PHILEAS FOGG’S FOLLOWERS

Knowledge Elites in the Global Financial Service Industry

by

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Traditionally the financial service industry has been characterised by high mobility barriers due to extensive Government surveillance. Similar barriers have also been existing for its employees, who have tended to be recruited among cautious candidates. Both these circumstances have undergone changes as the working conditions of the industry have altered. An important event in this context is the introduction of modern computer and communication technology. It has to some extent created new barriers to mobility by the requirements for extensive investments, but primarily it has reinforced tendencies of deregulation thereby increasing competition. This in tum has implied the creation of new instruments and the need for a new type of employees with another time and risk orientation than earlier. They constitute a new knowledge elite, the introduction of which may be expected to create tensions in traditional financial institutions.

1. Introduction

Phileas Fogg argued at the Reform Club in the 1870s that the development of transportation had made the world smaller (cf. Verne, 1873). He was right at the time, but he is even more so to-day in the late 1980s, when individuals may travel around the world in much less time than the eighty days used by Jules Verne’s hero. In addition to the innovations in transportation, the distance in time has been reduced by a rapid evolution of communication technology. Messages may thus to-day go around the world several times within an hour. This development has had important repercussions for many industries, but particularly for those handling information rather than physical products. One such industry is the financial service industry, within which to-day sudden changes in exchange rates, interest rates and quotations will flow instantaneously from one financial center to another. Trading around the clock has therefore become the rule for many financial institutions. In this way experts in the financial service industry can be regarded as followers of Phileas Fogg, although they concentrate on moving financial information in terms of orders and quotations rather than people.

This paper will discuss the implications for the financial service industry of the described changes. In order to provide a background for this analysis the following two sections will deal with the traditional working conditions in the
industry and recruitment policy, respectively. In so doing the concept of mobility barriers for corporate and individual actors will be used as an analytical tool. Sections 4 and 5 will then discuss how these mobility barriers are influenced by the introduction of computer communication technology.

2. Mobility Barriers in the Financial Service Industry

One basic assumption in the theory of perfect competition is that “there is a free entry and exit in every market” (Cohen & Cyert, 1965, p. 5). In reality there are, as shown by Bain (1956) and Mann (1966), considerable barriers to entry in a number of industries. These circumstances have also contributed to the occurrence of markets of imperfect competition (cf. Chamberlin, 1933 and Robinson, 1934). The barriers to entry in industries often are of an economic character, i.e. that established firms have advantages over potential entrant firms through (1) product differentiation, (2) absolute cost advantages, and (3) economies of scale (Bain, 1968, p. 255). These barriers to entry may also be reinforced by barriers to exit for actors in other industries, i.e. “economic, strategic, and emotional factors that keep them competing in businesses even though they may be earning low or even negative returns on investment” (Porter, 1980, p. 20). Together the barriers to entry and exit will constitute factors of inertia, which we will here denote as mobility barriers (Engwall & Johanson, 1984).

In certain industries the mobihy barriers are a result of Government intervention. Primarily they imply screening of entrants for the exploitation of natural resources and the provision of public services (cf. e.g. Scherer, 1970, Ch. 22). Among the latter we may include the focus of the present paper: the financial service industry, which throughout the world is characterised by a high degree of regulation (cf. e.g. Wilson, 1986). The most central financial intermediaries, banks, thus need a charter to begin their operations and are then carefully scrutinized by regulators. The industry therefore contains both high barriers of entry and high barriers to exit. The main reason behind this is the concern of Governments for economic stabilhy, ultimately fears of financial crisis through domino effects if a bank should fail. Needless to say the central role of banks in the implementation of economic policy is another important explanation for the concern regarding soundness in the financial service industry. In the tradition of Siebert er al. (1956), who — in addition to the
Executive, the Judiciary and the Legislative branches — have mentioned the Press as a fourth Branch of Government, there are therefore good reasons to consider banks as a fifth such branch.

The basic function of the bank charter is to permit the holder to build up relations to different kinds of customers. In certain countries legal restrictions, for example the Glass-Steagall Act in the United States, limit the customer categories basically to depositors and borrowers, whereas others, among them many European countries, provide the possibility for a bank to be involved in both commercial and investment banking (Wilson, 1986). Of these the analysis here will concentrate on the former type of activity.

