

FINANCIAL MARKETS – A CHALLENGE FOR IMP?

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Abstract

Financial marketplaces are extremely complex networks of organizations characterized by eight features. While some of these features exist in non-financial markets it is arguably only in financial markets that all eight are found together. If financial markets are distinguished by the simultaneous presence of these eight features then it is necessary to consider whether and how the IMP model is applicable to them? Does it ‘fit’ or does it need extending? In considering this question the following matters will be addressed. First, how applicable is IMP thinking to services? Second, how can the existence of ‘stars’ be incorporated into IMP thinking? Answering these two questions will require examination of the IMP’s concepts of ‘actors’ and ‘resources’. Third, does the IMP model take adequate account of the systemic nature of financial markets?

Keywords: financial markets; actors; resources; interaction

INTRODUCTION

Modern financial markets are, by any measure, of major importance to the smooth running of modern economies. They are responsible for providing the finance needed for economic growth both domestically and internationally and in many countries are significant employers. These markets are based on extensive networks of institutions and individuals within which a wide variety of interactions and relationships operate. As such, understanding these markets is both interesting and important. Given its success in analysing industrial markets, this paper considers the usefulness of the IMP ‘model’ when applied to financial markets. It first identifies the distinctive features of financial markets and then considers whether the concepts of ‘actor’; ‘resource’ and ‘interaction’ as set out in the IMP ‘model’ need development if they are to be applicable to financial markets.

MODERN FINANCIAL MARKETS¹

The modern financial marketplace is an extremely complex network of organizations characterized by eight distinctive features. While some of these features exist in non-financial markets (examples being given in Table 1) arguably, it is *only* in financial markets that all eight are found together.

- Insert Table 1 about here -

First, behind the 'visible' activity in financial markets is an intricate web of business-to-business exchanges. For example, the so-called 'ABACUS transaction', which was at the centre of a case which the SEC pursued against Goldman Sachs, is represented in Figure 1.

- Insert Figure 1 about here -

Yet, although ABACUS "sat at the heart of a web of very complex transactions" (Davidoff et al., 2012, p.539), in the opinion of experts, it "was not particularly innovative, and its execution was not unusual." (Davidoff et al. 2012, p.531)! ABACUS involved not only several organizations based in a number of different countries but also a variety of different types of financial instruments (Guerrera et al. 2010). ABACUS was comprise relatively small sums of money² but was one example of the convoluted nature of financial markets which led *The Economist*, when reflecting on the 2008 financial crash, to comment that: the "the complex interconnections of securitised finance meant that no one understood what assets were worth or who owed what." (2013a, p.16) Although the supply chains that lie behind the manufacture of many modern products are often complex, there can be few to which a similar comment might be applied.

Second, within this web of exchanges the interdependencies are systemic in that events at one point in the network impact on the integrity of the system as a whole. Financial systems only 'work' because it is assumed that all parties behave in a trustworthy and prudent manner. Indeed financial markets cannot operate without trust because with regard to some elements of a financial exchange "complete, fully contingent, costlessly enforceable contracts are not possible" (Klein 1980, p.356). There are two reasons for this. First, many possible contingencies exist and it may be costly or impracticable to specify responses to all of them. Second, transaction costs such as: unforeseen contingencies; the cost of writing contracts; the cost of enforcing contracts; and, the cost of renegotiating contracts (Tirole 1999) may make it very expensive or effectively impossible to measure some types of performance. These non-verifiable elements would include tacit and credence factors (Darby and Karni 1973) which are those that cannot, when starting a relationship, during it or after it, be specified in terms which are subject to objective evaluation and they have to be taken 'on trust' (Blois 1999). Indeed "Markets could not work without non-calculative trust" (Nooteboom 2004, p.508) and a complete lack of trust would prevent a party from entering into any exchange because, without it, endless safeguards would be sought.

Any loss of trust in the reliability, in terms of it honouring its commitments, of any one element in the financial system rapidly infects the strength of the whole system. This was illustrated when in 2008 the financial stability of Deutsche Industriebank AG (a medium sized German bank which specialized in lending to small and medium-sized companies) was financially threatened by the growing number of individual American citizens defaulting on their mortgage payments (Tett 2009, pp.204-9). It is even the case that individual financial firms have been described as "systemically important financial Institutions" (The Economist 2013b, p.69). However, the systemic nature of financial markets is not found in manufacturing. For example Boeing's recent problems with a battery on its 'dream liner',

although raising concerns about the plane's safety, did not call into question the safety or integrity of any other part of the plane (Fontevicchia 2013, p.5).

