

Location and Company Competitive Advantage: The View from the Business

Abstract

This paper investigates apparent contradictions in competitive advantage theories. The aim is to reconcile firms' self-centred, competitive and monopolistic strategies - particularly as represented in Porter's "five forces" and generic corporate strategies - with strategies involving local cohesion and cluster building - as represented by Porter's "dynamic diamond" and subsequent research in business strategy and economic geography. Employing methodological and theoretical tools from the strategic management literature, this approach provides a unique "firm's eye view" of how companies see the effects location has on their competitive advantages. The study focuses on the financial services sector in Edinburgh, a successful cluster dating from the founding of the Bank of Scotland in 1695 that is currently as strong as ever. In 2012 the industry was worth over £4 billion to the city in terms of GVA, having grown 225% since 1997.

This paper is very much **work-in-progress** and is part of a wider research effort that aims to make a unique contribution to understanding how competition and cohesion can work alongside each other in a city environment. Initial results show the importance of external threats, collegial professional "glue" and a world market orientation on how firms temper their strategic imperatives between single-minded self-interest and more collective action.

This research is likely to be revealing for the businesses themselves as well as for policy makers and economic development practitioners and will, in turn, help reduce the gaps between academic theory, policy practice and corporate strategy implementation.

1. Introduction

How is competitive advantage achieved? Is it through ruthless, single minded, firm specific corporate strategies or through capitalising on the common benefits of a certain geographical location? Is it perhaps from a combination of these elements, strategies that somehow combine both a narrow self-interest and a broader common cause?

This paper investigates apparent contradictions in competitive advantage theories. The aim is to reconcile firms' self-centred, competitive and monopolistic strategies - particularly as represented in Michael Porter's "five forces" (Porter, 1980) and generic corporate strategies (Porter, 1985) - with strategies related to the success factors for national or regional competitive advantage as represented by Porter's "dynamic diamond" and clusters (Porter, 1990). The apparent contradictions in these theories make it difficult to see how both bodies of work, the corporate "bottom up" view (here called the corporate model) and the national or regional "top down" view (here called the regional model), can apply in explaining the attainment of competitive advantage.

Competitive advantage is something firms work to achieve through pursuing certain strategies.

“A firm is said to have a competitive advantage when it is implementing a value creating strategy not simultaneously being implemented by any current or potential competitors”, (Barney, 1991).

It is clear also that, as some companies do better than others, some nations enjoy greater economic prosperity than others and that the wealth of regions within nations can also vary markedly. There is a debate as to whether or not countries and perhaps other geographical locations compete directly with each other. Nobel laureate Paul Krugman dismisses this notion in his article *Competitiveness: A Dangerous Obsession* (Krugman, 1994) and suggests the idea of nations competing like companies is misleading and mistaken and potentially dangerous in encouraging the misallocation of resources. Michael Porter is less clear-cut. He talks of nations and regions competing but also acknowledges that:

“Firms, not nations compete in international markets. We must understand how firms create and sustain competitive advantage in order to explain what role the nation plays in the process.” (Porter, 1998).

In a free market economy at least, the prosperity of a nation or region is essentially a composite of the prosperity of the commercial enterprises within that location. This study is about the competitive advantage of firms but the question addressed is whether this advantage derives from the firm’s strategies in isolation, from advantages accruing to the firm from its geographical location or from a combination of the two. This question is mirrored in comparing the two bodies of theory as mentioned.

On the one hand, in the corporate model, corporate strategies designed to achieve competitive advantage aim to attain monopoly power; to maximise gains through reducing competition, securing strong and durable barriers to entry and deliberately driving down the power of suppliers and buyers. On the other hand, in the regional model, it is suggested that competitive advantage can be obtained through harnessing forces that occur at national – or regional – level which derive from strong “clusters” of companies serving demanding markets, breeding innovative and dynamic suppliers, encouraging knowledge transfer and sharing resources.

Section 2 following addresses the theory of corporate competitive advantage. Section 3 relates this to theories of corporate strategy. Together these constitute the corporate model. Section 4 describes in more detail the theory behind national competitive advantage – taken here as a general theory for locational competitive advantage, the regional model – and section 5 summarises the apparent contradictions emerging from consideration of these theory sets. Section 6 on Methodology gives more details on how this research aims to investigate and reconcile the apparent contradictions through looking at competitive advantage in financial services in Edinburgh. Section 7 considers some more recent work on cluster theory of particular relevance to financial services. Section 8 describes the findings, analysis and conclusions to date.

This research is still underway and therefore conclusions are provisional. What is clear is that firms are clearly mostly driven by a narrow view of self-interest and that the strategies related to this can be linked to the generic strategies driving the achievement of competitive advantage, the corporate model.

What is also clear, however, is that this is not wholly the case. There are obvious examples of cluster forces and the regional model at work, albeit discontinuously. Firms' views on their own self-interest are not always narrowly focused on immediate economic logic and gain and can be significantly affected by elements like perceived, wider external threats or the trade-offs between short term and long term where narrow self-interest and community or cluster interest converge. The ultimate conclusion is that corporate strategies in practice accommodate a balance between the apparently divergent theories, tempering a ruthless pursuit of efficiency and self-interest with an eye to the benefits that can accrue from being part of a wider, more cohesive city interest.

