate returns. An ensuing credit crunch was very painful to many such banks, and many failed or nearly failed during the 1980s. Regulators were required to intervene extensively, limiting the freedom of banks and their capacity for growth. During this period, many corporate clients abandoned banks as a source of finance and turned instead to capital markets. In the early 1990s, banks argued that they had survived the worst and were ready to compete for business again, but banking regulations prevented them from keeping up with their investment banking competitors for business in the wholesale market. Regulators were sympathetic, believing that more competition in financial markets would lower costs of capital and stimulate in-

dustrial growth and restructuring. As a result, in the United States the McFadden Act restricting banks' interstate activities was repealed. So was the Glass-Steagall Act, which since 1933 had separated commercial and investment banking. The United States also participated in the Basel Agreement (among 12 leading financial countries) to require banks to maintain a minimum amount of capital relative to their risk-weighted assets. In Europe, the EU adopted the Second Banking Directive that allowed banking operations to extend to any member country. In Japan, provisions similar to Glass-Steagall were also repealed. So banks were now free to plunge into the investment banking business to win back their clients from the capital markets to which they had migrated in such large numbers.

But investment banking was risky and involved entirely different skills from the deposit-taking and loan-making commercial banking business they knew well, despite many changes related to credit cards, automated teller machines (ATMs), and a variety of different consumer products. As a result, most American, European, and Asian banks chose to stay focused on consumer and small business finance (including all companies with no or limited access to capital markets) within their national markets and to ignore (or at least deemphasize) the more complex, global wholesale sector which comprised syndicated bank loans, securities underwriting and placements, and merger and acquisition advisory work.

But, of course, a handful of the largest banks with the longest history of corporate banking relationships—in the United States, Europe, and Japan—elected to compete for a fair share of their clients' lending, securities, and merger businesses. But it was difficult for many of them to develop the necessary product skills and support capabilities. It was also necessary to project those capabilities into markets in the United States, Europe, and Asia in competition always with firms with greater product expertise and regional knowledge. This task was especially difficult for Japanese banks, hugely powerful at the end of the 1980s, but very diminished by the Japanese stock market decline, loan write-offs, and the many bank failures and forced mergers that occurred during the 1990s.

Finally, the period of the 1980s and 1990s saw many changes in the competitive alignments within the financial services industry. Many banks demonstrated a preference for the "universal banking" model so prevalent in Europe. Universal banks were free to engage in all forms of financial services, make investments in client companies, and function as much as possible as a "one-stop" supplier of both retail and wholesale financial services. (Others would say that these banks had become financial "conglomerates" and the end of the 1990s had become unwieldy and inefficient.) Even then, however, some European universal banks chose to rid themselves of some of their activities that siphoned off profits, especially their securities businesses and investing in the shares of their industrial clients. Many of these banks would be better off, they thought, specializing in either retail or wholesale services, but not both. Others took an opposite view, so there were many different strategic alignments. Many such possible alignments could be accomplished only by large acquisitions, and there were many of them. As a result, the process narrowed the field of competition in wholesale services considerably. By the end of 2000, a year in which a record level of financial services transactions with a market value of $10.5 trillion occurred, the top ten banks commanded a market share of more than 80% and the top five, 55%. Of the top ten banks ranked by market share, seven were large universal-type banks (three American and four European), and the remaining three were large U.S. investment banks who between them accounted for a 33% market share.

1990			2001		
1	Industrial Bank of Japan	57.1	1	Citigroup	259.7
2	Fuji Bank	52.0	2	American International Group	207.4
3	Mitsui Taiyo Kobe Bank	46.3	3	HSBC Holdings	109.7
4	Sumitomo Bank	46.0	4	Berkshire Hathaway	100.2
5	Dai-Ichi Kangyo Bank	44.8	5	Bank of America	99.0
6	Mitsubishi Bank	44.0	6	Fannie Mae	79.5
7	Sanwa Bank	41.2	7	Wells Fargo	73.7
8	Nomura Securities	25.5	8	J.P. Morgan Chase	71.7
9	Long-Term Credit Bank	24.8	9	Royal Bank of Scotland	69.4
10	Allianz	24.6	10	UBS	67.1
11	Tokai Bank	21.3	11	Allianz	62.9
12	Mitsubishi Trust & Banking	17.2	12	Morgan Stanley Dean Witter	61.4
13	Deutsche Bank	16.4	13	Lloyds TSB	60.3
14	American International Group	16.3	14	Barclays	55.2
15	Bank of Tokyo	15.9	15	Credit Suisse	51.3

Source: Morgan Stanley Capital International.

Exhibit 1.1. Top Financial Firms, Market Capitalization, End Year ($billion).

Consolidation in the industry and concentration of market share had already achieved substantial levels by the year 2000. (See Exhibit 1.1.)