Third, this is a global network. The Deutsche Industriebank AG example above can be replicated many times to show how the collapse of the American mortgage market impinged on the financial stability of many other banks inside and outside the USA including large organizations such as the Dutch bank ABN AMRO. A more complex example is that in September 2008 Barclays Bank acquired the core business of, by then bankrupt, Lehman Brothers for about \$1.35 billion. Yet only two months later in November 2008, Barclays needed a large (£7 billion) injection of cash which it could only obtain from investors in Abu Dhabi and Qatar (Jeffery 2013). There are of course many producers of goods and services which rely on suppliers from all around the world, but the distinctive feature of global financial markets is that suppliers of finance can be switched literally overnight. In the case of the supply of manufactured goods problems in one geographical market cannot be so easily overcome, as was illustrated by the disruption to the supply of electronic components following the serious floods in Thailand in 2011³.

Fourth, most financial institutions are both lenders and borrowers and, as such, act as a conduit of funds and, as Brunnermeier observed: "Modern financial architecture consists of an interwoven network of financial obligations." (2009, p.96) At its simplest an organization (say, a bank) accepts a deposit from one client which it then lends (in whole or part) to one or more third parties. Thus part of a financial institution's role is to act as a middleman and as such their role is exactly that of a wholesaler as classically set out by Alderson (1954). However, a distinctive feature of financial 'middlemen' is the impact of their reputation on the transactions. For example a depositor will expect to receive a higher rate of return if the deposit taker's reputation or credibility is not robust⁴. Thus the intermediary's reputation impacts on the nature of the product (finance) being handled. That is a million euros deposited with institution A is not identical to a million euros deposited with institution B. With physical products, except in the case of items whose physical surroundings strongly affect their condition, a 1,000 units of a product from wholesaler A is no different than a 1,000 units of a product with identical physical specifications from wholesaler B – though elements of the marketing mix other than the physical specification, such as price and delivery, may differ between the two wholesalers.

Fifth, an organization's ability to obtain finance is often dependent upon a third party providing assurances of the quality of the securities being offered as collateral (Morrison and Wilhelm 2007). Indeed a crucial role of the recognized credit rating agencies, such as Moodies and Standard and Poor, arises from the fact that the SEC restricts money market funds to purchasing "securities that have received credit ratings ... in one of the two highest short-term rating categories or comparable unrated securities" (Donohue 2008) and the US Department of Labor restricts pension fund investments to securities rated A or higher (The Financial Crisis Inquiry Commission 2011). While there are some markets for manufactured goods where third party validation is either specifically required or beneficial these are not common. It is for example difficult in the UK to get insurance against the costs of an accident involving an industrial boiler unless the boiler has been regularly checked by a specialist third party.

Sixth, there are firms whose function is not to manage funds themselves but only to design and market financial instruments for other organizations to use. Thus a significant financial consultancy claims to provide "leading financial institutions with custom solutions covering

all aspects of risk management, including its application to financial management.” (Oliver Wyman 2013). Given the complexity of many modern financial products, the willingness of organizations in financial markets to utilize such products is dependent upon the reputation of organizations like Oliver Wyman for producing products which meet the requirements of the regulators and the tax authorities. Within the manufacturing sector there are similarly organizations which develop and sell product concepts and, although their reputations are also important to their potential customers, in general their customers are better able to assess and test⁵ the capabilities of the products they are offered than is the case in the financial markets.