2. The Theory of Corporate Competitive Advantage

As noted, Porter (1980) examined the industry environment in which firms work – or might work – in order to identify the main factors that determine the possibilities for gaining competitive advantage and thereby profit and success. This was summed up in his famous “five forces” as illustrated below.

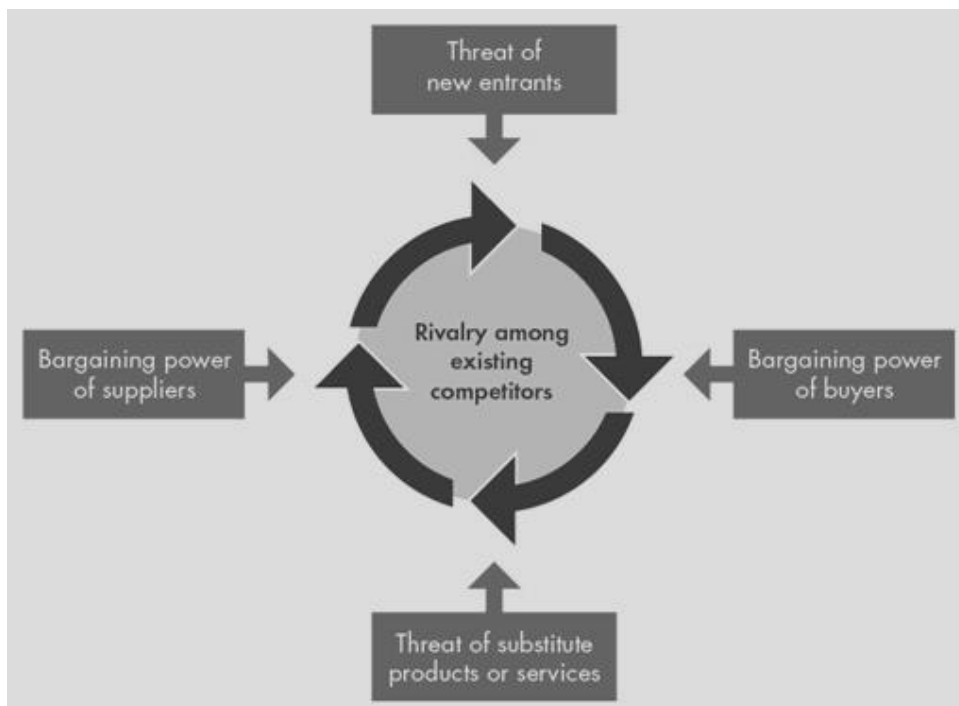


Figure 1 Porter's Five Forces

According to this theory, the state of these five forces in the industry in question in relation to the individual company will determine its competitive power and therefore its ability to achieve competitive advantage. In summary, it is to a firm's advantage to adopt strategies that reduce the powers of buyers and suppliers, reduce the possibilities for new entrants and substitutes and thereby reduce rivalry.

Whilst the logical outcome of this approach – a monopoly position - would be recognised by most as an unacceptable social outcome and one against which, failing all else, the state would be expected to intervene, it is still the natural ultimate destination (in theory at least) of the successful pursuit of competitive advantage in the face of the five forces identified.

3. Generic Theory of Corporate Strategy

Michael Porter also identified strategies for achieving competitive advantage through changing the balance of power in the above areas in the firm's favour (Porter, 1985). He identified two sources of competitive advantage for companies – namely lower cost and differentiation – and two types of competitive scope – namely broad target and narrow target. This gave a choice of four generic strategies to achieve competitive advantage as per the table below.

		Competitive Advantage	
		Lower Cost	Differentiation
Competitive Scope	Broad target	Cost leadership	Differentiation
	Narrow target	Cost focus	Focused differentiation

Table 1 Porter's Generic Strategies

These four routes have largely been refined to three in subsequent literature with various different labels including product focus, market focus and cost focus. For example, Michael Treacy and Fred Wiersema writing in the Harvard Business Review introduced the concept of *Value Disciplines*, being product leadership, customer intimacy and operational excellence effectively mirroring Porter's strategy breakdown (Treacy & Wiersema, 1993).

These strategies can be used to improve a company's position vis-à-vis the five forces determining competitive advantage. For example, cost leadership achieved through highly efficient production for a very large market can be a barrier to entry. It is difficult for a new entrant to get economies of scale without a large market and it is difficult to get a large market without a cost advantage. Product differentiation can reduce both buyer and supplier power. If rivals cannot bring to market a comparable product or service then buyers and suppliers have less choice and a reduced bargaining position.

These generic corporate strategies identified by Porter and others show a logical connection to the "five forces" theory and constitute the corporate model for understanding and achieving competitive advantage.

