The Purpose of Finance:

# How much does finance cost?

THE PURPOSE OF FINANCE
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## The finance industry:

Keeps people's money safe

Provides an effective payment system

Manages and pools risk

Moves money from where it is to where it is needed

**£847bn**
held in current and savings accounts in high street banks[1]

**164m**
There are around 164m payment cards in issue in the UK[2]

**3/4**
of households have savings and pensions that are managed by the UK fund management industry[3]

**£449bn**
Loans made by major banks to UK businesses totalled nearly £449bn[4]

Yet despite its importance, no one has ever tried to measure the efficiency of the financial services sector in Europe.

**How efficient is financial services?**

The paper sets out to measure the cost of finance to the end user.

## Main conclusions

The UK has consistently had the most cost efficient financial services sector

France saw a dramatic decrease in the cost of financial intermediation, following a period of deregulation from the 1950s onwards

On current trends, the data suggest that France will overtake the UK

The average cost of finance to the end user has remained fairly static in the UK albeit with significant increases in costs prior to "Big Bang", followed by significant falls. The cost of intermediation today is similar to the cost 70 years ago.

1 UK Finance2018
2 The UK Cards Association
3 TheCityUK 2017
4 TheCityUK 2016

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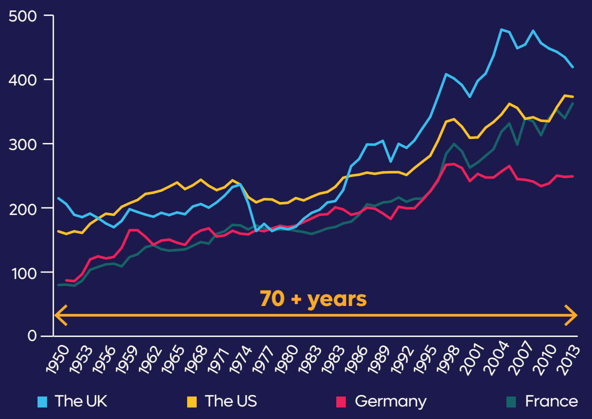
For more information please contact: Jeremy Apfel, Head of Corporate Affairs | 020 7105 2140 | apfel@pensioncorporation.com

# How do we measure efficiency?

1

**Financial intermediation (%GDP)**




First, the paper measures the output of the finance industry in terms of intermediation and liquidity provision: the value of the savings that it gathers from the outside world as well as the value of the capital and investments that it provides (this includes savings, pensions and investments on one side; and the provision of bank credit and market-based financing on the other).

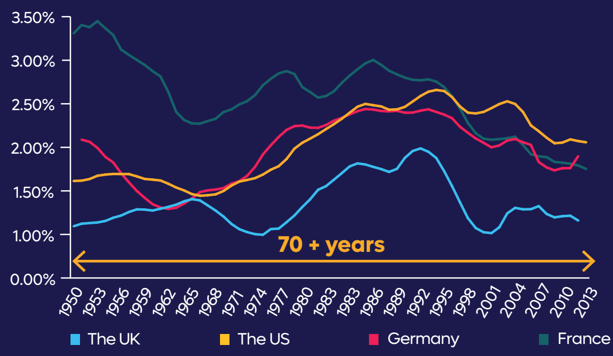
2

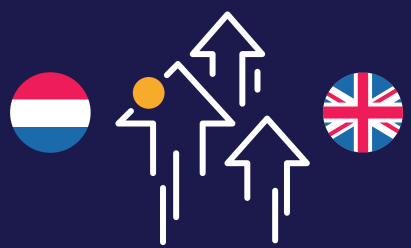
Second, it measures the economic cost of the financial industry in terms of the profits that it makes and the salaries and bonuses that it pays.

3

And third, to derive the unit cost of financial intermediation, it divides the cost into the output.

**Unit cost (all adjustment)**



## Historically, improvements in the efficiency of finance and the subsequent decrease in the costs of financial intermediation were a central factor in the rapid growth of the Netherlands in 16th and 17th centuries, and of the UK in the 18th century.

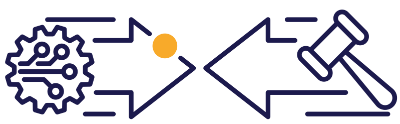
**Increased financial development and efficiency were a precondition for the industrial revolution and are two of the main defining factors in innovation and economic growth today.**

**Given their importance, it is vital to better understand how developed and how efficient the financial industry is, and how that has changed over time.**

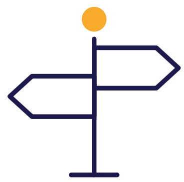
# The paper raises important questions:

**How do we improve the cost efficiency of UK financial services in light of Brexit?**
A small improvement will increase investment in jobs and growth

**What is the right level of financial efficiency?**



**What are the forces acting on the final number to theoretically bring it down (technology, innovation, competition) vs the forces potentially working the other way (abuse of asymmetric information, regulation, short-termism, increased amount of financial transactions)?**



**What do we expect of our financial services industry?**

**What is the right direction?**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**The third paper in the Purpose of Finance series**