The economic inefficiencies of market liberalization : The case of financial information in the London Stock Exchange

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ARTICLE

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ABSTRACT

This article returns to the long-running public service versus free market debate in media and communications but from a rather unconventional perspective. Critics of the steady, globally driven marketization of national public media and information services tend to object on social and political grounds. Market advocates, in contrast, make their case on economic grounds. Greater competition in markets, including media markets, brings economic efficiencies which, in turn, are a 'public good'. This economic assertion is rarely scrutinized within media studies. The study presented here, which looks at financial media and communications in the London Stock Exchange (LSE), does just this. In recent decades the LSE has been opened up to accommodate the needs of international financial institutions and international capital flows. This has had a detrimental impact on its media and information systems. Such liberalization, it is argued, has made the LSE less economically efficient, not more, and with quite negative economic (as well as social) consequences.

KEY WORDS

economic efficiency ▪ financial information ▪ free market media ▪ stock markets

Media, information and the public good[1]

This article restates the case for greater financial support for, and regulation of, public service media and communication systems. However, it does so on grounds rather different from the norm. Instead of focusing on the social and political consequences of marketization, the usual starting point for critiques of neo-liberal economic policy, the emphasis here is on economic consequences. Rather than looking

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backwards, at a 'golden age' of public service media, this piece looks forward at a communication system that has been subjected to a period of intense, globally driven market liberalization. In place of social crises and democratic deficits, it is economic crises which are observed. Instead of nation states and citizens, it is markets and market participants that provide the case study material.

Objectors to the ascendancy of neo-liberal, public policy making and the rise of transnational media conglomerates have made their criticisms largely on social and political grounds. Such policies, they argue, have contributed to social inequality at all levels and a weakening of democratic systems. Economic progress is often achieved to the detriment of the greater 'public good' at the local, national and global levels. In respect to communications, media is regarded as a 'public resource' that offers many services vital to the sustenance of democratic systems and the global public sphere. Media help citizens to make informed social and political choices, hold the powerful to account, reflect pluralist public opinion, and provide a public sphere for objective and rational debate (see Keane, 1991; Curran, 2002 for overviews). However, the steady marketization of public media and information systems means that information is being increasingly guided by market needs rather than public ideals. A 'refeudalized' (global) public sphere and a crisis of public confidence and political participation are the consequences (Habermas, 1989; Deacon and Golding, 1994; Blumler and Gurevitch, 1995; Herman and Chomsky, 2002).[2]

Market advocates have responded with two lines of reasoning. One is to contest the social and political assumptions about what best advances the 'public good'. Politically autonomous communication industries with greater diversity, audience choice and access are regarded as social and political advances and, therefore, also a 'public good'.[3] Thus, the 'golden age' thesis of an earlier, 'better', public service media, public sphere and social system is questionable.

Secondly, neo-liberals have argued that the 'economic good', advanced by free market policies, can in itself be a greater contributor to the 'public good'. This emphasis on the market, as the means to harmonize individual self-interests with the greater social and economic good, has an intellectual history dating back to Adam Smith. In its contemporary form, free market advocates argue that liberalization brings economic advancements, measurable in terms of greater efficiency, productivity, competitiveness, investment and innovation. Such economic developments, in turn, bring about positive, measurable, social consequences as a natural by-product. These include greater employment, lower prices and more consumer choice (see, for example, Brittan, 1983; Littlechild, 2000). The same arguments have been applied to Britain's communication industries (Peacock, 1986; Veljanovski, 1989; Beesley, 1996) and driven negotiations at successive international trade talks (Freedman, 2005). Whatever the debates, it appears that free market advocates, and economic arguments, appear to be driving the long-term communications policy agenda in Britain, as in most OECD countries. Those industries which have not been fully privatized have still been restructured and funded according to market thinking (see Curran and Seaton, 1997; Leys, 2001, for overviews of the UK case). With a few notable exceptions, what is rarely questioned or tested in media studies is this presumption of economic advancement made by the free market lobby.

This study, centred on the production and dissemination of financial media and information in the equities (company shares) market of the London Stock Exchange (LSE or 'City'), does just this. The LSE, in terms of assets managed and people employed (over 300,000) is the third largest stock market in the world. On the one hand, being increasingly dominated by international 'institutional investors' and banks, it has a significant effect on, and is also affected by, the UK economy and the global financial system. However, at the same time, it is also a relatively autonomous socio-economic entity with its own legal and economic rules and, significantly, its own media and information systems. In recent decades the City has been subjected to intensive competition and deregulation. In many ways, these liberalization policies have had a debilitating impact on these internally produced and consumed information systems. This, in turn, has had a negative impact on the economic strength of the LSE itself. In effect, greater marketization has not necessarily brought greater economic efficiency and advancement.

