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BREXIT and International Finance:

Impact(s) of (a no deal) exit on financial service firms in the UK.

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Resumen

Este estudio analiza el impacto que un Brexit duro tendría en los ingresos y la situación de las instituciones financieras del Reino Unido. Examinará las implicaciones reales de ser parte de la Unión Europea y su mercado único. Esta investigación presenta el posible escenario de las operaciones financieras en Reino Unido en el caso de que el Brexit duro se ejecute. Además, presentará y determinará los posibles mecanismos a través de los cuales el Reino Unido podría negociar con éxito un Brexit duro.

Palabras Clave

Brexit, Brexit duro, economía de UK, Unión Europea, mercado único.

Abstract

This Study looks into the impact that a hard Brexit would have on the revenue and situation of the UK financial institutions. It will go through the actual implications of being a part of the European Union and its single market. This research will go through the possible scenario on the UK financial operations of a no-deal Brexit. Additionally, it will present and determine the possible mechanisms through which the UK might successfully negotiate a hard Brexit.

Keywords

Brexit, hard Bexit, UK economy, European Union, single market.

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CHAPTER ONE: INTRODUCTION TO THE RESEARCH

1.1 Background of Study

The financial service sector makes up a large share of the UK economy and is as such extremely critical. Its contribution to tax revenue generation, employment and export financing make it the largest contributor to the economy. In 2013, the sector accounted for more than 7% of UK GDP. It contributed 12% of personal income tax and national insurance, and 15% of onshore corporate tax. Financial services pay in excess of £60 billion in tax annually. Over 25% of this is remitted by foreign banks operating in the UK. About 2.2 million people are employed in financial and other related business in the sector (House of Lords 2016). Nearly half of the revenues generated by banks can be attributed directly to other European Union players. At $71 billion UK net export of financial services is the largest in the world and contributes significantly to its balance of trade activities. Majority of these activities involved stakeholders from EU member States. London is the leading global financial center possessing the largest infrastructure and financial capacity. Majority of EU stock market capital is traded on the City's Stock Exchange. It is also the second largest warehouse of collective investment funds and largest host of EU hedge fund managers (Quaglia 2014). As a result euro-denominated securities in excess of £440 billion are cleared in London every year despites its being outside the euro area. The insurance and retail banking sub sectors are equally dominated by the UK. Half of the pension assets of EU workers are resident in the UK. Lloyds bank of London has the largest re-insurance portfolio in the world James & Quaglia, 2017).

1.2 Brexit and access to the European single market

1.2.1 The European single market

The European Single or Common Market is an internal market that aims to guarantee freedom of movement for goods, services, labour and capital within the Union (Barnard, 2013). The market is made up of all 28 EU member countries and has been extended to include some other countries outside it through the European Economic Area agreement and bilateral treaties. Some of these countries are Iceland, Norway and Switzerland. Others still have limited access to single market benefits by either relational or sector participation. For example Turkey possesses restricted access to free movement of selected goods through its Customs' Union relationship with the EU (Antonucci and Manzocchi, 2006). The aims of this single market include enjoyment of economies of scale; efficiency in resource allocation; improved specialization and economic synergy/integration.

Free Movement of Goods: Custom Duties and Taxation

The EU Single Market makes provision for a customs union and legislation requiring EU member States and partners to adopt uniform VAT codes for tax collection. The absence of an internal tax and competitive tax regulations keep goods from EU member States competitive within the Union. Goods manufactured at one end of the EU can enter into any EU market free of customs payments. This reduces the cost of goods to the final customers. It also facilitates the speed and efficiency of the supply chain while giving businesses access to over 500 million potential customers. This efficiency and easy access fosters competition and increased quality of goods (Barnard, 2013)

Free Movement of Services and labour: Passporting Rights and migration

The single market gives the rights to firms and individuals to establish and then render services anywhere within the European Economic Area (EEA). This enables organizations to establish an international base quickly and cost effectively. It also cuts through the red tape present in establishing a business in an underdeveloped member state's public service. Passporting rights as they are commonly called enable financial institutions set up and transact business easily cross border. Each member country also benefits from collectively negotiated Passporting rights in a third party state (Schoenmaker, 2017).

Similarly a single market provides a single regional workforce to firms in the member states. Scarce human resources can move unhindered across borders without the previous high cost and tedium required to recruit European expatriates. This free movement of workers also serves to increase income tax collections and facilitate redistribution of wealth. The waiver of Visa fees and other international access cost drastically reduced the cost of travel and restrictions on working abroad (Al Ariss & Crawley-Henry, 2013).

Free Movement of Capital

Article 63 of The Treaty of the Functioning of the European Union (TFEU) prohibits all restrictions on the flow of capital within its member states or between the EU collective and a third party state (Geiger *et al*., 2015). As such multinational organizations can move capital within the region without additional restrictions and charges ().It states that all Capital within the EU can be transferred between countries without restrictions on amount asides from those which have been specially restricted - like capital outflows from Greece (). Transactions done within the EU in euro are treated as domestic payments and are charged at the local transfer rates. Digital transactions such as card and Automated Teller Machine (ATM) transactions are also treated as domestic and charged accordingly. Establishment of a European Central Bank serves to facilitate and regulate this regional capital freedom.