4. The Competitive Advantage of Nations

Michael Porter went on to look at national competitive advantage (Porter, 1990). His theory is that common forces at the national (and possibly regional) level can affect firms to the extent that, acting together, these can help to create competitive advantage at the industry level. In other words, success does not just depend on the correct analysis of the "five forces" affecting the industry environment and the choice of correct corporate strategies accordingly but also – perhaps exclusively - upon advantages deriving from the particular location that can assist the performance of all companies there.

He postulated that an appropriate corporate strategy on its own would not be sufficient to achieve competitive advantage. There need to be enabling factors in the environment for success to be realised. These national/regional forces are summed up in “Porter’s Diamond” as illustrated in the following diagram.

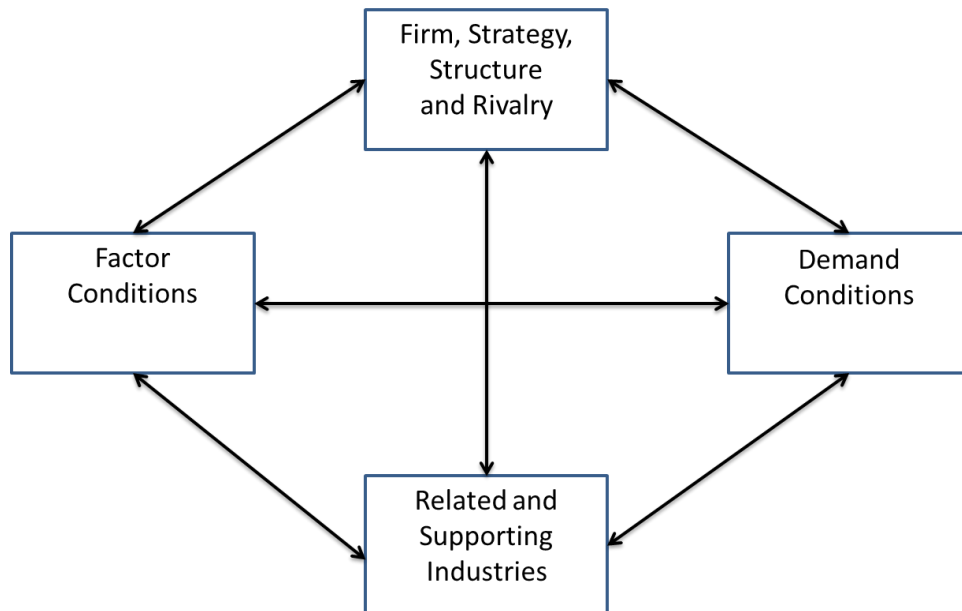


Figure 2 Porter's Diamond

Factor conditions include physical inputs like labour, natural resources, energy and capital and also intangibles like knowledge, skills and education. How these are used in a particular location – or even how any deficiency in their availability is compensated for - can contribute to the achievement of competitive advantage.

A sophisticated and demanding home market can also be a spur to innovation and improvement in a firm and thereby its attainment of competitive advantage as can the development of industry clusters where businesses form strong links with suppliers and with related industries.

Naturally a firm’s strategies, its structure and its competitive position will also affect the achievement of competitive advantage but Porter also noted here that national features like education, culture and values could shape these. He acknowledges that corporate strategies in themselves are a significant part of the mix but here he plays down the importance of independent choice of action based on self-interest in favour of locational determinants behind corporate strategies, corporate structures and rivalry.

Porter saw these four factors as mutually reinforcing in what he envisaged as a “dynamic diamond” as illustrated above. This would lead to clusters of interconnected companies that, in aggregate, would constitute a globally competitive nation or region, the regional model.

Porter builds on classical economic theory with an updated view of the world dominated by globalisation and economic inequality. He has provided a very useful framework for considering the issues around location and competitive advantage that is widely taught and used today. His model is far from being accepted as being definitive, however, and there is a

wealth of commentary on his theory and proposals and, particularly, suggestions to extend and reshape the model to fit the apparent competitive advantages seen in various industries in various locations around the world.

What has attracted less attention, however, is the precise nature of the relationship between the interdependencies of the “dynamic diamond” and the single minded self-interest of corporate strategy in the “five forces” industry environment. We have two logical assessments of how companies might achieve competitive advantage – the corporate model and the regional model - but, from the firm’s point of view, the strategies could appear to be not just different but contradictory.

5. Apparent Contradictions

As already noted, Porter acknowledged that “Firms, not nations, compete...” (Porter, 1998) and that a successful nation – or region – was no more than a composite of successful firms. However, his model for national success envisaged groups of companies, in clusters, sharing advantages derived from their location and working together - to a greater or lesser degree – for a result that meant effectively that the whole was greater than the sum of the parts. The “dynamic diamond” has mutually self-supporting forces that mean individual firms do better in a cluster than outside and that the nation (or region) will be internationally competitive as a result. This would appear to be at odds with the strategies identified for individual success which tend towards the elimination of competition and the “survival of the fittest” as monopoly suppliers. There are apparent contradictions in various areas.