Seventh, there are ‘Stars’ - that is small numbers of people who “earn enormous amounts of money and dominate the activities in which they engage” (Rosen 1981, p.845) - whose standing is so significant that, even where the organization that employs them is highly regarded, clients will not proceed with transactions without the involvement of these individuals. As Macey commented about Wall Street firms, “personal reputation has replaced firm reputation as the relevant point of reference” (2013, p.91). The reputation that Stars have for making above average returns on investors’ funds acts as a magnet to investors who demonstrate great trust in these ‘Stars’ by either investing their money in funds that the Star manages or allowing the ‘Star’ to determine where their money should be invested. An example of this is that, when Neil Woodford left Invesco (an investment company), one of Invesco’s corporate clients removed £8 billion from Invesco and invested half of it with Woodford Investment Management - a company which Mr. Woodford had just created. (*The Independent* 2014, p.57). ‘Stars’ are influential in other sectors of the service sector (e.g. advertising; law; fashion; design) but are much less evident within the manufacturing sector. For example, until he died, the name of Brian Sollitt, the creator of *After Eights*, *Yorkies*, *Matchmakers*, *Lion Bars* and other major confectionary products, was unknown⁶ outside the Rowntree Confectionary Company where he worked for the whole of his 53 years career.

Eighth, is the importance of financial transactions’ tacit elements. As Davidoff et al. point out: “Tacit contracts of this type (viz. bilateral tacit contracts) abound in finance.” (2012, p.548) yet “typically outsiders are unable to verify whether contractual obligations have been met.” (Brown et al. 2004, p.747). Indeed financial trading relationships are “riddled with informal agreements and unwritten codes of conduct” (Brown et al. 2004, p.747). Although tacit elements are often used to augment manufactured products (Blois 1991) generally the objective evaluation of the product’s core value proposition is possible through examination of its technical specifications.

Arguably the simultaneous presence of these eight features distinguishes financial markets from most service and manufacturing markets though, as has been suggested above (see also Table I), some markets manifest a number of these features but three features: products’ significant tacit elements; systemic interdependence; and, the role of ‘Stars’ are seldom met outside financial markets. If the above assertion is correct then it may be the case that the models used to analyse B2B markets need some adaptation if they are to be applicable to financial markets. In particular it has to be suggested that the IMP model may currently not ‘cope’ with financial markets because of the difficulties in incorporating these features into it.

FINANCIAL MARKETS AND THE IMP MODEL

In considering the question ‘Does the IMP model ‘fit’ financial markets or does it need extending in some way?’ the following matters will be addressed. First, how applicable is

IMP thinking, which originated in industrial markets, to a service such as finance? Second, how can the existence of ‘Stars’ be incorporated into IMP thinking? Answering this question will require examination of IMP’s concepts of ‘actors’ and ‘resources’. Third, can the concept of the systemic interdependence of financial markets be taken account of by IMP?

Services in the IMP Model

The title of the first book (1982) to be produced by the IMP Group was: “International Marketing and Purchasing of *Industrial*⁷ Goods: An Interaction Approach” which makes it clear that the IMP model was originally developed in the context of ‘industrial marketing’. As the IMP model has become more widely known and appreciated, it has often been cited and sometimes used in research conducted outside of the context of industrial/business marketing⁸. However, the extent to which the model is applicable outside the field of industrial/business marketing has been questioned. For example, Axelsson – one of the “most senior IMP researchers” (Hakansson 2010, p.1) - in a paper that “provides a reflective view of some of the developments of the IMP - orientated research” (Axelsson 2010, p.3) commented that: “IMP research had its origin in manufacturing industries. The industry totally dominated the early studies and probably the models and concepts developed as well.” (2010, p.25). Indeed he reports that his students have noted that the IMP interaction model appears to be “old-fashioned, as most applications still seem to be from manufacturing industries.” (Axelsson 2010, p.8). Interestingly while Axelsson in an earlier paper (with Wynstra and van der Val) on B2B service marketing says that: “Some researchers have used the IMP approach in studies of business services (e.g. Eriksson and Lofmarck-Vaghult 2000; Eriksson et al. 1999; Eriksson and Mattsson 2002; Leek et al. 2004).” (Wynstra et al. 2006, p.476), in fact Wynstra et al (2006) pass almost no comment on the role of IMP.

Arguably what is important in the context of financial markets is not whether or not the IMP model can encompass services but whether or not the model ‘works’ in cases where a product’s tacit elements are dominant. A customer’s acceptance of the value of a product with dominant tacit elements will be based on trust in the actor offering that product. In financial markets ‘Stars’ are perceived by customers as offering products in which they can have confidence⁹.

‘Stars’ – Actors and/or Resources?