1.2.2 Hard Brexit

It is no longer news that Britain has decided to leave the European Union. What has become the main topic is the manner in which Brexit will happen. In a simplified version there are two possible exit plans – a soft and hard Brexit. While the former guarantees some access to the single market; the latter entertains no such provision. A hard Brexit in essence one in which Britain will lose all access to free movement of goods, services, labour and capital (Armour, 2017). In the light of difficult negotiations with the EU and the rapidly approaching Brexit deadline, pressure has been on Prime Minister Theresa May to reach a favourable deal or exit without a deal. The hard Brexit option has become a significant topic for debate in UK academic and professional circles. While some caution against a hasty, no-deal Brexit, highlighting financial and economic repercussions; others support the move, citing the strategic opportunities for unrestricted bilateral free trade with non-EU states. They propose that freedom from the EU regulations will allow the UK access to better deals and protect it from economic recession affecting some EU member states (Dhingra *et al*., 2018)

1.3 Motivation for study

The potential effects of political and socio-economic environmental factors on specific international business parameters underscore their significance to trade. The positive and negative impacts of a no-deal single market exit and potential loss of Passporting rights is bound to have an interesting effect on European and UK banks operating within the Union. A personal academic interest in the consequences of a hard Brexit on Western European States and worker migration also contributed to motivate the investigation.

1.3.1 Aim

This research aims to investigate the potential impact(s) of a no-deal Brexit on financial service firms in the United Kingdom.

1.3.2 Research questions

- How will the loss of single market access impact revenue generation in UK financial institutions?
- How will a no-deal Brexit affect the operations of foreign financial institutions in the UK?
- How can the United Kingdom take advantage of a hard Brexit?

1.3.3 Objectives

In order to achieve the above stated aim, the study will:

- Investigate the impact of a hard Brexit on the revenue generation potential of UK financial institutions
- Explore the effects of a no-deal Brexit on Foreign financial institutions' operations in the United Kingdom
- Determine the mechanisms through which the UK may successfully negotiate a hard Brexit.

1.4 Research scope and limitations

The Study is scoped to investigate the activities of banks and other professional service stakeholders that operate within the United Kingdom and originate from the EU member states. These include banks, securities and insurance brokers, pension fund managers and other. Investigation will be carried out to encompass the hypothetical impact of losing all four freedoms of the EU and total exclusion from the EEA. As the event itself i.e. Brexit has not occurred at the time of writing, information reviewed and analyzed are hypothetical scenarios forecast with the help of underlying theories and frameworks.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

In this chapter the relevant theories and principles of international business and trade are reviewed and discussed to form a basis for the research framework. General theories of how political and socio-economic variables of the external environment can influence organizational fate and home country strategy formulation. A critical look at the general literature on the dynamics of free trade and single market models and how they affect country operations and decision making. This critical review is done in the context of national governments as well as multination corporations and forms the basis on which the research framework is developed.

The chapter is divided into three major sections. In section 2.2 definitions and concepts of international business and globalization as well as how external environmental factors shape home and host country activities are presented. In sections 2.3 and 2.4 free trade, the European single market and the UK motivation for Brexit are discussed respectively.

2.2 Definitions and concepts of International Business

2.2.1 Globalization

This may be described as the interaction and integration of individuals, firms and governments with others beyond their geographically defined borders. In the context of trade, these interactions enable organizations to expand their activities into foreign markets. These markets often offer new opportunities for organizations that have currently achieved their local capacity or cannot compete for market share (Kriesler & Neville, 2016). The decision to internationalize is a function of both internal and external environment scanning. In performing an analysis of the factors within the organization's control using a tool like SWOT, the entity identifies its strengths and weaknesses, opportunities to leverage and threats. As such it is able to gauge saturation, efficiency of production, opportunities for expansion and consequences of action and inaction. External environmental scanning on the hand involves those environmental variables outside the organization's jurisdiction of control. These are very crucial to globalization as home and host countries are bound to have differences in their external environments even within the same region. On a firm level, multinational companies have had to leverage favourable factors or adapt to challenging environments in order to successfully establish host country presence. The PEST analysis is the most significant tool for scanning the external environment. It considers 4 factors of the macro-economic environment of target host country/sector, deciding whether to make entry and if yes, what mode of entry to adopt (Wheelen & Hunger, 2011).

Political factors: These are those factors that determine the extent of government intervention in a country's economy, specific sectors or industries. A government's decision to monopolize or protect local goods and services automatically increase the cost of transactions for a foreign firm. This can be done in a number of ways. These include but are not limited to legislating economic exclusion of some businesses, subsidizing local production equipment, prohibiting imports, and increasing fee payments for foreign firms e.g. tax, customs and duty payments. While this does not necessarily eliminate entry, it may inform a different entry strategy. Foreign firms may choose to work with a local partner to facilitate lower cost of production and/or enjoy incentives offered by the government for such arrangements (Acemoglu & Yared, 2010). Conversely target nation governments may be more tolerant to/in need of foreign direct investment (FDI) and as such create a welcoming political climate. Offering tax incentives, reducing or eliminating custom duty and creating policies that encourage free trade are some of the ways host country governments encourage capital inflow.

Economic factors: These are determinants of the economic performance of the target environment. They are a direct reflection of how well the economy is doing and can help forecast short to midterm organizational performance. Foreign exchange and interest rates can directly affect the cost of capital of foreign firms. The potential of operating in an environment with a strong local currency and high lending rates may discourage entry. Demand and supply of the goods and services in the host environment also helps in decision making. Countries with low demand or a saturation of the products in question suggest the absence of sustainable market share to justify internationalization. A blue ocean however presents the firm with high demand for their goods and services with little competition. This can help rapidly expand their business (Agnihotri, 2016). Other economic indicators include GDP, inflation, growth rate ad per capita income

Social factors: Social indicators such as the demographic distribution and educational qualification of a residents in a target environment can have serious product demand and human resource challenges. A market with a mainly geriatric population will have low demand for products targeted at a youthful population. Similarly firms requiring young, highly educated/skilled workforce will struggle here. Factors such as age, gender, religion and cultural norms can ultimately influence cost of production and time to market. A firm unable to find suitably qualified local hands may have to resort to employing an expatriate workforce or train locally. These decisions cost money, time or both and would have to be factored into the home firm's management strategy (Noe *et al*., 2017).