Suppliers

The corporate model suggests that firms would like to limit the power of suppliers and thus reduce costs and make suppliers more compliant with the company’s demands. Weak suppliers are good for a firm’s prospects of competitive advantage. The regional model however envisages a strong role for supporting services and suppliers where they are key to knowledge transfer and, in themselves, can become centres of international competitive advantage. They are seen as integral to the collective competitiveness of industry clusters; not as subservient, isolated dependencies. This role is also emphasised in other cluster studies including the work by Henry and Pinch on the motor sport industry in the United Kingdom (Henry & Pinch, 2000). Here strong suppliers are seen as desirable.

Buyers

Similarly, firms’ preference is for weak buyer power. Strong buyers can put downward pressure on margins and make greater demands on companies. The corporate model sees weak buyers as an advantage. On the other hand, in the regional model, a strong and demanding local market is seen as a key driving force in pressing firms to greater efficiency, innovation and productivity that can then give greater international competitive advantage. The “dynamic diamond” thrives on powerful, sophisticated buyers.

New Entrants

Existing, successful companies generally would like to see barriers to new entrants who will eat into their market share and profits. Obviously a firm that is a new entrant will have a different view, but it is likely to change to a more protectionist stance once “in”. Most

companies see new entrants as threats. The regional model, however, sees new entrants as an important source of growth in regional wealth and in innovation, particularly through spin-outs. Again the work on the UK motor sport cluster (Henry & Pinch, 2000) showed significant empirical evidence supporting this.

Substitution

As with new entrants, substitution is generally seen as a threat to existing successful businesses but as a source of welcome innovation and evolution to a healthy cluster. Whilst some companies may see the benefits of Schumpeterian style creative destruction, they will seek to control this internally whilst protecting established products and markets. From the point of view of the regional model, however, both new entrants and substitution are essential for the cluster to thrive beyond the life cycle of any one firm.

Firm Rivalry

Whilst some firms may recognise the advantages of rivalry in spurring them on to achieving greater things, very few would actually encourage increased competition. In fact, most corporate strategies are directed at benefiting the company at the expense of rivals; gaining market share through product differentiation or cost leadership or market focus. The regional model, on the other hand, sees the benefits of firms learning from each others' successes and from striving to outdo each other in the cluster. One model sees the route to competitive advantage in eliminating competition, the other in embracing it.

Factor conditions

Firms will obviously be attracted to places with, for example, supplies of essential labour or natural resources, but they will seek to limit others' access to these rather than facilitate it. Even if a firm has more than enough of the necessary factor inputs it will always want to maximise advantage from national assets by limiting access. The regional model is based not on the simple existence of favourable factor conditions but on how the factors of production are used. To get the best utilisation, greater access is to be encouraged to foster efficiency and innovation.

The Role of Government

In considering the role of government in promoting national or regional competitive advantage, Porter advocates limited intervention beyond ensuring the necessary macroeconomic framework. Ironically, given the general preference of most businesses for free market conditions unhindered by government intervention, it is often individual businesses that are most interested in greater government involvement. This would not be, of course, to limit their own freedom of action and their drive towards monopolistic positions but more often to create barriers to entry against newcomers and to give subsidies and tax incentives in the face of real or apparent unfair competition from elsewhere. Most firms want government involvement so long as it is of the "right" sort, as protection against the "five forces", which runs counter to the regional model for success.

Knowledge transfer

Knowledge has always been a vital component of a firm's success whether it relates to technological advances, to market behaviour, to economic trends or to scientific breakthroughs. Sharing is not a default strategy however; a company's knowledge is more often than not a

primary source of competitive advantage. Companies will often go to great lengths to acquire knowledge and also to protect what they have.

In the regional model, the easy transfer of knowledge – nowadays tacit knowledge in particular – is central to the cohesion and effectiveness of clusters. Work by Saxenian (1994), Maskell (2001) and by Maskell and Malmberg (2002) amongst others very eloquently describes the importance of knowledge creation, transfer and spill-overs for economic success and the important role clusters play in this area. Whilst this does not necessarily mean firms will actively seek to share their knowledge it does mean that barriers to knowledge transfer are as low as possible, a position quite contrary to that in the corporate model.

Table 2 summarises these contrary positions suggesting the differences derive essentially from either a protectionist or a free market outlook as determining what achieves competitive advantage.

	Corporate Model	Regional Model
Suppliers	Protectionist	Free Marketeer
Buyers	Protectionist	Free Marketeer
New Entrants	Protectionist	Free Marketeer
Substitution	Protectionist	Free Marketeer
Firm Rivalry	Protectionist	Free Marketeer
Factor Conditions	Protectionist	Free Marketeer
The Role Government	Protectionist	Free Marketeer
Knowledge Transfer	Protectionist	Free Marketeer

Table 2 Summary of Corporate Model v Regional Model

Despite the many apparent contradictions facing companies in choosing strategies to achieve competitive advantage and in the theories behind these strategies, there are clearly locations that are much more economically successful than others whose prosperity derives from clusters of successful companies. How can this be the case when there are apparent contradictions in the theoretical conditions for success? This research aims to address this apparent dichotomy.