For two extended periods, in 1998–99 and 2004, research investigated aspects of media and communications used in the trading of company shares in the LSE. The studies included some 95 semi-structured interviews at over 80 different City locations.[4] Each specific set of interviewees (communications staff, fund managers and journalists) was 'theoretically sampled' from professional/industry publications. Each set were asked for responses to the same list of semi-structured and open questions. The citations used here are representative of the majority or most common responses. In addition, several government, regulatory and industry reports and data-sets were collected and compared with the interview findings.

The social information market meets the free information market in the London Stock Exchange

Financial markets, like nation states, are social systems which seek to balance the needs of individuals with those of the general public good. Thus, markets must consider the needs of individual market participants (citizens) next to those of the market itself (society) and, in the process, establish ideals and principles that best achieve a balance. The freedom of participants, as profit-maximizing individuals, must not outweigh the needs of a cohesive market, dependent on elements of consensus and cooperation in order to function. Like national social systems, information is a central element of this tension. The production and dissemination of accurate market data exercises the thoughts of participants and authorities more than any other issue. On the one hand, it is assumed that markets work most efficiently (are 'frictionless') when prices reflect all available information. For that to happen all price-sensitive information should be as cheaply, accurately and widely distributed as possible.[5] This should maintain confidence and attract more participants to a market. On the other hand, individuals will also only participate if they believe they can gain information that will give them a trading advantage over others. Thus, like states, financial market regulators are faced with a similar free-market/public service dilemma in regards to the regulation of information. Financial information is a public resource that must be freely available and widely disseminated, yet participants continue to seek exclusive, private, alternative (or commodified) sources of information to gain a trading edge.

Legislation and regulation of the City under the Thatcher Government (1979–89), particularly those measures put into force in 1985–6 ('Big Bang'), were strongly determined by the principles of financial market theory. One part of this involved introducing greater competition into the City to lower trading costs and attract more investors. In terms of competition, the once 'closed shop' of the City was forcibly opened up. Stock Exchange monopoly trading conditions were broken, competition increased and transaction costs decreased. At the same time, legislation also demanded better regulation and greater availability of the 'price-sensitive' information produced by quoted companies. By 2000, the 2488 pages of regulations that had been produced worked to reduce insider trading, increased investor confidence and drew more investors (see Marston, 1996; Kynaston, 2001; Chapman, 2002, for general accounts).

For many observers these changes brought great economic success. The combination of regulated information supply and market deregulation led to significant growth in the LSE in terms of market infrastructure, trading activity, capital investment and employment. International financial services grew at an average of 7 per cent per year. By 2000 the City had an annual surplus in overseas trade of £31.1 billion (Golding, 2003: 11). The intense marketization of the LSE helped the City to successfully maintain its position as Europe's leading financial centre.

However, in the longer term, such intense marketization has also had a detrimental impact on the production and dissemination of financial information in the LSE itself. This is primarily because information regulation focused exclusively on the information produced and disseminated by companies about themselves. In a national media system, this would be akin to putting the onus on governments and others to honestly disseminate information about themselves through a passive, central media system and then to deregulate all other media entirely. It misses the points that: (a) companies (and governments) are only one source of information about themselves; (b) such information is unlikely to be neutral; and (c) alternative media producers then operate in a completely unregulated environment. Most of this non-company generated information is not really treated as a competitively produced commodity in itself: i.e., in terms of its independence, quality, cost or efficiency of production.

In terms of the equities market of the LSE, the main occupation of many companies, indeed, involves the generation of large quantities of price-sensitive information in order to inform trading decisions. Financial news media/information suppliers, research analysts and fund management companies all generate and exchange large quantities of price-sensitive information (see Figure 1). A whole set of smaller information service providers also exist, including legal and accounting firms, financial public relations and investor relations companies and investment consultants. What became apparent through both research periods was that increased competition, in all these parts of the LSE, has, accordingly, affected their production of financial information. Obvious trading costs have been reduced but, in the process, price-sensitive information, the lifeblood of the LSE, has become commodified to an extreme level.

At each stage of the research a similar set of developments and consequences was apparent. Increased sector competition had led to attempts to cut the costs of information production and/or hide those costs from those further down the investment chain. This led to greater dependency on 'information subsidies' (Gandy, 1982) being supplied by market intermediaries which, accordingly, have grown in number. Since these intermediaries tended to generate very similar information, based on the same material supplied by traded company sources, information over-production was one result. Lack of competition and diversity, amongst these information intermediaries, was another. At the same time, this widespread dependency on 'information subsidies', supplied by the very companies being 'independently' evaluated, meant that much information was unlikely to be impartial. Investors, at the end of the information chain, were then left to take their chances with such information or, alternatively, use investment strategies that excluded the necessity for such information altogether. In all cases the trading practices and patterns that resulted did not appear to operate efficiently. In effect, unfettered free market policies, applied to the institutions and financial information providers of the London Stock Market, have had a detrimental effect on the market's operations. Liberalizing the LSE has corrupted its information systems which, in turn, has made trading operate less efficiently.