Technological factors: The level of technological advancements with respect to factors of production can significantly influence a firm's internationalization decisions. Environments with a high level of automation; requiring extensive research and development; highly integrated supply chain and logistics can raise the entry barriers for firms from less developed economies. On the other hand those from similar backgrounds may find it easier to establish. Similarly, those from environments leveraging technology systems may find it difficult to enter less advanced environments. The cost of technology transfer i.e. hardware, software and human resource systems may prove unprofitable (Camillo *et al*., 2014).

A country's stance on foreign participation in the local economy and the influence of other environmental factors are not necessarily static. As the needs and realities of each nation changes; their stance on foreign trade also adjusts to suit the new reality. The result is a scenario where firms within nations interact with each other based on trade agreements and existing environmental conditions.

2.2.2 International trade

International trade can be described as the exchange of goods and services across international borders. It is driven by the conventional forces of demand and supply on a macro-economic scale. Countries requiring certain goods and services that they lack or produce at a higher cost import them and export those which they have in excess (Johnson, 2013). International trade is more complex than domestic trade and requires the negotiation of home country environments e.g. currency conversions, policy, judicial systems and market peculiarities. In order to facilitate and regulate international trade, economic bodies such as the World Trade Organization (WTO) was formed.

2.2.2.1 Balance of trade

Balance of trade, also referred to as net exports or commercial balance represents the difference in monetary value between a country's exports and imports over a period of time. Sometimes a distinction is made between a balance of trade for goods versus one for services. When a nation's exports are of greater value than imports, it is described as having a trade surplus. Conversely where imports are of a greater value, it has a trade deficit. This in itself does not absolutely determine the health of an economy. While physical/material trade deficits may occur in developed economies; the financial balance of trade may show a surplus. The material deficit can be due to large importation of raw material for domestic consumption and further production which may then add value when exported. The case is often reverse in third world nations which usually record large material trade surpluses (often from a single/few export source) and financial trade deficits due to importation of finished goods and services (Johnson, 2013).

2.2.3 Theories of international trade

2.2.3.1 Mercantilism

Mercantilism as an international trade theory was popular in early England and France up to the 18th century. It is an economic practice where governments regulate the economy and foreign trade so as to encourage domestic production. This often involved prohibition on exports of high value metals and raw materials as well as high tariffs on importation of manufactured goods in the home country and its colonies (Viner, 2017). The idea was to boost local conversion of raw materials since exports of finished goods are of a higher value. The overarching principle is discussed to have been the consolidation of national power at the expense of rival economies. This often led to wars and motivated the drive for colonial expansion by the American and European powers. Authors like Adam Smith criticized the mercantilist perspective showing how inefficient it was and the advantages of specialization. He argues that it is inefficient to produce all goods and services internally as some will be at higher cost than if they were imported (Heckscher, 2013).

2.2.3.2 Absolute advantage theory

Adam Smith's theory of absolute advantage is based on the premise that trading entities have varying cost of production per unit produce. The country or firm that can produce a good or service at lower cost per unit than any other is described as having absolute advantage. What this means is that they use a fewer number of factor inputs and as such can offer these products cheaper to others in the form of exports. From an economics standpoint, those with absolute advantage can produce more of a product than its competitors over the same period of time. In the classic theory of absolute advantage labour was the only input. Based on this simple contrast of labour input, it is possible for some countries to have no absolute advantage. In a purely academic sense, no international trade should occur. Critics observed that this was not the case and no one country has to have absolute advantage before benefitting from international trade (Utkulu & Seymen, 2004).

2.2.3.3 Theory of comparative advantage

David Ricardo propounded the theory of comparative advantage which emphasizes the ability of an entity to produce a specific product or service at lower marginal as well as opportunity cost over another entity. It proposes that if an entity is more efficient in product A than it is in product B; it would gain from producing more of A and importing B from another. In this way trade is possible and both countries can benefit from trade. This of course holds when the latter entity is less efficient in producing A and more efficient in B (Smit, 2013). Proponents of mercantilist and other protectionist theories disagree with the stance. While they agree that a country may initially be comparatively disadvantaged; they surmise that active nurturing would eventually make it advantageous. Another criticism is noted in the assumption that capital is immobile across nations.

2.2.3.4 Porter's Diamond Theory of National Advantage

Underscoring that countries compete in the international markets for market share on a global scale much like firms Porter (1990) theorized the Diamond theory of national advantage. This theory suggests that there are intrinsic reasons why countries are more competitive in a particular sector/product than others. It explains that factors in the home country of a firm help it to compete better on a global scale. Asides the traditional factors of land (and minerals), labour and location which are inherited, the theory recognizes factor conditions, demand conditions, related and supporting industries and firms strategy-structure-rivalry as instrumental to global competitiveness.

Factor Conditions: These are factors existing within the nation which can be exploited by firms within it. These conditions help firms to build secondary or advanced factors due to their presence. These factors may be tangible like raw materials and infrastructure or intangible such as climate, education, capital or skilled labour. While some factors are directly advantageous like the ones mentioned previously, others may appear disadvantageous. For example while skill shortages in itself may be problematic in the short run it may lead to improved efficiency and technological advancement that leads to competitive advantage (Smit, 2010).

Demand Conditions: A country whose local demand for a product/service is greater than foreign consumption will potentially improve to accommodate demand; becoming more production/delivery efficient than its foreign competitors. Local firms who export will attain global competitiveness. Local demand conditions are in this instance a driver of innovation and high quality. For example, the high local demand for quality electronics in Japan has led to a global competitiveness in the electronics sector by its indigenous firms. When ones local market sets the trend, it is easy to anticipate and meet global needs.