6. Methodology

To look at this question in depth in a manageable way, this research considers a successful industry sector in a successful location and a small number of firms therein. The approach is both quantitative and qualitative; quantitative in identifying the successful industry sector and location and qualitative in collecting data about firms and their strategies to achieve competitive advantage. The overall context is competitive advantage in the United Kingdom and the main source of data for the quantitative aspect is the UK Office for National Statistics (ONS) figures for Gross Value Added (GVA).

Porter (1990) advocated the consideration of productivity as the key measure of success in looking at national competitive advantage, although he also referred to exports as being significant indicators. Furthermore, he restricted his analysis to only home based companies as contributors to competitive advantage. Grein & Craig, in their article *Economic Performance Over Time: Does Porter's Diamond Hold at the National Level ?* (Grein & Craig, 1996), questioned both the confusing addition of exports as metrics - as opposed to GDP - and the limitation to only home based companies. These criticisms were echoed by Davies & Ellis in

their article *Porter's "Competitive Advantage of Nations": Time for a final judgment?* (Davies & Ellis, 2000), which also highlighted the too narrow focus exclusively on home markets and home based industries and a confusion in measures of success between export market share and productivity.

In terms of identifying competitive advantage for this research the focus is on productivity, something that is clearly measurable in both scale and rate of growth for both firms and locations and which renders easy comparison across firms and locations. ONS data on GVA over the years 1997 – 2012 have been used to isolate competitive advantage in the UK by industry sector and location. This is a reliable, tested source of information and this period was chosen because of the ready availability of consistent data across a sufficiently long time frame to detect sustainable trends. The data has been considered at the lowest, most detailed, level available (NUTS3) which serves to illustrate the greatest relative differences in performance over time.

In terms of differences of opinion over the most appropriate criteria for success, this measure is a widely accepted indicator of productivity and one that embraces all economic activity in an area and not just export oriented business or the output of home based firms. It therefore addresses some of the concerns about Porter's original database.

Figure 3 below shows industry sector performance in the United Kingdom for the period in question in terms of actual GVA (y-axis) and GVA growth (x-axis).

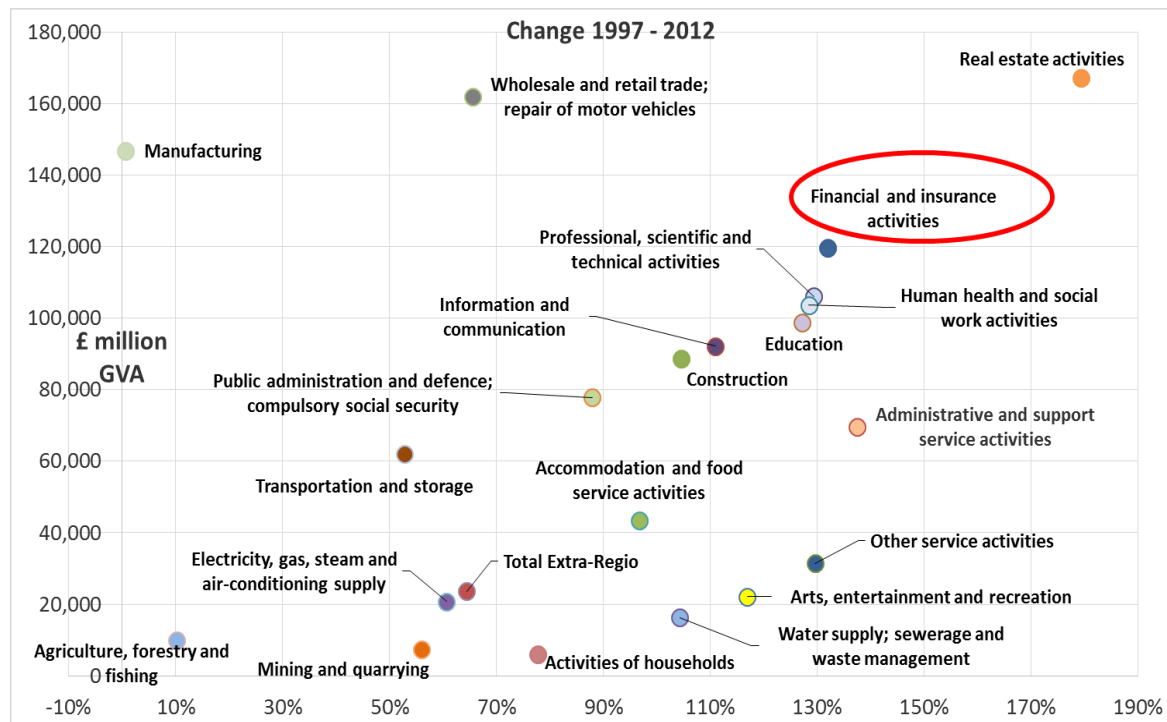


Figure 3 UK workplace based GVA by industry groups at current basic prices, % Change 1997-2012 v GVA 2012 Source ONS Table 1.3

Looking to the top right hand quadrant as a guide to the best performing sectors over the period, *Real Estate* has been the clear winner. In the context of this work, however, this outstanding performance has been considered less indicative of company success driving economic growth

than as a product of such economic growth. This is less the case for *Financial and Insurance Activities* which has therefore been taken as the key sector focus for further analysis.