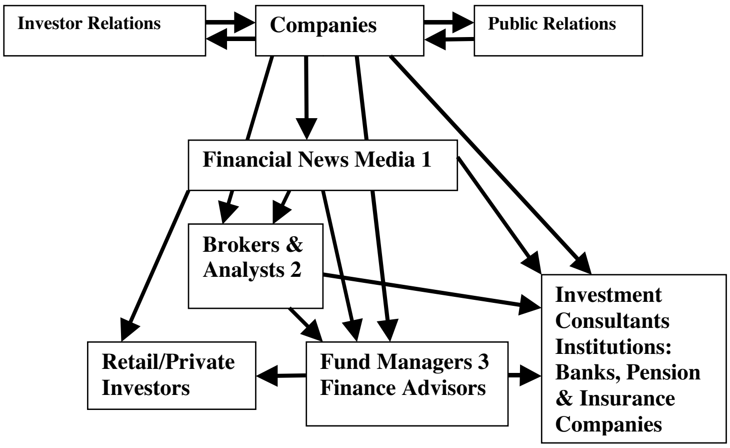


Figure 1 The financial information chain of the London Stock Exchange

The market corruption of information in the London Stock Market

The research looked at the three main producers and disseminators of financial information about traded companies (excluding the companies themselves) within the equities market of the LSE (see Figure 1). According to interviews with professional investors (see also MORI, 2000) these are: (i) financial media/news wire services; (ii) brokers' (or 'sell-side') analyst research; and (iii) fund manager (or 'buy-side') research.

Financial journalism

One obvious source of financial information in the LSE is the financial media, including news wire services. It is the most common information source for amateur (retail) investors and closely watched by fund managers (Davis, 2005). In financial journalism, expansion, combined with greater media and financial competition, has forced journalists to produce more copy with fewer resources. This has increased journalist dependency on a range of 'information subsidy' suppliers, including quoted companies, financial public and investor relations professionals, and brokers' analysts. Since all these sources are, in the main, using information produced by quoted companies themselves, news content is rather less diverse and independent than appears to traders.

The post-war rise in financial/business journalism (television and newspaper) has been noted in many studies (Parsons, 1989; Tumber, 1993; Tunstall, 1996; Cassidy, 2002). Such journalism now makes up approximately one third of serious news space. However, during the 1980s and 1990s, just as competition reached new levels in the financial sector so it did in the news media industries (Seymour-Ure, 1996; Tunstall, 1996; Franklin, 1997). Financial journalism, like journalism generally, was continually forced to increase output while making cuts in staffing and other resource levels. This made financial news particularly reliant on the information supplied by corporate advertising and public relations to support its expansion (Curran, 1978; Newman, 1984; Davis, 2002). As interviews revealed, there are too few specialist journalists, covering extensive 'beats' that require complex knowledge of financial accounting and City practices. Even for the most experienced reporters, there do not exist the resources to check the financial details produced in company documents. As one explained:

> There are a large number of people with interests a mile wide and with knowledge an inch deep. Newspapers just don't have the specialists. Standards per se have not got worse. If a single journalist has to cover banking, aviation, etc., then your level of knowledge gets worse because there is just too much. (Paul Barber, 20 August 1998)

For another:

> Even experienced journalists who have been covering the financial services sector for years are not experts and some have admitted to me that they don't really understand the field. (Nick Chaloner, 16 September 1998)

The resource gap, since the 1980s, has instead been filled by companies employing financial public relations specialists. To many observers, public relations and advertising have indeed had a greater influence on financial media than any other sector of the national news media (Parsons, 1989; Cassidy, 2002; Davis, 2002; Golding, 2003). This was the assessment of two former financial journalists now working in financial PR:

> Undoubtedly there is more PR in financial news than other sections. (Roland Rudd, 15 October 1998)

> I would say it [financial news] was 85 or even 90 per cent driven by formal announcements or events . . . The majority of journalists wouldn't even go down to Companies House to look up the annual reports and accounts. (Martin Adeney, 17 December 1998)

During the 1990s, the investor relations (IR) industry developed and expanded to become a third source of information subsidies for financial journalists. They began promoting companies directly to large investment institutions and did so, in large part, by supplying information to brokers' analysts and journalists. According to several accounts (Marston, 1996, 1999; Holland, 1997), the IR function increased the levels of 'controlled information disclosure' between companies and analysts. By the end of the 1990s, 77 per cent of analysts had at least weekly contact with their investor relations counterparts (Investor Relations Society, 1998: 33). Since journalists regard analysts as the independent 'experts' on companies, and regularly use their comments, this has become yet another form of company-supplied information subsidy for financial journalism.