Related and Supporting Industries: A firm's source of competition along a supply chain is often its local suppliers and supporting industry players. As such if they are highly competitive and efficient, the firm can leverage on this cost efficiency and competitiveness to dominate its own space globally. If two firms A and B have the same internal cost of production but receive parts from 2 different suppliers. While supplier C is of quick to market, has parts that are higher quality and cost effective; that of D isn't. The firm who receives parts from C can come to the market quicker, sell a better quality product at a lower market price.

Firm strategy, structure and rivalry: Porter also identifies the internal characteristics of the firm like structure and processes as factors of competitiveness. Business managers exploit Porter's diamond, using it to analyze a firm's readiness to compete internationally. Google, Amazon, Facebook and Virgin Inc. are relatively new firms but among the quickest growing and valued. These firms are dynamic, made up of semi-autonomous teams, set up to leverage information, learn and scale opportunities up quickly. Their strategy, structure and competitiveness (especially in the Tech space) are unique yet similarly flat and agile. These firms have all successfully internationalized; leveraging the internet and millions of local partners around the world. This new and highly efficient business structure and intense rivalries help firms innovate and create global competitiveness (Rugman *et al*., 2012).

2.3 Free trade and the European single market

Free trade is an international trade policy born of an anti-protectionist ideology. It promotes a free market idea between nations, encouraging the removal of restrictions to imports and exports (Anderson & Yotov, 2016). It is a multilateral trade matrix with member nations of the WTO where certain concessions are traded on identified goods and services. Free trade is not absolute as agreements are not made to remove all fees and subsidies on all products and sectors. While global trade is not entirely free of tariff, certain countries allocate areas called free trade zones where goods sold are duty free. This tends to reduce the cost of production and is done to attract both sellers and buyers. Governments often designate free trade zones/duty free areas to encourage development of the regional/local economy. Free trade zones can be used to stimulate economic growth and reform as observed with China. From the Shenzhen special economic area to the Shanghai Pilot Free Trade Zone, the Chinese government has employed free trade areas to grow rapidly and then to accommodate the slower growth patterns of its trading partners (Yao & Whalley, 2016).

2.3.1 The European Union

Free trade can alternatively be created among groups of countries where they have made agreements to eliminate fees and border charges. They form a single open market which allows for the free movement of factors and products of production. The extent of the free trade agreement is contained in the binding agreement to which all the nations agree to. One of the most popular single market in existence is the European Union. It is a political and economic alliance of 28 member states majorly located in Europe. Coming into full effect in 1993 Maastricht treaty, the European Economic enabled the movement of capital, goods, services and labour within the Union free of tariff and extra taxes. The EU also legislates regionally on areas where the member states have agreed to have common ground. Periodically it adopts new members who are then allowed to enjoy the same trade benefits and be subject to common regulation (Wallace *et al*., 2015).

2.3.2 Trade benefits of the European Union

Common Commercial/Trade Policy: By delegating authority to the EU to negotiate third party trade relations, member states gain access to a large single market and are able to increase their bargaining power with the rest of the world trade. They are able to get more value and concessions as a bloc rather than when they traded individually. This is especially significant for the less economically developed members. Spain and Italy, much smaller members of the EU leverage this opportunity. Over 65% of Spain's exports are to EU member countries while 62% of their imports are similarly sourced (Wallace *et al*., 2015).

State Aid Control: The EU regulates the application of government intervention to home country business thus levelling the playing field for all member states. Government intervention in private enterprise has the potential to reduce production costs internally and enable such firms to outcompete the competition who do not have such luxuries. As the EU is a single market for all its members and for third party countries it is important to regulate government activities thus preventing disparity of prices (Cordewener, 2012).

Customs and Monetary Union: This enables the application of common external tariff on good and services entering the union. This means that as they travel within the market, additional duty, customs or taxes will not be applied. This ensures that there is no discriminatory pricing within the union. It also ensures that third party countries get a unified external tariff and as such preferential ports of entry based on import duty is discouraged (Cameron, 2010). Apart from 9 member states (UK inclusive) all other members of the EU adopted the Euro as a single currency. States who adopted the Euro are governed by monetary policy set by the European Central Bank (ECB). The single currency eliminates the bureaucracy, cost and risk involved in sourcing, stockpiling and trading in foreign currencies. The size of the common market also brings stability to pricing and reduces the potential for financial collapse of any one member State. The EU monetary framework is meant to oversee budgetary matters of the member states in a bid to maintain financial stability of the individuals as well as the collective (Rogers, 2007).

2.4 The United Kingdom: Motivation for Brexit

The existing literature on the United Kingdom often portrays it as a reluctant integrator with Europe, preferring to cooperate on some self-determined level. Right from the early formations of the EU precursors, the United Kingdom has often opposed integration as this would give up autonomy. Its refusal to join the Eurozone and buffet adoption of EU policy has also called into question its commitment to a fully integrated union. On the 23rd of June 2016, the Brexit referendum put this in new perspective as its results showed that the majority of its citizenry wanted to leave the EU. The autonomy of government decisions on touch points like immigration and employment, trade and EU financial contributions (Wallace *et al*., 2015).

2.4.1 Immigration and employment

The number of migrants entering the UK from outside and within the EU has dramatically increased since the mid-1990s. A large number of which migrated for better employment opportunities and comparably higher wages. In 2003, over thirty thousand work permits were issued to low, medium and highly migrant workers from within the Union. Majority however where for low skilled labour (Gilpin *et al*., 2006). The joining of the EU by 7 new members led to a rapid increase in inflow of migrants. UK along with a few EU15 members at the time granted the citizens from these – A8 countries rights to free movement and employment. This was an acceptable strategy to fill low wage employment shortages). Between May 1st 2004 and December 2005 approximately three hundred thousand A8 migrant workers had registered to work in the UK. Considering those who were in the UK illegally prior to EU admission, the figure could be much higher (Anderson *et al*., 2006. The 2008 global economic crisis and other more regional economic misfortunes encouraged a heavier flow of migrants from the EU and has stretched the UK job market. With fewer jobs and the lower local wages in the EU, many employers of non-skilled labour have exhibited a preference for EU migrant workers (Scott, 2013). This has understandably caused tension between UK employment stakeholders, EU migrant member states. From local industrial relations to various spectrums of the political environment, there have been calls to protect the rights of the local UK worker. The wave of populism in Europe has been discussed as a platform on which Brexit was made possible.