Both the greatest rate of growth and the highest actual total GVA in *Financial and Insurance Activities* occur in London. Because of the size and complexity of London as a global hub it has not been considered appropriate for the objectives of this particular research. Figure 4 below shows the performance of the top 10 NUTS3 areas excluding London over the period in question, once again in terms of actual GVA (y-axis) and GVA growth (x-axis).

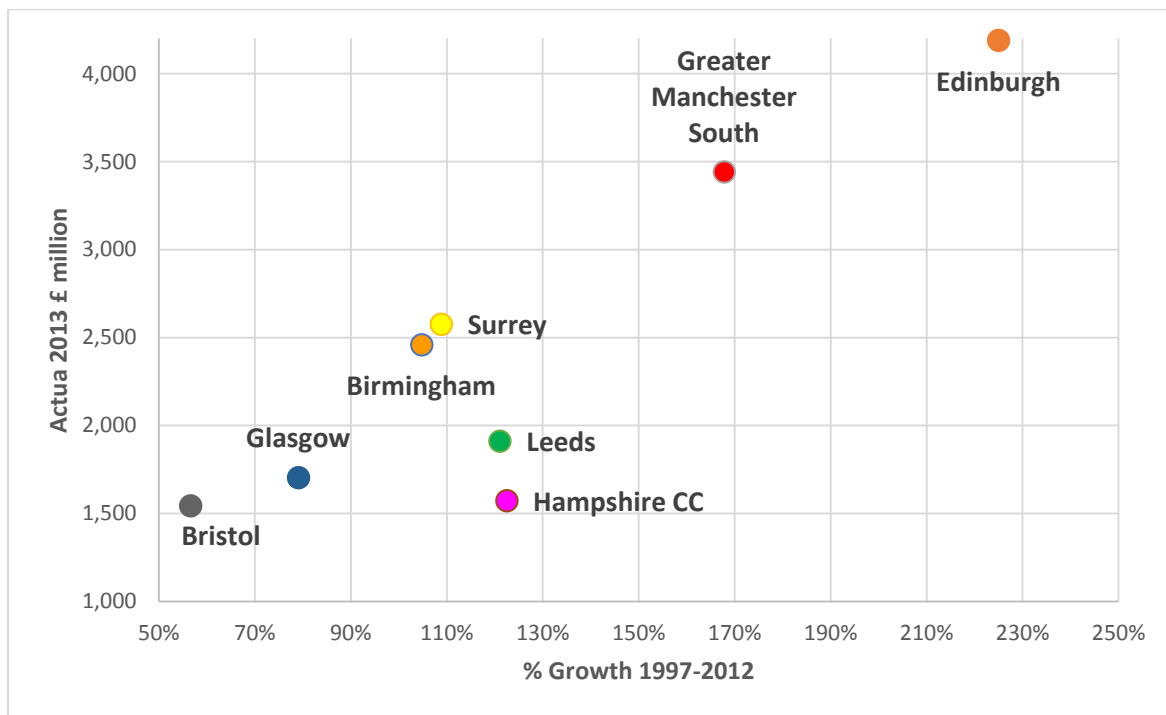


Figure 4 Finance and Insurance Activities UK Top 10 Workplace based GVA NUTS3 at current basic prices Growth 1997-2012 v Actual 2012 (excl. London) Source ONS Table 3.4

Edinburgh has been chosen for this work because it is the country's second most successful city but of a size where it is easier to identify the companies and people behind the success and the interplay with local social, cultural, economic, historical and political forces.

The study has therefore focused on the financial services cluster in Edinburgh which has existed since at least 1695 and the founding of the Bank of Scotland and is as strong as ever. In 2012 the industry was worth over £4 billion in terms of GVA (that is over £8,000 per head for a city with a population of less than half a million) and the sector grew locally by 225% between the years 1997 and 2012. There is, today, a dynamic roster of large and small companies with clear world class competitiveness. These range from the insurance giant Standard Life to retail and commercial bank the Royal Bank of Scotland to fund managers Aberforth Partners to new ethical investment house the Green Investment Bank. The following table gives a breakdown by type of company in the city.

Retail/Commercial Banks	HQ/Main Office	8
	Back Office	6
Private Banks	HQ/Main Office	3
	Branch Office	1
Insurance and Pensions	HQ/Main Office	3
	Branch Office	1
Asset Management/Investment Banks	HQ/Main Office	14
	Branch Office	7
Asset Servicing	Branch Offices	5
Support Services (strong financial services orientation)	Accountants	6
	Business Consultants	4
	IT/Software	2
	Lawyers	4
	Professional Institutions	5
	Recruitment Consultants	3

Table 3 Edinburgh Financial Services Companies and Organisations by Type

A programme of semi-structured one-to-one interviews is underway with key figures from a number of institutions across all the categories listed. These interviews are designed to get the firm's view of how they have achieved competitive advantage, the key strategies adopted to this end and the role location has played in the shaping and success of these strategies.