Fund managers, interviewed some years later, were clearly sceptical about the content of financial news and its reliance on company, public relations and investor relations information. It seemed common knowledge that many company intermediaries attempted to 'manage expectations' and share prices by regularly leaking information to journalists, directly or through third parties:

> Most of the financial media get their ideas from the analysts they talk to, their mates in the City tell them what's going on and what's likely to go on. They are basically trying to sell things and then the journalists pick up on the trends – by and large. (Tony Dye, 7 April 2004)

> But a lot are just fed by the financial PR machine and that's all they do; they regurgitate the financial PR, which ain't much good. There are journalists who are conscientious and experienced, but there aren't many these days. (Anonymous fund manager, 2004)

During both research periods, it became apparent that financial news coverage had become overly influenced by the very companies journalists reported on. Quite apart from the overt pressures companies could exert – in terms of advertising clout and controlled access – journalism was extremely dependent on a variety of information subsidies provided by companies and their promotional intermediaries. In cutting costs, financial journalism had become more dependent on, and encouraged the growth of, several unregulated sources of financial information production. That information was over-produced, unreliable and lacking in diversity.

Brokers' analyst research

The most central and prolific set of information producers in the LSE are the research (also known as 'sell-side') analysts working for the broking houses. An estimated 14,000 people employed in broking houses (City Business Series, 2003), produce and disseminate 52 per cent of all financial research on companies (FSA/Deloitte and Touche, April 2004). Increased marketization in the 1980s caused a number of problems in this research process too.

Prior to the 1986 Financial Services Act, a small number of London-based brokers controlled access to the market by managing all trading activity and at high, fixed rates of commission. The high rates effectively paid for analysis, and investors therefore selected brokers on research ability and tip quality rather than on cost. After 1986 fixed commission rates were abandoned and any outside company could act as broker and 'market maker'. This had the obvious benefit of reducing trading costs and encouraging more trading. However, it also meant that brokers were encouraged to cut research costs to compete for business in an international, intensely competitive market. As one ex-broker explained:

> And this is why a lot of the brokers then [post-Big Bang] went into market making because they knew their stand alone business on 0.25% wouldn't survive really . . . The research departments got too big and became very expensive . . . so they had to cull some. (Mike Cunnane, 8 October 2004)

Fewer research resources thus meant a greater reliance on company information subsidies, either directly or indirectly, via investor relations practitioners (see above).

Equally significantly, broking houses became legally open to takeover and were almost all bought up by wealthier international investment banks. Investment banks have multiple forms of income, the largest of which involves offering financial services to publicly quoted companies. Since these are the same companies that brokers' analysts are researching and promoting, obvious conflicts of interest arose (see

Kynaston, 2001; Chapman, 2002; Golding, 2003, for accounts). As Tony Golding explained:

> In the 1970s, pre-Big-Bang, the advice of analysts was listened to and there was a natural mechanism and they were paid more for having good judgement. After Big Bang, when investment banks bought up brokers and the profitability of broking went way down, it became quite clear that you couldn't justify analysts just being analysts. You had to use them to open doors to other kinds of corporate business. So the whole thing became distorted. (Tony Golding, 6 April 2004)

The conflicted and unreliable nature of broker research was clear to many on the fund management side:

> Everyone puts their brokers' circulars or sell-side notes out . . . To the corporations they are saying 'we know all about your industry and we would be very good to advise you on all your financial business'. To the fund managers they are saying 'we know all about these companies and we can advise you on investments in them'. The great incentive for the investment bank is to push itself all the time. (Gordon Midgley, 12 March 2004)

> Brokers at the various houses will have their own agenda which has been set for the day – because these are information dissemination, selling operations. That is what they are – it's like double glazing salesmen. (Michael Rimmer, 5 May 2004)

The degree to which analyst information has been corrupted became apparent in research on analyst recommendations during the 1990s stock market boom period. During this time brokers became increasingly reluctant to make 'sell' recommendations for fear of offending the companies they analysed. By 2000, according to FSA research (FSA, July 2002: 12) 'buy' recommendations in 2000 outnumbered 'sell' by a ratio of nine to one. If a broker's parent investment banking company was found to directly advise the company traded, the ratio was 40 to one (FSA, July 2002: 18, see also Chan et al., 2003). Even through the period 2000–02, when share prices fell heavily, the ratio remained at five 'buys' to one 'sell'.

