

Preface

This dissertation addresses the attractiveness of financial centers with a primary focus on the mutual fund industry and uses different empirical analysis approaches in an attempt to disentangle the reasons for location attractiveness in order to identify its influence on fund pricing. The presented research tackles an issue that is fundamental to the understanding of organizational behavior in finance: the rationale behind the decision-making process of market participants and its consequences for an economy. Literature on the subject presupposes the decreasing general relevance of agglomeration in a globalized financial world. However, the findings of this thesis indicate that spatial proximity still matters in finance. Overall, a financial center can be defined as the nexus of ties between companies and institutions in a geographically defined area which are involved in functions that enable and facilitate financial transactions. Historical developments should be taken into account when talking about the relevance of the financial centers of today (e.g., Euromarkets in London or strategic clustering in Frankfurt am Main). The literature emphasizes that the outcomes of location decisions are long-lasting and often irreversible. The effects of path dependence would have far-reaching consequences not only for the financial company itself, but also for its social relation with other market participants (in the cluster) and for the (fiscal) government.

The first empirical analysis provides a unique insight into market participants' views on factors that affect the locational attractiveness of a financial center over time, taking into account assessments before, during, and after the financial crisis. This analysis of market participants' views is carried out by explaining their assessment of what makes financial centers attractive and of the central influencing factors in this regard. In particular, the results reveal that cluster concentration with a rapid information exchange within dense social networks is a competitive advantage. In comparison, an existing specialized pool of labor without concentration does not seem to be relevant, as the human capital factor is relatively mobile in an increasingly integrated Europe. Furthermore, governmental support and parameters of regulation strongly determine a location's attractiveness for financial institutions, whereas the level of taxation does not seem to be important on the micro level. Despite some progress in establishing a level playing field in the EU, the financial market is not yet fully harmonized and countries can take different paths in regulation as long as there is scope for interpretation. Hence even minor differences in financial regulation within the EU may lead to regulatory arbitrage. Overall, the attractiveness of financial centers varies over time as opposed to the relatively persistent location factors. The findings do not

hinge on differences in market participants' socio-economic background. It is shown that fund companies seem to value the attractiveness of a financial center much more than banks, insurance companies, and corporates.

Based on these findings, the domiciliation decision in the mutual fund market is analyzed in the second empirical analysis. The intensified competition among fund companies in the EU has provided incentives to relocate companies' activities and to domicile their funds in financial centers which offer the most favorable regulatory environment. The second empirical analysis suggests that the decision on where to domicile a UCITS fund is primarily driven by fund-specific legislation, conditions in the approval process, and the cluster of specialized experts. In contrast, traditional cost factors such as registration charges, fund company tax burden and labor costs are generally considered to be less important. A further central implication of this dissertation is that fund companies sort their preferences with regard to the domiciliation decision in a very similar way and that managers' assessments are more consistent the more relevant the determinants are. This finding also reinforces the significance of the results. Further, this thesis stresses that despite virtually uniform regulation conditions for UCITS funds, differences in practice still exist between countries (e.g., relationship between actors in the fund company and authorization body). Luxembourg remains the winner in almost all considered determinants, whereas countries with a large domestic market size, such as France and Germany, lag behind. Therefore, the common divergence between the production and distribution of funds is still motivated by clear reasons; indications of path dependence do not seem to exist.

Competition among fund companies in the EU corresponds to the idea behind many reform approaches taken by the European Commission to create cost benefits for investors through the free flow of services in a harmonized single European market. Current studies imply that economies of scale in fund size can create cost benefits. Building on the previous insights, the thesis will then consider whether investors benefit from a concentrated domiciliation in a financial center, which has been made possible by the EU market integration of the European fund industry. To do this, it will analyze the determinants of recurring fund fees. The results will show that the fees charged by funds differ significantly across countries and across fund types. It will also be shown that economies of scale can be generated by fund size and fund company size and that funds domiciled in Luxembourg have considerably lower cross-border distribution costs. However, these advantages, which are passed on to investors, are countered by several drawbacks. Generally, funds complying with UCITS policy are more expensive for investors. Furthermore, fees rise with an increase in the number of countries in which the fund is distributed, as additional distribution partners and permits are required. The results do not clearly show that investors pay lower fees for funds from the specialized financial centers Luxembourg or Ireland than for funds of other countries. All in all, it is shown that the market integration of the European fund industry has reduced costs significantly, which is due mainly to the concentration of specialists in clusters and economies of scale, leading to greater welfare.

The results of this thesis are particularly interesting when brought into context with the current implementation of the revised UCITS directive (UCITS IV, Directive 2009/65/EC). This next step towards EU market integration allows fund companies to domicile a UCITS fund in any other EU Member state without having to comply with formerly required infrastructural “substance criteria,” i.e., they are no longer required to have a subsidiary in the country of domiciliation. Nevertheless, cluster advantages may still give fund companies incentives to stay in a specialized financial center. In any case, this step towards market integration will create more opportunities for fund companies to geographically optimize their business model. This does not only concern new funds, but also domiciliation decisions for two existing funds that are to be merged. This development could have positive implications for investors, i.e., lower fund costs.

Overall, the core findings of this thesis support economists who believe in the virtues of economic integration in finance. The results of this dissertation strongly indicate that market integration works in the globalized mutual fund industry.

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