2.4.2 Trade and the economy

Critics of the United Kingdom's membership in the EU often point to trade restriction regulations as detrimental to local businesses. In principle, uniform trade tariffs and common pricing of exports eliminate the revenue from customs duties and trade taxes on European made goods. Since the EU is the UK's largest trading partner, there is a lost opportunity to trade with individual states at higher WTO prices. Similarly rights to establishment encourage migrant individuals and foreign business to set up cheaply in London, a hub of international trade and professional services (Dhingra *et al*., 2016). This has had a knock on effect on local property and service prices. Monetary contributions to the EU and allocation of these funds to improve infrastructure is also an economic concern. The UK is one of the largest contributors to the EU budget contributing in excess of £12 billion in 2017. In the same year the UK got about £4 Billion from the EU. In conjunction with the fact that some member states pay considerably less, receive markedly more, and others yet do not meet their obligations, commentators have questioned the rationale of this (Keep, 2018). Economic crises in Italy, Spain and Greece have received bailouts from the EU which they have not repaid. The UK government and opposition have previously publicly criticized this union where differences on socio-economic, political and security issues exist and appear to widen.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents a brief description of common research methodology concepts in general and social research. A brief overview of the various research philosophies is mentioned alongside the tools available to researchers in customizing research design. The specific design for this study and justification for choice of tools are also discussed. It is structured into four main sections. In sections one and two the general philosophy and methods of research are presented. While section three justifies research design, section four describes data collection and analysis.

3.2 Research philosophy

Research can generally be viewed as two broad philosophical frameworks. These are two world views through which researchers view the world and its constituent issues. These world views shape a researcher's approach, methods and choice of tools employed in achieving research goals (Collis and Hussey, 2009; Saunders *et al.* 2011). These two identified philosophies governing research are the interpretive and positivist philosophies.

- Positivist Philosophy.

The older of the two philosophies, the positivist philosophy is premised on the belief that truth is fact and can be distilled objectively from observing variables and constants. Adopters of this experimental world view criticize subjective reasoning and discount its findings as chaotic and not objective. They believe researchers should separate themselves from their subject so as to prevent bias during the research process. It is mainly championed in the pure sciences (Easterby-Smith et al., 2008). This world view presupposes the quantitative research method.

- Interpretive philosophy

Research based on this philosophy are hinged on the premise that truth cannot be objectively arrived at. Proponents of this world view believe truth is subjective and can only be constructed as the result of social interaction rather than scientific study. As such the truth is context specific and may vary based on the perspectives from which it is viewed (Collis and Hussey, 2009). The interpretive school of thought is more recent than its positivist counterpart and its supporters criticize scientific study to lack richness and depth of meaning (Easterby-Smith *et al*., 2008). This philosophy encourages the use of qualitative research method and tools.

There are others however who do not believe both perspectives should be treated in isolation but rather as extremes on a single continuum. In this way researchers may design research using hybrid principles and methods that leverage on the strengths of both philosophies while avoiding their weaknesses.

3.2.1 Research methods

The type of information a researcher wants to collect and how it is to be collected is dependent on the dominant world view of the researcher as mentioned in the previous section. Methods of collection may either be quantitative or qualitative. Quantitative methods are usually employed in the collection of numerical data for onward collation and rationalization using statistical formulae. This method is mainly characteristic of objective research where variables and constants have been identified and operationalized i.e. in the pure sciences. It is however possible to apply them in social research after appropriate rationalization and modifications where necessary.

Qualitative methods on the other hand are used to collect subjective information such as words and behaviour that can intimate the researcher on the opinion of the subject population on a specific matter; in a specific context. Usually traditional to social research it can be employed to investigate issues with a level of objectivity. While the quantitative methods encourage cross sectional research with snapshot data collection; the latter is more longitudinal, requiring a longer period of time. Quantitative data is also easy to collate and analyze while qualitative methods are more difficult requiring transcription and methodical interpretation. This is comparatively more difficult to achieve. The choice of methods to influence research design ultimately rests on the researcher, the objectives of research and resources at her/his disposal.

A mixed methodology perspective in line with the world view of the world as a continuum mentioned in section 3.1 validates the employment of hybrid research methods where both quantitative and qualitative elements may be incorporated into a single study.

3.3 Research design

This research adopts a mainly interpretive stance to research; viewing the issues through a subjective lens and basing conclusions on the merit of individual opinions. As the events in itself i.e. Brexit is yet to occur, the study is speculative, dissecting individual opinion of researchers in search of emergent themes on which to understand the research questions. As there is little existing knowledge about an actual hard Brexit, the need for induction is paramount, hence informing research design choice. (Collis & Hussey, 2013). As the research area is within the sphere of speculative knowledge, an interpretive study was designed (Easterby-Smith, Thorpe & Jackson, 2012). Analysis was performed on individual and collective opinion on the impact on UK financial institutions in the context of a no-deal exit. Sources were identified, classified and analyzed. Investigation centered on the significance of a hard Brexit and the nature of influence on revenue generation and fate of foreign banks in the UK. This research adopts a qualitative research method, collecting and analyzing non numeric data for emergent themes. This information is then grouped and presented for further discussion.

3.4 Method of information collection

The absence of current data on the effects of Brexit on any sector there is no source of primary data. Secondary research data was obtained from academic articles on the general subject of Brexit's impact on financial services and the larger effects on the European economic landscape. Journal articles within the last decade were selected for the study. Points of convergence and divergence on the impact of a hard Brexit were reviewed and classified on the basis of their similarities. The resultant opinion groups were then discussed in the context of the research framework.