Following the post-2000 crash in the equities market, the FSA and Treasury began devoting greater attention to the problem in a series of discussion papers and policy statements (FSA, July 2002; FSA, February 2003; FSA, October 2003; FSA, March 2004). These papers revealed, in the words of Howard Davies, then Chairman of the FSA (press release, 12 February 2003) '. . . evidence of systematic bias in analysts recommendations, and of bad management of conflicts of interest'. The picture built up was one in which analysts had become subsidized, rewarded, pressurized and threatened by companies, in much the same way journalists are by powerful news sources.

Thus, as with financial journalism, market competition has had a negative impact on information production in the broker sector. There is a general over-supply of information by too many analysts. That information is increasingly dependent on companies and their intermediaries and is, thus, lacking diversity or objectivity. Analysts are not rewarded for the quality of their information but, instead, through promoting other financial services and/or pleasing clients regardless of conflicts of interest.

Fund manager research

The third major source of financial information production is fund management (or 'buy-side') analysis. Fund management companies produce an estimated 45 per cent of company research (FSA/Deloitte and Touche, April 2004), as well as making most of the major trading decisions. Once again, increased market competition has impacted on the information production process at this level. Deregulation of the financial markets led to a rapid influx of international financial institutions and intense competition. The London Stock Exchange is now the most concentrated, and has the largest overseas investment presence, of any of the major international exchanges (see Kynaston, 2001; Golding, 2003). On the one hand, fund managers seek to digest as much price-sensitive information as they can to make better trading decisions to attract big investors. On the other, resources are limited and have to be justified when trying to offer a competitive commission rate. According to one senior financial actuary, increased competition has indeed resulted in a reduction in fund manager research:

> All the competition on percentage of funds does the wrong thing as well. It may drive the fees down as a percentage of funds under management, but, what that does, if you then look at the mechanics of your business, is it forces you to cut your research staff and cut your overheads, which is the lifeblood of the information that's valuable to the client. So . . . They are competing over funds under management charge instead of competing over a more matched fee for research. (Jeremy Goford, 29 September 2004)

Consequently, fund managers have, in one way or another, attempted to economize on their information gathering costs and/or hide those costs from their investing clients. The most obvious way that is done is through greater reliance on brokers' analyst research. For many, brokers simply did the essential 'donkey work' and they then did the serious evaluation:

> No buy-side institution could ever afford to pay for that kind of quality of [broker] analyst . . . typically, sell-side can be much more concentrated because there are more of them than buy-side, who, are covering several sectors. (John Davies, 13 May 2004)

> In the ideal world the broker's role is simply to break bulk . . . I think there is a legitimate and defensible role that the fund manager should not read all 150 pages of [an annual results statement] and that it's fair for him to ring up somebody who has and ask the question 'What's the important bit in here?' It would be a great waste of everybody's time if every fund manager had to read all 150 pages. (Anonymous fund manager, 2004)

However, recent treasury/FSA investigations of the LSE (Myners, 2001; FSA, April 2003; FSA/OXERA, April 2003; FSA/Deloitte and Touche, April 2004; FSA, May 2004) have found that the information dependency of fund managers on brokers, generally, is rather more extensive and costly than that. This research estimated that, in 2000, £2.3 billion was paid in commission to brokers, of which, approximately 40 per cent went towards research and other information services. These 'bundled brokerage' and 'soft commission' arrangements, as these services were labelled, were not formally documented or accounted for. Thus, there was no means of judging the quality or cost-effectiveness of that information. At the same time, fund managers were encouraged to do business with brokers because of their ability to supply free information subsidies rather than their trading skills.

This also led to information over-supply, as well as a false picture of information diversity, as every broker competed to supply the same information to their clients. As one top actuary explained:

> I mean the whole soft commission thing . . . arguably encourages over supply of research. It's like having 50 TV channels. Is 50 TV channels better than four or five? Well, yes and no. You're getting more choice, but you're probably getting much lower quality, which is why people flick channels a lot. There's a big debate about that. (Andrew Kirton, 22 December 2004)

Alternatively, fund management companies have sought to save on information/research costs, and so offer lower commission rates to investors, by doing away with research altogether. A number of investment approaches simply buy and sell company shares according to price movements in the market itself. 'Index tracker' funds typically buy and keep FTSE 100 shares and are run automatically by computer programs. According to estimates by Myners (2001) and Golding (2003), 20–30 per cent of shares are managed in tracker funds or in 'closet indexers'. Phillips and Drew (1999, 2000: 5) put this figure higher, at 41–42 per cent. Alternatively, 'momentum' investing and hedge funds rely on computer analysis of internal market movements and trading anomalies. Each of these investment approaches, which have increased significantly since the early 1990s, has considerably reduced research costs but has not, according to financial market theory, encouraged efficient trading in the market as a whole.