Banking operations have traditionally been built on trust and long-term relationships with a certain reciprocity, i.e. that a customer both deposits his surplus in the bank and obtains loans and other financial services. Particularly in wholesale banking (the relations to corporate customers) it has been common to talk about house banks. In this way the financial relations have exhibited similar characteristics to those observed in industrial marketing and purchasing, i.e. long lasting permanent relationships (cf. eg. Håkansson, 1982). These relations in tum are built on the experience that reliability and mutual understanding of arising problems are important assets for both partners.

The importance of permanent relationships in the financial service industry no doubt imply additional barriers to mobility. Customers tend to stick to their old bank relations. This tendency is reinforced by the fact that service products are extremely easy to copy. Companies operating in service industries thus do not have patent protection or other technical barriers to imitation similar to those existing in manufacturing industries. In the financial service industry it is thus difficult for an actor to break into old customer networks through the development of new products, particularly when the hardware component is insignificant. For the introduction of the new product in most cases only results in competitors taking it up. In the words of a banker quoted by Mayer (1984, p. 59): “We have to copy what the other banks are doing — it’s a product, and customers will perceive us as a less useful bank if we don’t offer it.”

The financial service industry has thus traditionally been characterised by high mobility barriers as a result of Government regulation. The mobility barriers created by the close surveillance of the industry have then been reinforced by the existence of networks of permanent relationships and the ease of copying newproducts. Together the different mobility barriers have created an industry of companies with access to crucial resources. To be accepted as em-
ployee in such an industry may therefore be a good precondition for elite positions.

3. Mobility Barriers for Individual Actors

The literature on professions has certain features in common with the just discussed research in industrial organization, particularly in terms of barriers to entry. For the whole idea of a profession is to control the performance of certain tasks in society. Therefore professions screen entrants by educational requirements and set standards for educational institutions as well as practitioners. Thus only a selected number of schools are authorized for a particular professional education, and those passing through them may be received in the profession after fulfilling certain additional requirements. As a member the professional is then expected to perform his duties according to the professional code and has to expect reactions — through different kinds of punishments, even expulsion — in cases of deviant behavior (cf. e.g. Larson, 1977, p. 132). In the strict sense there are very few professions. Theology, medicine and law are the three major groups, which comply with a strict definition. As pointed out by Larson (1977), however, the growing body of academic education has implied that a number of groups become increasingly professionalized, or in the words of Collins (1979, p. 184) have become semi-professions.

But even without the academic training within an occupational group one may expect mobility barriers to be existent, particularly when the appropriateness of employee behavior is crucial. One example in this context is daily newspapers, in which one may observe (cf. Engwall, 1978) that gate-keeper mechanisms are important, not only in the selection of news, but also in recruiting new employees. The screening of potential candidates is performed on the basis of their earlier performance and interviews, and the selection is made with the aim of minimizing uncertainty about future behaviour. One important procedure is then to recruit people for temporary positions in the periphery — for example as local editor in a small place — and then gradually have them move towards the centre, if they perform well (Engwall, 1985). This step-by-step strategy also means that employees may be subject to a gradual socialisation through informal contacts with more experienced newsmen, in editorial conferences and through editorial revisions (Sigelman, 1973). In this way employee mobility will be subject to successive mobilhy barriers; the temporary employ-
ment being one first step, the permanent employment a **second**, whereas the movement to more and more central positions are **further** steps, which all are **subject** to gate-keeper **mechanisms**.

In this **selection** process the **existence** of a **certain** professional education provides a screening **device** (cf. e.g. Blaug, 1976, pp. 845-849), but it also constitutes a form of **presocialisation** into the **occupation**. An important post-war example of this is the business graduates, who to an increasing extent penetrate the modern **corporation** with a **language** of their own with **concepts** for **accounting**, administration, **finance**, managerial economics and marketing (cf. Engwall, 1986 and Whitley, Thomas & Marceau, 1981). In terms of Collins (1979, p. 189) they constitute a techno-bureaucratic profession, and they tend to **fit** into the requirements of Larson (1977, p. 132) for a strong profession, i.e. that they exhibit "a real **technical skill** that produces demonstrable **results** and can be taught". Interestingly enough studies from Sweden have shown that banks were early to absorb **numbers** of business graduates (Lindgren, 1988, Markgren, 1983 and 1986). In this way bankers and managers have come to **have similar backgrounds** and professional **vocabulary**, a circumstance which of **course** has facilitated the above mentioned **creation** of networks.