3.5 Ethical consideration

In conducting the research it is good practice to consider the ethical aspects of conducting a study. These include the sources of the data, stakeholders affected the findings, and how information is presented, stored and eventually discarded. In research where primary data is collected, concerns of access, informed consent and anonymity are critical. In this case where the research concern is speculative and information sourcing was secondary; these concerns o not exist. Care was however taken to cite the academic writings from where the concepts, theories and empirical data were collected.

CHAPTER FOUR: PRESENTATION AND DISCUSSION

4.1 Introduction

In this chapter the journal articles selected are presented, analyzed and findings discussed in the context of the research questions and within the framework of earlier reviewed literature. Section 4.2 presents the impact of a no-deal Brexit on the revenue generation of UK financial institutions. While section 4.3 analyzes its impact on foreign financial institutions domiciled in the UK, section 4.4 presents options for local banks post-Brexit.

These findings are then discussed in the context of the framework in the earlier reviewed literature; highlighting the consequences for the UK, EU and non-EU member states.

4.2 Impact of a hard Brexit on revenue generation for UK financial institutions

4.2.1 Capital and equity

As the largest hub of financial services on the continent; the United Kingdom is the choice location through which the bulk of European capital is invested. The rights to free capital flow and establishment have encouraged large inflows of capital from EU and EU partner investors. Shareholders and directors of firms need to plan long term and react strategically to government policy changes and environmental instability (Brogaard & Detzel, 2015). In this context, a no-deal Brexit would signify a long period of uncertainty and high risk. Pastor& Veronesi (2012) associate such large uncertainty with a corresponding drop in share prices. According to Tielmann & Schiereck (2016) and Schierek *et al*. (2016) the news of 'leave' outcome led to Brexit had effects for UK banks and logistics companies. A loss of bank Passporting will prevent international banks domiciled in the UK from conducting business easily in all member states. This restriction could further compromise the flow of capital coming through UK banks as seamless access to EU member country investments opportunities will be restricted. Not only is there a possibility to lose capital streaming in from the EU; capital from the rest of the world, destined for Europe will be diverted away from London.

Similarly the UK banks will not have access to relatively low cost and long term equity based on the common commercial policy agreement. It is estimated that UK banks have current pension liability figures of over 9 billion. In the event of a no-deal Brexit, the cost of these funds will rise drastically as the UK will be outside the union. Brogaard & Detzel (2015) highlight that once the political and economic uncertainty resolves the stock prices should rebound. If the uncertainty in the relationship between the UK and EU post-Brexit continues. There will be mid to long term pressure on bank stock as investors move their funds to more stable markets. International and UK banks will lose their rights to operate 27 country offices in Europe. They would automatically lose the capital inflow from them (Armour, 2017). Table 4.1 below shows the EU financial commitment in the UK as at 2015.

According to Harris *et al.* (2012) Brexit will have an indirect impact on private equity fund raising in the UK. The limited shelf life of private equity means that new funds have to be generated continuously. This ability will be negatively affected by a shortage of capital inflow. Wright *et al.* (2016) highlights the option of private equity firms to relocate offshore in order to retain access to European funds. Along with their offices they have already started moving assets in order to satisfy EU regulation for continued operation. This leads to losses of local jobs and capital (Wright *et al*., 2016). If it were to be a soft Brexit, the UK might have been able to negotiate some privileges for its financial institutions in EU countries. Non EU members who belong to the European Economic Area (EEA) enjoy Passporting rights but are obligated to contribute to the EU budget and allow free mobility. This clause is especially unacceptable by the UK negotiators and has led to the stalemate warranting a hard exit (Keep, 2018). Alternatively, the UK may establish access to choice European locations through special bilateral treaties with the EU or individual members (City of London, 2013). These are however based on the assumption that the EEA of EU will permit such relationship.

Table 4.1: EU component of UK financial service sector in £ billion (Armour, 2017)

Sector	Banking	Asset Management	Insurance	Market Infrastructure	Total
Intra EU revenue	27	6	5	12	50
Total revenue	117	23	42	26	208

Insurance may not be hit as badly as the banking and market infrastructure sectors. Insurance legislation at the EU level has a less stringent third country equivalence framework. As such it will be easier for UK insurance companies to retain EU member states (Armour, 2017). While it does not provision for third country firms to provide insurance; it makes provision for reinsurance. Since the insurance industry mostly operates through subsidiaries; loss of Passporting rights will not necessarily lead to loss of international business.

4.2.2 Transaction costs, collections and other service charges

Without the rights to free flow of capital and digital transactions; the cost of operations for UK banks in the EU is bound to increase. Previously feeless transactions encouraged by the single market will no longer be the case. Over the counter instruments; digital transfers; withdrawals and deposits in the retail banking operations will attract charges which increases operational cost, Removal of interchange fee regulations post-Brexit will see UK banks being charged higher when their services are used in the EU. These charges could range from product to product such as transfer and debit and credit card charges (Wright *et al*., 2016). Increased cross border taxes and duties will also increase the cost of freight. These cost increases along the service supply chain may be passed to the customer. This may lead to changes in retail consumer shopping behavior and /or reduction in bank margins from such services.

With the predicted lull in FDI, capital flight and relocation of EU banks and businesses financial transactions are predicted to fall considerably. There will be loss of direct revenue in the form of transaction service charges as well as access to liquidity with which to perform financial intermediary duties. Hence there will be reduction in demand deposit charges as well as revenue from interest bearing loans. If access to funds is disrupted like discussed in the earlier section; increased interest rates may further discourage lending.