According to one interviewee, such approaches disconnect trading prices from real prices, reduce the amount of active buyers in the market and encourage volatile and 'herd-like' trading patterns. As Paul Woolley explained:

> It pays everybody individually to index but, collectively, the market suffers because there is no efficient pricing. However efficient or inefficient the market is it's a zero-sum gain. Second thing is momentum. It pays everyone to use momentum but momentum causes bubbles and collapses and is damaging. The third thing is hedge funds. It pays everyone to use them but collectively it's extremely damaging . . . we get a bubble like that in 1999 or 2000 which is highly damaging . . . We had half a trillion of fruitless investment in telecoms infrastructure as a result of that bubble. (Paul Woolley, 29 April 2004, see also Myners, 2001; Woolley, May 2002, December 2002)

In attempting to reduce the spiralling costs of information and research, fund management companies have taken two routes. The first is to rely on a mix of overt and covert information subsidies, supplied by brokers' analysts which are, themselves, subsidized and overly influenced by companies. The second is to do away with research altogether and manage their investments electronically and purely in relation to the internal market. Both these options are likely to lead to less efficiency in trading in the market overall.

Consequences for economic efficiency

The ultimate consequence of liberalizing the LSE's market structures has been to liberalize most of its information production also, which, in turn, has made the LSE a less efficient market. The LSE appears to offer competitiveness and diversity in information production. However, much information is repetitive and over-produced, incurs high hidden costs, and is of poor quality and corrupted.

First, a large proportion of analysis consists of the same information being repackaged and presented by multiple intermediaries. Public/investor relations practitioners, journalists and analysts all pick up, process and pass on the same company-generated information. For fund managers:

> It's an industry with over-capacity. On average for a large company there will be 20–25 analysts per company and that must be an over-supply because basically their information comes from the same source, which is the company. (Tony Golding, 6 April 2004)

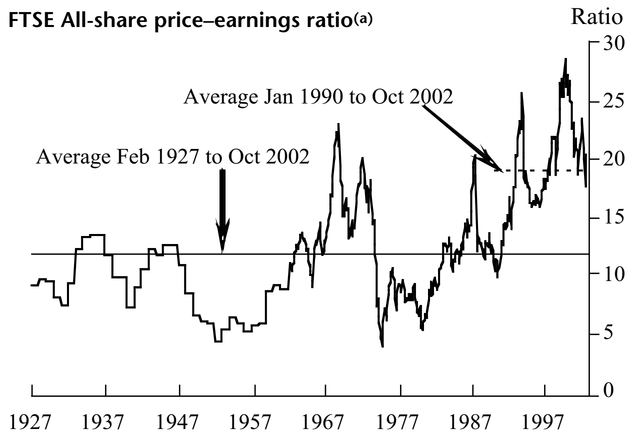
> There's too much information. So, you could spend your life analysing things to the end and not coming to a decision. Like *100 Years of Solitude*, that book by Gabriel Marquez. You get to the end and there's nothing. (Andy Brough, 28 September 2004)

Of equal significance, a large proportion of the 'objective' information produced is extremely unreliable. Competition means economizing on research costs, leading to a reliance on the information subsidies that are supplied by the very companies and experts that are the subject of evaluation. Consequently, there is a high level of scepticism amongst fund managers about the value and objectivity of much financial information in circulation:

> The main thing is we don't trust anything we get from the company and we don't trust anything from sell-side analysts. They offer a tainted product. They all get money from the companies they comment on . . . The sell-side are all journalists really. They are no better then journalists using company information. (Richard Krammer, 26 April 2004)

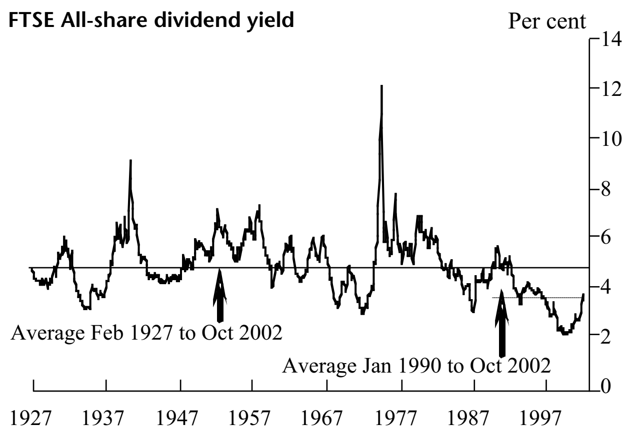
> The only credible source as far as we are concerned is us. That's the way it should be for anyone who's got any sense in the City. There's incredible sources and there's less credible sources but there's no credible sources at all. (Tony Dye, 7 April 2004)