The interviews are being recorded and transcripts analysed. This data is being supplemented by a review of specialist literature, company histories, information from local media coverage, financial reports and meetings with local business, educational and government organisations.

To give additional structure to the data collection and analysis, consideration has been given to some more recent cluster theory work that extends beyond Porter's "diamond" with a focus on the financial services sector. This work is summarised in Section 7 following.

7. Cluster Theory and Financial Services

There have been several papers recently on British financial services clusters involving Naresh R. Pandit, Gary Cook and others. In *The Dynamics of Industrial Clustering in British Financial*

Services (Pandit, et al., 2001) mathematical modelling is used to show positive clustering effects but, significantly, this also shows variations in effects across sub sectors and only limited benefits for companies located with those in other sub-sectors. One important consideration from this for the current research is the need to consider the possibility for differences across sub-sectors; in other words, what holds true for banking may not be relevant for insurance and asset management and vice versa. Financial services is not a homogeneous industry sector.

In *The benefits of industrial clustering: Insights from the British financial services industry at three locations* (Pandit & Cook, 2002) there is a comparison of London, South Scotland and the South-West (England). Cluster effects similar to those experienced in high tech manufacturing were identified including access to specialised inputs and knowledge spill-overs, a clusters reputation and close proximity to sophisticated customers. These benefits were not experienced equally across the three areas, however, which was partly due to the areas representing different cluster types as identified by Markusen (Markusen, 1996). Again, here is support for the evidence of cluster benefits but a caution against assuming homogeneity.

In *The role of location in knowledge creation and diffusion: evidence of centripetal and centrifugal forces in the City of London financial services agglomeration* (Cook, et al., 2007) several authors including Cook and Pandit built on Malmberg and Maskell's (2002) work on a knowledge based theory of spatial clustering, concluding that "interfirm interaction aided by face-to-face contact occurs in high magnitude and is of high importance". They note that financial services clustering in London is very dependent upon "...the formation of relationships characterised by trustworthiness, rapport and confidence..". This conclusion would appear to sit well with the early findings from Edinburgh.

This evidence of cluster effects in UK financial services centres, particularly in South of Scotland (which includes Edinburgh in a wider geographical area with Glasgow and the Scottish Borders) has influenced the framing of the one-to-one interviews and the interpretation of the results. This paper does not seek to prove or disprove these earlier findings but to use them in structuring the investigation and conclusions here.

8. Preliminary Findings, Analysis and Conclusions

Results so far suggest that, at the firm level, the strategic emphases of financial services firms in Edinburgh are in line with the theories of generic strategies and the corporate model. Businesses will seek the most appropriate ways to outdo each other and gain advantages. This has been evident right from the start when The Bank of Scotland, supported largely by Tory grandees, was founded in 1695. This was followed by the Royal Bank of Scotland in 1727 which was specifically set up by prominent Whigs as a rival to the original bank. The two banks have been bitter rivals right through to their recent collapse in the wake of the financial crisis. As one interviewee commented, "they grew on the backs of each other". Their rivalry was undoubtedly a spur to ever better performance and – ultimately, it could be argued – to their downfall.

This is true of other financial institutions in the city. As insurance businesses grew in the 1820s there was intense competition in Edinburgh, quite a lot of which ran along lines of political differences. The Life Assurance Company of Scotland – the precursor to the current Edinburgh

giant, Standard Life - was established in 1825 as a Whig challenge to Tory hegemony. The Company was even prevented from having offices in the fashionable “New Town” area of the city which was Tory dominated. The fierce rivalry led to rate cutting wars that, arguably, helped to see off other potential competition from England.

None of the interviewees so far has talked of any Edinburgh spirit of conscious collaboration or knowledge sharing in mainstream business. In fact, there is an increased awareness that co-operation and knowledge sharing in this sector can be viewed as potentially prejudicial to the public interest and possibly illegal. In many financial transactions there have to be counter parties, of course, which require trustworthy business relationships, but there is no sense that there is a particular Edinburgh or Scottish culture or social structure that is especially advantageous in this regard. Business relationships tend to be competitive and formal, with joint efforts largely confined to “safe” areas like training.

There is a recognition of there being a critical mass and a degree of spatial inertia in the city - akin to that identified by Frenken, Cefis and Stam (Frenken, et al., 2015) - that has both helped the development of, and been the product of, a sound support structure in accounting, the law, consultancy, recruitment and IT. These common services do carry a degree of knowledge and innovation transfer and spill-overs, particularly as mentioned in relation to the legal profession below.

There is no real trace, however, of strong and determining factor conditions, of a particularly sophisticated and demanding local market or of an exceptional stimulus from innovative related and supporting industries. Surprisingly, perhaps, there is no strong feeling that a “canny”, Calvinistic Scottish culture has had a particular effect on individual firm strategies, structure and rivalry. The legacy of the Scottish Enlightenment, an excellent record in education and a reputation for probity and care with money are perhaps features of the Scottish character but it is not felt that these have been significant in Edinburgh’s success in financial services.