But not all financial service providers were banks. Large corporate players were beginning to find their way into the financial service community, offering competition to established banks. Many of these players had been ignored before their businesses began to overlap. Most prominent among these corporate players were finance subsidiaries of large industrial companies, such as General Electric Capital Services, General Motors Acceptance Corporation, Ford Motor Credit, and others. There were further disturbances in the competitive force by such insurance giants as American International Group, Berkshire Hathaway, and Allianz and such mortgage finance giants as FNMA and its siblings. Indeed, by the end of 2001 the market capitalization of the world's 15 largest financial services providers included four nonbanks (though Allianz, which is included, has since acquired Dresdner Bank). The top 15 such companies included eight U.S. firms and seven Europeans—four British, two Swiss, and one German). By comparison, at the end of 1990, the 15 largest financial firms by market capitalization contained 12 Japanese firms, two German, and one American. The Japanese firms, within the decade, disappeared from the list entirely. (See Exhibit 1.2.)

1.4 FACING THE FUTURE. It is difficult to predict the future and this chapter is not going to attempt it, except to note that there are now certain conditions in place that will affect how the future develops, and we can rely on these conditions to remain in place for some time.

(a) Market Integration is Irreversible. Certainly, the market integration that has developed among the United States, Europe, and Japan will continue to send both borrowers and investors to the cheapest markets, and their experience will reinforce the

Rank	Firm (Rank 2000)	Market Share	Syndicated Bank Loans	Global Debt U/W & Private Placement	Global Equity U/W & Private Placements	M&A Advisory Announced	MTNs Arranged	Total
1	Citigroup (4)	10.81%	278,375	429,342	48,789	476,149	640,797	1,873,452
2	JP Morgan Chase (1)	10.35%	514,476	299,192	14,644	428,011	538,515	1,794,838
3	Merrill Lynch (5)	9.65%	37,987	367,429	61,324	597,350	608,608	1,672,698
4	Goldman Sachs (3)	8.43%	43,953	238,695	60,928	748,990	369,735	1,462,301
5	Morgan Stanley (2)	8.20%	20,060	225,691	44,446	626,839	505,256	1,422,292
6	Credit Suisse Group (6)	6.99%	42,485	303,724	44,225	426,358	395,483	1,212,275
7	UBS-Warburg (9)	5.58%	33,870	220,815	29,662	212,449	470,308	967,104
8	Deutsche Bank (12)	5.29%	83,423	206,799	16,946	119,269	491,265	917,702
9	Lehman Brothers (11)	4.99%	32,760	237,902	18,428	172,180	403,508	864,778
10	Bank of America (8)	3.83%	238,057	151,205	5,746	67,116	202,344	664,468
11	Dresdner Bank (10)	3.12%	48,339	49,202	29,729	343,353	69,822	540,445
12	Barclays (15)	2.38%	58,742	72,722			281,110	412,574
13	ABN AMRO (7)	2.34%	30,869	83,018	4,824	29,173	258,323	406,207
14	BNP Paribas (16)	2.22%	28,938	49,829	4,767	36,599	264,007	384,140
15	Bear Stearns (17)	2.17%	4,492	130,706	3,650	90,569	146,269	375,686

Exhibit 1.2. Global Wholesale Banking Rankings: 2001: Full Credit to Book—Running Manager Only ($ million).

international character of the wholesale market place. This market nexus will encourage other countries and regions to tie into it (e.g., as the countries of the EU have done by allowing the transnational Euromarket to become the principal wholesale financial market for the entire region) and to integrate their own markets to it. Much of this has already happened and will no doubt continue in more advanced emerging market countries.

(b) Regulation Will Continue to Converge. The wholesale market largely consists of institutions, corporations, governments, and sophisticated investors. This group does not need much protection from government securities regulators (in Europe there is no government body that regulates the Euromarkets, and in the United States securities sold to qualified investors may be exempt from registration requirements), and the absence of such regulation is a considerable economic benefit to the market. However, regulation of financial exchanges and of conduct of professional operators is developing in the EU and following established American principles. Regulation of minimum levels of capital for banking institutions, though a continuing work in progress, has developed to embrace all major capital market countries. Surely, these regulatory matters will continue along the paths they are now committed to. The result, however, suggests a moderate amount of reasonable regulation, which is healthy for an integrated, global financial marketplace.

(c) Competition Will Continue to Provide Benefits to Users of Financial Services. The bigger, more robust the market, the more attractive it will be to competitors. There are still many competitors large enough to attempt to secure a prominent position in the market, though the identity of these competitors has changed considerably over time. No doubt this will continue, as will the ongoing debate over whether universal banks with large balance sheets will dominate, or whether quick-adapting, flexible, smaller specialist firms will. European banks have already demonstrated the ability to become competitive in capital markets, recovering somewhat from an earlier period in which American firms were especially prominent. Will Japanese banks and securities firms accomplish the same competitive recovery in the decade ahead? They very well may do so, and we may also see nonbanking enterprises become much more aggressive in stripping business away from the traditional players. But the volume of transactions should continue to rise, providing the base for the motivation by all the competitors to secure a larger market share. Time will tell.