Inefficient and corrupt information, in turn, contributes to inaccurate company valuations and/or a tendency to adopt investment 'styles' which do not require company research at all. These have resulted in pricing for the stock exchange, as a whole, to move away from historical measures[6] and/or become less stable. From the late 1980s annual returns for investors were impressive but, according to historical market data, bore little relation to conventional accounting values. According to Bank of England data (see Figure 2), the LSE's price–earnings ratio was 50 per cent higher than its long-term average in the 1990s and by 2000 was two and a half times that average.[7] The average dividend yield (dividends paid to shareholders) was also markedly lower than its long-term average and had hit a new low in 2000 (see Figure 3). Both these trends meant that short-term profits were made but, in the long term, contributed to the LSE being as over-priced as at any point in the 20th century. Obviously, the corruption of information production was only one contributing factor to this state of affairs, but, it was a significant one.



(a) Annual data until 1962, monthly data thereafter
Source: Wetherilt and Weeken (2002).

Figure 2 FTSE All-share P/E ratio (1927–2002)



Source: Wetherilt and Weeken (2002).

Figure 3 FTSE All-share dividend yield (1927–2002)

Ultimately, the costs to the City and those professionally involved in the LSE have been high. Following the 2000 crash, the market lost almost 50 per cent of its value over three years. The most severe job losses in any sector of the UK economy were in the City itself. Despite a modest recovery since 2003, at the time of writing, it is still below its peak of 2000 but is still regarded by many as overvalued. Monthly surveys of fund managers in the industry (Merrill Lynch) indicate it has been consistently labelled the second most 'overvalued' of the markets after the New York Stock Exchange (see also Smithers and Wright, 2004).

Since 2000 the LSE's owners and regulators have been regularly criticized in business and political circles. In recent years four other international exchanges have made, or come close to making, take-over bids for the LSE itself. At the time of writing its future is far from assured.

In effect, the LSE has become less efficient. While direct transaction costs in the City have gone down, indirect costs have gone up. The companies and investors at either end of the investment/information chain, directly or indirectly, have to pay the rising costs of these multiple layers of information intermediaries and their excessive information outputs. As one independent analyst explained:

> At the moment the evidence is . . . there is far more research and effort made in the management of research than is needed to keep the market efficient. The City of London and Wall Street make more money than they should. (Andrew Smithers, 20 April 2004)

Information may be more universally available but its quality, and hence trading utility, is questionable. It is less diverse or pluralist in nature and its producers are not rewarded for greater accuracy or attempted objectivity.

All these concerns were echoed, rather vociferously, by some of the interviewees:

> So maybe the conclusion that you come to is that competition doesn't work . . . It's only because the OFT doesn't understand that competition does the wrong thing for customers and they still don't understand that . . . they just believe that competition will just solve everything. (Anonymous actuary, 2004)

> I think the whole thing is utterly disreputable. Competitive markets are not efficient markets. The academics have taken us all up the garden path and the practitioners have enjoyed making money from the whole thing. (Anonymous fund manager, 2004)

> Once you have lost [even] self regulation . . . You get the lunatics running the asylum quite frankly . . . The UK is wide, wide open and if anyone is going to bring a tin opener to any part of capitalism it's going to come in the UK. In 35 years of it I've never been so concerned. (David Bailey, 16 August 2004)

Conclusion

Initially, the combination of market deregulation and company information regulation appeared to have contributed to the overall health of the London Stock Exchange. The break-up of a privileged and exclusionary market system encouraged international investment and maintained the LSE's position in the global financial system. In financial market terms the City began operating more efficiently. However, extreme marketization has impacted directly on most non-company generated financial information. Information concerns, such as independence and objectivity, quality, cost and efficiency of production, have not been properly addressed.

This state of affairs has contributed to the LSE becoming, in plain economic terms, less efficient and cost effective, not more. The costs of sustaining the market and its many information intermediaries grows. Investment has become increasingly haphazard as decision-making comes to rely on 'promotional' rather than 'objective' information. Stock market trust, external investment and employment in the equities market itself has declined. In essence, free market policies, given free rein in the LSE, have worked to corrupt information. Such developments have, to an extent, helped put in jeopardy the long-term survival of the market itself.

The arguments put here have been in terms of the social sphere of the London Stock Market. But, because the LSE is embedded in both the British economy and the global financial system, there are also wider economic (not to mention social and political) consequences. Inefficient allocation of capital in industries in the UK and elsewhere, costly and wasteful takeover activity, industrial and employment decline and displacement, financial instability and unpredictability in national budgets, large-scale corporate frauds, banking crises and pension fund collapses are some of the many repercussions noted by observers.[8] Interestingly, these problems have also been documented in other deregulated financial markets, such as the New York Stock Exchange,[9] as well as in the global financial system more generally. None of these consequences are considered to be 'public goods'.