The actor in the IMP model. In retrospect it is perhaps unfortunate that the term ‘actor’ was used to label this component of the IMP model because, in everyday use, it is a term generally associated with an individual. However, the IMP model has most usually explicitly or implicitly taken the actor to be ‘a company’. Thus Axelsson comments that: “The actor level has often considered actors as *companies*⁷” (2010, p.26) and Ford et al. state: “The paper interprets business interaction as a process that occurs between specific *companies*⁷ and which changes and transforms aspects of the resources and activities of the *companies*⁷ involved in it and the *companies*⁷ themselves.” (2010, p.82). However, the use of the term ‘actor’ by some IMPer’s is not consistent with this interpretation and later in the same paper Ford et al. comment that: “Throughout this paper we use the term business actor to refer without distinction to companies, subgroups or individuals.” (Ford et al. 2010, p.96 fn.12) Furthermore, Axelsson comments that “Actors could be firms or individuals as well as units in a firm.” (2010, p.13) Yet treating individual sub-components of a company in the same way as the company itself would appear to ignore the evidence that, for example, the behaviours of boundary spanning individuals may not be consistent with their

company's policies (see, for example, Humphrey and Ashforth 2000; Ingram and Roberts 2000; Blois and Ryan 2012).

One of the difficulties of much B2B research (and not just that of IMP) is its tendency to use "the easy analogy from individual to institutional issues that abstracts from institutional constraints" (Hardin 1993, p. 511). Yet, if it is accepted that: "The dynamics of authority are distinctive with respect to individuals and institutions. That is, the reasons why people obey an individual are different than the reasons why an organization is obeyed" (Koppell 2008, p.180), then the simple substitution of measures of individuals' behaviours for that of their employing organizations is questionable. Indeed Axelsson appears to be sympathetic to the need to separately recognize the role of individuals in interactions when he suggests that the IMP interaction model: "should be complemented by a fourth layer, namely individuals' acting, interpreting processes in networks" (2010, p.24). In making this statement Axelsson mirrors the interest expressed by Strategy researchers for "a shift in the strategy debate towards a micro perspective on strategy and strategizing." (Johnson et al. 2003, p.3).

Thus because the IMP model does not clearly distinguish what an actor is, the concept of 'Stars' does not necessarily fit well into the IMP model. However it may be that the existence of 'Stars' not only supports the view that: "It seems as if both the interaction and the ARA models would benefit from bringing in the dynamism and the interpretative individual as actor in new and improved ways." (Axelsson 2010, p.29) but also leads to questions about a second component of the ARA approach utilised by IMPer's namely the 'resource'.

Resources in the IMP model. The IMP literature does not appear to define 'resources'. However, such a position is far from unique for, as Srivastava et al. pointed out, there is in the marketing literature an "absence of any generally accepted delineation and classification of resources" (2001, p.779) Indeed, with some exceptions (e.g. Ulaga and Reinartz 2011, p.6), the literature does not clearly distinguish between: resources; assets; and, capabilities. However, Barney et al, in a paper reviewing the status of the resource-based view of the firm, state that: "resources and capabilities can be viewed as bundles of tangible and intangible assets, including a firm's management skills, its organizational processes and routines and the information and knowledge it controls." (2001, p.625).

Barney argues that, to provide the basis on which a firm may create a competitive advantage, a resource must be: rare; imperfectly imitable; and, not substitutable by other resources (Barney 1991, p.117) which are criteria that 'Stars' fulfill. However, a distinctive feature of 'Stars' is their mobility in the sense of their ability to leave their employer and possibly join, or even set-up, a competitive organization. In comparison a firm's physical resources are not mobile and even its intangible resources such as its reputation are more embedded in the firm itself than is a 'Star' whose presence in a firm will determine whether or not the firm can retain a customer.

Stars as actors and resources. In financial markets many customers interact with a firm only because it employs a 'Star'. Yet, no matter how significant the Star is, the interaction will not be totally dependent on the Star because customers will also need the reassurance that the Star's employer is administratively competent and, in particular, meets relevant Regulatory (particularly fiduciary) standards. Thus, while the Star may, because it is the actor's most significant - indeed critically important - resource, be perceived as in essence being *the* actor it is not the actor as complete entity. Furthermore, because of its mobility, a Star has the capability of leaving its employer and by doing so to completely change the interaction of the

actor which employs them with others in its network. A Star thus has the distinctive potential of transforming the actor by: a/ by depleting the actor's resources; and b/ changing the essence of the actor's interaction with others in its network. It would seem therefore that 'Stars' are neither 'actors' *or* 'resources' but are simultaneously 'actors *and* resources'.