As a result of the importarne attached to trust and **stability** in banks (cf. Section 2) their recruitment policy has been somewhat wary. Remitz (1960, p. 219) thus concluded that although “bank employees do not show a personalny structure different from that of people in general they show one **common** trait: **caution**". Similarly McMurry (1958) has argued that banks tend to stress security before creativity in recruiting. In this way, McMurry continues, the hired employees will be persons who have "spent all their working lives in well-structured positions, . . . have had little opportunity to make decisions, to take risks, and, particularly to work through people" (ibid., pp. 95-96). Therefore turnover of bank employees tend to be lower than in other industries. Those once accepted tend to stay, although their top **bosses** may be brought in from other companies.

The above arguments imply that employees of **financial** service companies, although they have been carefully screened, have not been professionals in the traditional **sense**. Although business graduates to a **large** extent have been hired by banks, they have often constituted a special segment of this population characterized by **caution** and only **slight mobility**. In this **latter** sense they have not exhibited a characteristic often mentioned for members of professions, i.e. an **identification** more oriented towards their trade than towards their **employ-
er. This traditional picture has, as will be shown below, changed somewhat during the 1980s.

4. The Development of International Capital Markets

The main task of financial intermediaries is to distribute liquidity and risks. In the last decades the operations of these intermediaries have been increasingly internationalized through the development of international capital markets. Behind this development we can track an internationalization of business in terms of an increasing world trade and a growing tendency of large corporations to become multinational through foreign direct investments (cf. e.g. Vernon 1971 and 1977). Another important explanation to the described trend is the development of the Euro-currency market. This has its origin from deposits of Soviet-owned U.S. dollars in European banks after World War II and has experienced a veritable boom in the last decade (Sampson, 1981, Ch. 7-8). The evolution of this market has implied a substantial change in terms of mobilny barriers: national Governments have to an increasing extent lost control over large parts of the operations of their financial institutions. In addition it has lead to a competition between different international centres for establishments of financial institutions, This in turn has forced most governments to deregulate and to relieve some of the existing barriers to entry for foreign actors (cf. e.g. Walters, 1985).

The said deregulation has led to an increasing market orientation of financial institutions, which have felt their margins squeezed by new competitors. The latter have not only been foreign entrants but also domestic actors, which have entered the financial service area. It is thus argued by Leavitt & Cunningham (1979) that banks of the 1980s, similar to the railway industry, have tended to define their business too narrowly thereby neglecting competition from adjacent industries. In the new deregulated world the border lines between banks and other industries are thus becoming less and less strict. Bank operations are to-day run by large industrial corporations, retail chains, travel agencies and insurance companies (cf. e.g. Ballatin, 1986 and Eisenbeis, 1985), thereby moving important business from the traditional commercial banks. In this way the traditional banks have been forced to reconsider their role. Some have even developed to financial supermarket all-purpose banks (Hanson,
1982), providing their customers with a variety of services. Many of these have been developed in the industry, frequently first in the United States, and have then spread rapidly (cf. above Section 2), be they different kinds of bonds, commercial papers, futures, money-market funds, options, swaps, etc. In case of considerable hard-ware components, however, the situation has been somewhat different. Then the actors have faced barriers similar to those in manufacturing industries: the need for far-reaching investment decisions and extensive design work. The described situation is also the one faced by the financial service industry as computer and communication technologies have moved into this sector. Investment costs, and also restrictions on access to computer networks, in this way have implied and still imply new mobility barriers for the traditional actors in the industry (Mayer, 1984, p. 128). For companies in the computer and communication industry, on the other hand, the technological development and deregulation have created new business opportunities, thereby loosening up the border limits between traditional industries still further. A striking example in this context is the development of the British news agency Reuter, established 130 years ago, for which today the dissemination of financial information has become much more important than their traditional business.

Although the investments in modern technology may lead to certain mobility barriers, its introduction has no doubt stimulated competition for financial services. It has made market information more easily accessible for different actors thereby making markets more efficient. In the domestic retail markets customers may notice — not always with enthusiasm, since it also implies the reduction of float — how transaction costs are reduced through bank cards, automatic teller machines, point-of-sales systems and computer networks (cf. e.g. Phillips, 198.5). Similarly market information tends to be spread to different actors more rapidly and accurately, which in turn has implied that another assumption of the competitive model — that actors have perfect information (cf. Cohen & Cyert, 1965, p. 5) — has become less questionable than earlier in financial markets. Trading of foreign currencies and securities have become activities, where continuous watch is both possible and necessary. The above mentioned internationalization of business has thus been reinforced by the technological development, and the latter can even be argued to be an important contributing factor to the wave of deregulation under way in the financial world.