4.3 The effects of a no-deal Brexit on foreign financial institutions' operations in the United Kingdom

4.3.1 Closure of UK operations

The loss of Passporting rights will have an immediate effect on EU bank operations in the UK. They will lose their right to establishment and with it the access to international financial services resident in the United Kingdom. The large presence of American banks in London signify its importance as a financial service partner. Similar long standing agreements with large Asian partners like India and South Africa who prefer to operate through London will be immediately out of reach of EU. The time and effort in negotiating with these parties would cost the EU billions of dollars in trade and revenue (Miedi & Pothier, 2016).

Third country parties who also desire to gain access to the UK or EU single market will also face difficulties post-Brexit. Those established outside the UK having lost their Passporting rights in the UK will either have to exit or renegotiate with the UK. Those head quartered in the UK as a channel to the EU would have negotiate with the EU separately (Schoenmaker, 2017).

4.3.2 Loss of financial contribution for EU financial institutions.

As a member of the EU the UK makes payment contributions to the European Union budget. Like every other member the UK contributes to the EU budget through three sources. These are through collection of EU custom tariffs and levies; VAT contributions as well as a percentage of its Gross National Income (GNI) (Armour, 2017).

Table 4.2: UK net contribution to the EU in £ millions (Armour, 2017)

	2012	2013	2014	2015	2016	2017
UK contributions to the EU						
Customs duties and levies	2,202	2,180	2,238	2,325	2,463	3,172
VAT contributions	2,279	2,344	2,388	2,661	2,677	3,040
GNI contribution	11,362	13,497	12,521	14,003	11,856	12,154
VAT & GNI adjustments	-98	114	1,631	571	-	258
Contributions	15,745	18,135	18,778	19,560	16,996	18,624
UK rebate	*-3,110*	*-3,674*	*-4,416*	*-4,914*	*-3,878*	*-5,633*
Gross contributions (after rebate)	12,636	14,461	14,362	14,646	13,118	12,993
Total Public Sector Receipts	4,169	3,996	4,583	3,883	3,492	4,084
Net Contribution	**8,467**	**10,465**	**9,779**	**10,763**	**9,626**	**8,909**

While the UK has been consistently in the top bracket in terms of contribution it has received comparatively among the least from EU spending.

From the table 4.2 above it can be observed that the UK has received an average of £2 billion on average between 2012 and 2017 on behalf of the EU. Similarly, the EU will lose the VAT contributions from the United Kingdom. The agreement reached by the EU and UK commonly called the divorce bill shows the UK will still pay a number of fees pre-and post-Brexit. This is evidence of the financial benefits the EU has received from the union (Armour, 2017).

4.3.3 Increased transaction cost

In order to gain access to the UK's financial hub, individual countries would have to negotiate bilateral trade agreements or wait for a favourable EU-UK agreement. In the absence of this the movement of goods and services through the UK to the rest of Europe will incur higher transaction costs. With over 60% of EU financial transactions routing through the UK, the cost implications for EU financial institutions will be astronomical without a deal (Schoenmaker, 2017). Similarly services from the UK will come at extra cost potentially serving as a source of revenue for the UK post-Brexit.

4.4 Navigating a no-deal Brexit

4.4.1 Expansion of bilateral trade profile with third party countries

The UK has a number of former colonies and potential third party countries to which it can push its surplus goods and service exports. This in theory will generate addition revenue and financial transaction fees and levies. This will also present opportunities to negotiate importation costs and fees for goods and services without EU regulatory control. The UK will be able to reap premium prices from individual emerging economies. Increase in trade with the BRICs nations, a large, potentially lucrative market for the UK financial institutions. Facilitating transactions between the 5 fastest growing economies and access to investment from these emerging markets can help reduce the shock from a no-deal Brexit. Trading in their international stock and derivatives through London will also give access to other equity funds. Government officials are currently working tirelessly to secure some of these bilateral agreements in the event of a no-deal exit (Schiereck *et al*., 2016).

China's aggressive expansion into Europe, South and Central America, Asia and Africa threaten the feasibility of this. As a much larger economy with raw materials and large government participation business; China has the ability to undermine these bilateral trade efforts, offering and accepting lower interest and higher import tariffs respectively. Without its larger EU bloc, the UK is at a negotiating disadvantage to the larger Western and Eastern trade giants (Tull, 2006).

4.4.2 Leverage European Economic Area (EEA) membership

The EEA agreement of 1992 is an international agreement that extends (parts of) the EU Single market to non-EU countries. It has been commonly suggested that the UK gain EEA membership status and through this means gain access to select sectors of the single EU market. The UK could alongside Norway, Liechtenstein and Iceland enjoy some of the same rules as EU members. In order to partake the UK would have to join the

Economic Free Trade Association (Geiger *et al*., 2015). Admission into the EEA however requires ratification by the members. Therefore there needs to be a tripartite agreement between the UK, EU and EFTA on EAA membership. Ultimately, controlled access to choice sectors of the single market and customs union will greatly improve their economic outlook. The assumption of a no-deal Brexit makes the scenario unlikely. Members of the EAA are subject to the allowance of free movement of capital, people, goods and services. Critical differences in immigration reform and EU economic regulation have kept the EU and UK government leadership from reaching a deal.

4.4.3 Provisioning for financial institutions

It may be necessary for the government to give the Bank of England intervention powers and tools to absorb any large financial shocks to the economy. The 2008 financial crisis and its link to the failing US mortgage bonds showed how vulnerable banks were and how quickly it could become global. It is therefore in the best interest for international banks to make provisions against the risk. Large scale investment capital exit could from UK banks could in principle lead to liquidity and operational issues. Moody's has however rated the UK banking sector as healthy and stable enough to absorb projected economic shock.