The general conclusion is that media and information are key resources that are essential for the stable functioning of any social sphere – be it on any scale and in any social, political or economic context. If they are subjected to unrestrained market forces, left under-resourced and under-regulated, the stability and longevity of that sphere is jeopardized. These arguments have usually been put in terms of the social and political consequences of economic liberalization. These, in turn, have been contested by those who emphasize that social gains are a natural by-product of economic stability which, in turn, is aided by free market policies. However, as argued here, economic stability becomes just as insecure and unsustainable if simply guided by neoliberal economic thinking. The core assumption that free markets are purely beneficial on economic grounds cannot be taken for granted.

Notes

1 Many thanks to James Curran, Frank Webster and an anonymous referee for their comments. Thanks also to the Bank of England for permission to reproduce Figures 2 and 3 from the Bank's quarterly bulletins.
2 For a range of social and political objections to increased marketization of media see: Postman, 1985; Schiller, 1989; Herman and McChesney, 1997; McChesney et al., 1998; Bagdikian, 2000; Golding and Murdock, 2000; Sparks, 2000; Davis, 2002; Franklin, 2004; Miller, 2004.
3 For a range of such market-oriented arguments see: De Sola Pool, 1983; Murdoch, 1989; Dahlgren, 1995; Waters, 1995; Norris, 2000; Lull, 2001; Street, 2001; Lees-Marshment, 2004.
4 These included: 36 directors of corporate public/investor relations (consultancies and in-house), 22 fund managers, 12 officials in related government, associations and regulatory bodies, 9 financial/business journalists and editors, and 16 others who work in the City (including CEOs, stockbrokers and actuaries).
5 It should be noted that the criteria associated with 'efficiency' in markets generally are not the same as those applied in financial market theory. A market may operate efficiently according to EMH criteria but still be inefficient in other ways. See Fama, 1970, for a description of the Efficient Markets Hypothesis. For Fama (1970: 387), ideal market conditions are those where: '(i) there are no transactions costs in trading securities, (ii) all available information is costlessly available to all market participants, and (iii) all agree on the implications of current information for the current price and distributions of future prices of each security'. See also Von Hayek, 1945; Arrow, 1979, for similar descriptions of the role of information in markets generally.
6 For most market theorists the idea that market prices are accurate or inaccurate is not a question to be contemplated. Prices are simply set by supply and demand and relative to measures set within the market. Many are thus sceptical at the application of historical and accounting measures to judge the 'accuracy' of a market.
7 The P/E or price–earnings ratio of a company or market is the total price of the share(s) divided by the actual annual earnings of the company or market. The higher the ratio the smaller the returns and the riskier the investment.
8 On these issues see, e.g.: Ingham, 1984; Strange, 1986, 1998; Hutton, 1996; Hirst and Thompson, 1999; Myners, 2001; Golding, 2003; Davis, 2007.
9 See Smithers and Wright, 2000, 2004; Shiller, 2001; Cassidy, 2002; Swedberg, 2005.

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Interviewees cited

Martin Adeney, Managing Director of Group Public Relations at ICI, 17 December 1998.

David Bailey, Chairman of Datacash, former Partner at Phillips and Drew, 16 August 2004.

Paul Barber, Group Corporate Affairs Director of Inchcape, 20 August 1998.

Andy Brough, Co-Head of UK and European Small and Mid-Cap, Schroders, 28 September 2004.
Nick Chaloner, Director of Corporate Affairs at Abbey National, 16 September 1998.
Mike Cunnane, Ex-Broker and Investment Analyst, 8 October 2004.
John Davies, Ex-Managing Director of Asset Management for 3i UK, 13 May 2004.
Tony Dye, Founder and Director of Dye Asset Management, 7 April 2004.
Jeremy Goford, Principal at Tillinghast Towers Perrin, Immediate Past President of the Institute of Actuaries, 29 September 2004.
Tony Golding, Ex-Fund Manager, Author and Consultant, 6 April 2004.
Andrew Kirton, Head of UK Mercer Investment Consulting, 22 December 2004.
Richard Krammer, Founder and MD of Arete Research Ltd, 26 April 2004.
Gordon Midgley, Director of Research, Investment Managers Association, 12 March 2004.
Michael Rimmer, Senior Portfolio Manager at Investec Asset Management, 5 May 2004.
Roland Rudd, Founding Partner of Finsbury, 15 October 1998.
Andrew Smithers, Ex-Fund Manager, Director of Smithers and Company, 20 April 2004.
Paul Woolley, Chairman of GMO UK Ltd, 29 April 2004.
Four further interviewees have been cited anonymously.

Biographical note

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