Computer and communication technology have thus radically changed the working conditions of the traditional actors in the financial service industry.
They have implied (1) heavy investment requirements financially, and in terms of human resources, (2) the intrusion of companies from other industries into the sector, and (3) pressures for more efficient markets through the reduction of transaction costs and the increase in the accessibility of market information.

5. The Development of a New Knowledge Elite

The tendencies discussed in the previous section no doubt have implications for employees in the financial service sector. One such consequence is the need to recruit people who have a background different from that discussed in Section 3. In addition to the earlier cautious persons with a general education, financial institutions increasingly need people with very specialised competence, some more oriented towards the new technology, others more towards the technicalities associated with the increasingly sophisticated instruments. They also need to a higher extent traders, who are willing to take fast decisions in turbulent markets, which require risk and time orientations different from those traditionally found in the industry. The recruitment of the mentioned types of persons may no doubt lead to tensions with more traditional employees particularly concerning the traditional issue in banking: risk and return.

Although the new employees will be more specialized than the earlier ones, the former can not be considered as professionals in the traditional sense. They do not exclusively graduate from special schools, they have no long traditions and they have so far limited professional codes. They do however, to quote Larson (1977, p. 132) once again, even more than before possess technical skills “that produces demonstrable results and can be taught”. In addition, in the fast expanding and changing markets they have — in contrast to the earlier employees — shown to be more oriented towards their trade than towards their employers. The new knowledge elite in the financial service industry has thus tended to be much more mobile than the traditional ones. Extreme examples of the latter were exhibited in London as the Stock Exchange took the steps referred to as Big Bang, i.e. the computerization of securities trading and the introduction of completely new rules in the system.

The members of the new elite are not only moving between companies providing financial services, however. They also tend to move to and from the wholesale customers, who to an increasing extent build up strong financial departments or even internal banks. Through this increasing sophistication of the wholesale customers, the financial service finns have entered a tougher
world with slimmer profits (Mayer, 1984, p. 213). Another result of the said development is that employees working with sophisticated instruments in financial service firms and their counterparts in customer firms become more closely related than they do to their colleagues in their own companies. They speak the same technical language, have the same frames of reference, and are both likely to signal their affiliation to the yuppie culture through dress, car purchase, sparetime occupation, etc.

The new technology has thus decreased the barriers to exit for certain groups of employees, but it has also implied certain reductions in the barriers of entry. The computerized trading networks, as soon as they have been created, provide the opportunity for decentralized trading. The individual actors therefore do not need to be part of a larger organization but may through a relatively small investment, a terminal and an entrance fee, get continuous access to up-to-date market information. Some, like Mayer (1984, p. 59), go even further and argue that "anyone with a computer can offer banking services".

Another feature of the new technology, which implies a certain threat to the new elite and their power in the system, is the development of automatic trading programs. Here research in artificial intelligence and computer technology has been employed to give the decisions to sell or buy to computers as prices of different securities reach certain levels. These trading programs were somewhat questioned, however, as the stock markets over the world went down dramatically in October 1987. On Wall Street the use of such programs was even banned during a period following the Black Monday (Institutional Investor, January 1988, pp. 43-46).

The introduction of modern computer and communication technology is thus likely to have effects that will cut mobility barriers. At the same time it will, at least in the short run, create new knowledge elites by their requirements for technical skills in handling the new technology and the new financial instruments.

6. Conclusions

A basic concept used throughout this paper has been mobility barriers, which has made it possible to discuss the changes in the financial service industry on the company as well as the employee level. The analysis has pointed to the traditionally high mobility barriers in the industry as well as to recruitment mechanisms characterised by a high degree of screening in order to obtain cautious
employees. In both cases efforts to reduce uncertainty concerning future behaviour have been the basic motive. The introduction of computer and communication technology, however, has implied that new actors are entering the finanical service industry. Industrial, retail and service corporations run their own banking operations and providers of the new technology enter the industry. This in turn has led to the hiring by firms in the sector of a new breed of employees. They are not professionals in the traditional sense, but no doubt knowledge elites by mastering the new technology and/or the new financial instruments. Their entrance in the traditional financial service firms have implied and will continue to imply sources of considerable tensions with the more traditionally recruited employees. For this new breed of employees has a more cosmopolitan orientation and are less risk averse than their colleagues. In that sense they do not just share Phileas Fogg’s knowledge of fast means of global communication, they also have another feature in common: the ability to take calculated risks in fast decisions. Unlike the situation of Mr. Fogg their counterparts in the wager remain an anonymous atomistic crowd, as they each individually bet on the future development of global financial markets on the basis of available information. In that work the computer remains their loyal servant, their Passepartout.
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