The Interaction

The concept of 'interaction' is central to IMP whose position is that "business actors, activities, resources are not simply the result of individual company strategy but are equally the outcome of specific interaction processes" (Ford et al. 2010, p.98). The interactions which occur between organizations can be categorized under many heads. For example, some interactions are very long-standing but with relatively infrequent exchanges of goods or services or even contact, such as may occur in the capital goods industries, but such a relationship may have a 'depth' created by the need for close mutual appreciation of technical knowledge. Other interactions, while equally long-standing, may involve almost daily contact and movements of products - such as occurs in the supply of car components. Interestingly several of the early studies by IMPers sought to "establish how the interaction will differ when we vary the situation variables." (Håkansson and Ostberg 1975, p.118) and "to find descriptive variables appropriate to increase our understanding of industrial markets." (Håkansson et al. 1977, p.319).

However, the nature of the interdependence which exists in financial markets is arguably an additional dimension against which an interaction should be judged. These interactions are systemic in that events at one point in the network impact the integrity of the system as a whole in three ways. There is first the direct impact whereby a default by one institution immediately impacts on all other institutions who have in any way invested money in it. For example, once the US mortgage market collapsed in 2007, banks which had bought mortgage based CDS's¹¹ found that that they were of little value. Depending on what proportion of its assets it had invested in CDS's this would either weaken the institution or even cause its collapse. Such a collapse would lead to the second impact where its collapse or even just its weakening would affect firms to whom it had loaned money because it would seek to call-in these loans in an attempt to rebuild its asset base. In addition firms from whom it had borrowed money would seek to get these repaid as early as possible thus further weakening its financial stability. The third aspect of the systemic interdependency is that other financial institutions not directly affected by the loss in value of the CDS's may pick up the 'nervousness' about them in the financial markets and adopt much more conservative attitude to the making and accepting of loans. The speed at which this nervousness can spread with its debilitating effect on business is one reason why the financial authorities intervene so quickly if a financial institution is even rumoured to be facing difficulties in meeting its commitments.

It is difficult to find analogies to such behaviours within product markets. The horse meat scandal is a close case where apparently fraudulent behaviour in one country led to the withdrawal of products throughout a complex international supply chain. However, while some firms found their reputation significantly damaged, and this resulted in their facing financial challenges, very few went out of business and the intervention of the authorities was limited to concern about public health not the financial health of any company.

Thus it would seem that the nature of interactions within financial markets is more complex and arguably less controllable by individual firms than is the case in non-financial markets. This would suggest that there is a need to develop the early work of IMP in establishing "how

the interaction will differ when we vary the situation variables.” (Håkansson and Ostberg 1975, p.118) – particularly for studies which explore the impact on the nature of interactions which are part of systemically linked networks.

CONCLUSIONS

This paper has asserted that the financial markets possess eight distinctive features and that three of these features are very seldom simultaneously present in the types of markets to which the IMP ‘model’ has primarily been applied. The paper suggests that, given the significance of financial markets, attempts should be made to develop the IMP ‘model’ to enable it to contribute to an understanding of these markets.

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ENDNOTES

1. 'Financial Markets' are markets in which: financial securities; commodities; and, other fungible items of value are traded. Securities include stocks and bonds, and commodities include precious metals or agricultural goods.
2. The ABACUS deal was centred on a portfolio of \$2 billion which, given that it was estimated that in 2007 the value of outstanding derivatives was \$532 trillion, was a small sum.
3. After the Thai floods it was reported that: "there is a shortage of surface treatments and component supplies and because of this HDD component makers can command a premium of between 20% and 40%." (Al-Zaquan, 2011)
4. The British Government guarantees UK bank deposits up to £85,000. A bank deposit therefore receives a lower rate of interest than a deposit in other financial organizations such as *RateSetter* or *Funding Circle* whose deposits are not guaranteed by the Government.
5. The 'testing' of new financial products is fraught with difficulties and the problems with collateralized debt obligations (CDOs) arose because it was assumed that the property markets in different American cities would move independently of one another. That this was not the case was a factor which was a major contribution to the 2008 financial crash.
6. Obituaries for Mr. Sollitt were published in many UK national newspapers and also *The Economist* with one saying: "YOU won't know his name, but Brian Sollitt was the genius who brought a perfect ending to countless dinner parties and family gatherings at Christmas." (Brooke, 2013, p.13).
7. Emphasis added.
8. The term 'industrial marketing' began to be replaced by the term 'business marketing' during the 1980's. Thus the title of the first edition (1981) of Hutt and Speh's textbook was "Industrial Marketing Management" but the fourth edition (1992) was "Business Marketing Management".
9. Even where they make big errors Stars seem able to retain a loyal following. For example, when Nicola Horlick, who had established an outstandingly successful record as a fund manager, still had no problem in retaining and attracting clients even