4.5 Discussion

4.5.1 Implications for revenue generation

London could lose its position as the biggest exchange of financial assets and liabilities due to the uncertainty of a no-deal Brexit. Drops in bank shares and depreciation of the Sterling following the referendum results indicates how quickly months of financial gain can be lost in minutes. Loss of rights to establish and free movement of capital will hurt both the UK and EU economies. Loss of UK GNI contributions equally reduce the EU budget and future spending. Without the efficient collections systems in the UK a large portion of VAT collections will be disrupted and expensive to resolve.

A drop in UK banks transactions would mean the growth of competitor banks in New York and Beijing. This reduces the global market share of the financial markets held by UK banks. Capital flight outside the EU and UK also provides opportunities for emerging economies to grow their international trade portfolio. Negotiating trade deals to leverage both partner's comparative advantage could lead to GDP growth for both the UK and the third country. Stiffer competition among nation states for scarce resources could lead to better efficiency among countries trading in similar products (Rugman *et al*., 2012)

4.5.2 Implications for globalization, migration and employment

The threat to the freedom of movement of people in a hard Brexit should be a point of concern for both parties. The rights to establish and reside in an EU-member state other than that of your origin gave people and small businesses the ability to expand across Europe without the prohibit cost. Higher cost of entry would limit the number foreign small businesses that contribute to the GDP (Camillo *et al*., 2014).

The travel/resident status of millions of Europeans instantly become uncertain once the UK leaves as is. Students, pensioners, migrants and expatriates in the UK become illegal and in breach of Visa conditions. With the current skill shortages in the UK, deportation of EU workers will lead to renewed labour shortages and higher cost (Sumption, 2017). Under current conditions third country states are required to apply expressly for work permits. Legislation is also in place to limit the number of hours students can work. A no-deal Brexit would require students from EU-member states to make paid applications for Visas and work permits. While the UK could enjoy short term revenue boosts due to demand for UK education, the fate of its citizens living in the EU makes resolution equally urgent.

4.4.3 Implications for Brexit negotiations

The proposed consequences of a no-deal Brexit for both the UK and the EU financial institutions makes it increasingly difficult to consider a hard Brexit. The potential loss of access to the single market by the former and Passporting rights to London by the latter motivates that negotiations remain ongoing. Taking this perspective contextualizes the potential loss of intra-EU and third country business due to self-inflicted market uncertainty. Compromises on immigration by the EU and flexibility of form by the UK will greatly improve chances of a deal.

The UK attempt to negotiate individual trade agreements will restrict it to small markets with limited capacity. The access to a single market with a large enough demand appears to put the UK in a weaker negotiating position. The level of EU imports to the UK however suggests a reciprocal need for a workable agreement

CHAPTER FIVE: CONCLUSION AND PROPOSALS

5.1 Introduction

This is the concluding chapter of the study and is structured into three main sections. Section 5.2 briefly summarises the findings of research. This is followed by sections 5.3 which highlights the possible implications for stakeholders and makes recommendations. Section 5.4 discusses the limitations of the study and suggestions for further research.

5.2 Summary of findings

The study revealed that a large portion of the UK economy is dependent on its financial service industry. A hard Brexit will lead to immediate financial losses in share value as well as more long term damage. There is common consensus that exit from the single EU market will restrict capital and equity fund raising. Capital flight of third-country nations from the UK will deprive banks of much needed business. It was also shown that the EU would lose a very important trade and financial partner as access to the London Stock

Exchange will become restricted. The cost of exports into both the EU and UK and logistics disruption will arise due to the loss of rights to free movement of goods, services and people. The loss of UK GNI and VAT contributions will significantly impact the EU budget and future spending.

5.3 Conclusion

The high level of co-dependence between the EU and the UK; as well as the importance of the relationship to the rest of the world suggest that a sustained, purely no-deal Brexit is unrealistic. Post-Brexit scenarios suggested by leading academics all show the need of some form of negotiated symbiosis. Accepting the UK as an EEA member; Negotiating a new bilateral trade agreement with the EU and seeking third-country equivalence will need the cooperation of the EU as either ally or competition. The EU could do with some financial compensation from the UK to access its single market. In order to arrive at a deal however, compromises have to be made. The EU would have to make concessions to its economic regulations and single market access policy while the UK would have to be flexible on immigration reform. With this foresight, it is imperative that the stakeholders take action to prevent the initial loss and disruption of a no-deal Brexit

Proposals

- Both parties should avoid a hard Brexit, looking to resolve uncertainty around Passporting rights for banks and other financial institutions
- The UK should negotiate access to the EU single market and Customs union
- The EU should place demand financial compensation/contribution for granting this access
- The EU and UK should work to resolve differences around immigration. Mutually agreeable policy enabling, monitoring and sometimes restricting freedom of people to work should be looked into.

- The EU should clarify third –country equivalence status for banking institutions. With the uncertainty currently round Passporting rights, this may be an avenue to allow banks continue to operate in both the UK and EU.

5.4 Limitations of research and suggestions for future work

The concluded study was conducted on an event yet to occur and as such was secondary research carried out using academic the academic opinion of others. While these opinions are based on established theory, historical data and occurrences post-referendum; it is instructive to consider that no nation has ever left the EU so there are no precursors. Based on this the findings of this study cannot be generalised. The foreign policy intentions of countries outside Europe and their reaction to both post-Brexit UK and Europe may not be accurately predicted. Proceeding from the notion that every nation state is competitive and in economic rivalry; it is assumed that third-countries will enter bilateral agreements beneficial to them.

Future studies could take a longitudinal approach to interpretive research; collecting primary data from stakeholders in financial institutions on their opinion of the impact of Brexit. It would be interesting to investigate how the UK will eventually access the single EU market; the concessions they will have to make and the long term effects on their economy. Alternatively, investigations may focus on financial institutions in small EU member states and how a no-deal Brexit affects their operations. Further studies may equally focus on how Brexit eventually affects consumers of retail banking products in order to understand its effects on a microeconomic scale.

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