Several key themes have emerged, however, suggesting the recognition and exploitation of cluster benefits in line with the regional model and akin to those identified by Pandit and Cook et al.

One of the most important has been co-operation in the face of a common enemy, namely the threat of London. The British capital has exerted an inexorable pull on Scottish business and talent for over three hundred years since the Act of Union in 1707 which accelerated the movement of political and economic power and resources south. As one interviewee remarked:

“It’s a kind of constant struggle to retain a centre of gravity in Scotland”.

This is as true today as it was in 1707 and has led to outbursts of collective effort in the city and the sector, for example to attract new financial institutions like Tesco Bank and Sainsbury’s Bank in 1997 and, more recently, the Green Investment Bank in 2012. One interviewee remarked on how hard it was to start out with a new private bank in Edinburgh and to win business, but that this was largely due to the industry default assumption to look to London and, in fact, the Edinburgh environment was supportive to the new venture on the basis of being an alternative to London. Rivalries might be fierce “at home” but can be overcome if it is a question of battling the UK capital.

A second important theme has been the institutional “glue” that has held many of the diverse financial bodies together. This has included the Faculty of Actuaries, founded in 1856 as the first such professional body in the world, and the Chartered Institute of Bankers, founded in 1875 and also the oldest such body in the world. Of even greater significance, however, has been the role of lawyers and Scottish law in the creation and governance of financial institutions in the city.

The existence and use of Scots Law itself has created a significant cluster barrier to entry and the fact that it is based on principle and not precedent – which latter is the case for English Law – is especially valued by financial businesses. As one interviewee remarked, it is far better to work with something that has been thought through from first principles than to go in search of precedent, of what someone else has done.

More importantly, the direct involvement of lawyers over the last three hundred years has been remarked upon as providing continuity, integrity and cohesion to financial services in Edinburgh. Many of the Board members of the city’s financial institutions have been drawn from the ranks of the legal profession which has enabled a beneficial cross-pollination and collegial knowledge transfer. Between 1945 and 1981, for example, eight out of ten Deputy Governors of the Bank of Scotland were lawyers. In terms of the possible clash between strategies favouring a firm’s narrow self-interest and a more collective benefit, lawyers are singularly well placed to reconcile any apparent contradiction. Their professional lives involve bitter court battles against each other whilst out-of-court they enjoy mutual respect and trust and, often, shared social and cultural interests. Furthermore, lawyers have often been the intermediaries for clients with financial institutions and have been particularly instrumental in the growth of insurance and investment banking in this context.

A third theme that has become increasingly evident is the **lack** of dependence on the local, Scottish market. The two major banks and the earliest investment trusts and insurance companies were based on local wealth, initially from land but increasingly from trade and industry. However, from an early stage and contrary to Porter’s “diamond” – though perhaps more in line with the “double diamond” suggested by Rugman & D’Cruz (Rugman & D’Cruz, 1993) - the financial institutions also looked outwards, particularly to England but also overseas. The first self-managed investment trust was the Scottish American Investment Company (SAINTS) established by William Menzies in Edinburgh in 1873 which focused on North American opportunities, particularly railroads. Scotland led Britain in the establishment and management of investment trusts and Edinburgh led Scotland, and these financial vehicles were the main conduits for the country’s extraordinary appetite for overseas investment. In 1914, 90% of investment trust investment was overseas.

This world market view was also true in insurance. As early as 1847 Standard Life appointed agents in the West Indies, India, Uruguay and China as Edinburgh financial services followed booming Imperial trade across the world.

In this particular respect one interviewee attributed the breadth of Scottish education as being a major contributor to a confidence in Scots that “the world was their oyster” both in terms of leaving the country to carve out a career elsewhere or to take on investment projects in the wider world.

This international outlook is not just a matter of history, it continues to be the case today, with by far the bulk of the funds handled and the investments made by all the financial institutions being outside Scotland. In explaining why there might be less competitive tension in the city than the interfirm rivalry might suggest, one interviewee noted:

“One of the reasons for that might be that it’s not like some other industries where they would be coming in to compete for the same customers in the same domestic area”.

Edinburgh firms are more likely to be competing with financial institutions in London, Luxembourg or Zug for business than with rival businesses in Melville Street in the heart of the “New Town”.

Overall, there are clear examples of financial services firms in Edinburgh accommodating both fierce competition and co-operation in a path dependent evolution that has sustained competitive advantage over a very long period. The story is one of flexibility and adaptation. Firms will act in their own self-interest in line with generic strategies and positioning within Porter’s “five forces” but they will also be aware that this self-interest might cross paths with a collective interest which requires compromises to be made for overall, longer term benefit. This results in cluster effects and benefits but these are not continuous. There is an apparent ebb and flow between fierce local competition and co-operation, the latter facilitated by consciousness of external threats, a network (the legal profession) for sharing knowledge and behaviours and a Scottish world view.

This research is at an early stage and will continue to refine the findings to date and test further the validity of the two bodies of competitive advantage theory as they apply to financial services in Edinburgh.

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