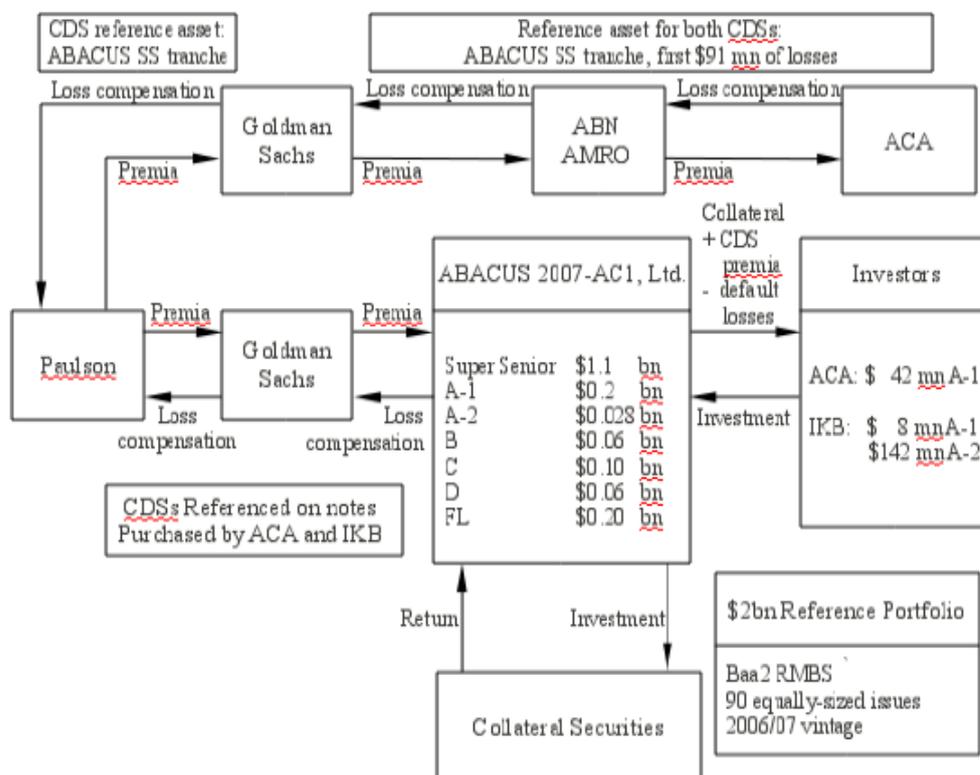
after losing £21 million of her clients' funds by investing them in a fund run by a fraudster.

10. A CDS (credit default swap) is a financial swap agreement that the seller of the CDS will compensate the buyer in the event of a loan default.

Table 1 A comparison of financial markets' characteristics with those of other industries

Financial markets distinctive features	Major Civil Engineering projects	Food supplies	Car manufacturing	Wholesalers	Advertising	Entertainment
a/ Intricate networks	Yes	Yes	Yes			Yes
b/ Systemic interdependencies		Yes				
c/ A global market	Yes	Yes	Yes		Yes	Yes
d/ Simultaneously supplier and customer		Yes		Yes		
e/ Third party validation	Yes	Yes	Yes			
f/ Outside technical advisors	Yes				Yes	Yes
g/ Stars					Yes	Yes
h/ Products with significant tacit elements					Yes	Yes

Figure 1 A simplified representation of the ABUCUS transaction



From: Davidoff et al., 2011, p.553.