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English bank development within a European context, 1870-1939

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This article addresses the long-standing comparison that is frequently drawn between the financial provision for industrial companies made by English and continental European banks in the half-century or so before 1939.[1] It is a comparison in which English banks are traditionally criticized. The article redresses the balance somewhat. It surveys recent evidence on the history of banks and bank lending from a variety of European countries, and draws conclusions that place English bank development in a more realistic context. Section I introduces the main elements of both the theoretical and historical comparison made between English and continental European banks. The second section notes that England was not alone in not developing universal banking. Section III provides a brief summary of recent research on the historical developments in those countries that did develop it. Section IV points to the similarities that the research has found in English and European bank lending to industry, despite the clear structural differences in the English credit bank system and that of the universal bank. Section V highlights a number of weaknesses in the continental system—weaknesses that were less obvious in England—before the overall conclusions are drawn.

I

At the outset it is important to note that industry is largely financed from internal funds, that financial institutions meet only part of the financial requirements of firms and, therefore, their role is only part of the explanation of industrial investment. Even so, bank provision of finance has generated a great deal of discussion and in the case of English banks it has often led to adverse comparisons being drawn with some of their European counterparts. Such criticism rests on both theoretical and historical/empirical grounds. The basic issue is whether or not the allocation of finance should be left to the sovereignty of the market place—where borrowers compete for the funds of investors—or is better served by bankers who have the power to distribute funds and exercise influence over the uses to which they are put. For analytical purposes the argument often highlights differences between two stereotyped financial systems: an

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Anglo-Saxon market-oriented system and a continental (or German) bank-oriented one.

A 'market-oriented' system is one largely characterized by financial institutions dealing in extensive, well-organized markets for standardized equity and debt instruments. On the demand side, private sector firms seeking external finance will borrow or raise capital in a competitive market at the going rate of interest. They do this by issuing shares, debentures, and other securities on the market. Within this model, it is the formal markets—and the individuals and institutions operating within them—that finance industrial investment, allocate financial resources, and transfer ownership rights. Within such a system of financial provision, the role of commercial banks is secondary: offering advice to clients, providing access to a network of contacts within the market, and supplying short-term credits to finance variable costs and to smooth out cash flows.[2] Firms' external financial requirements are largely met in the market and the relationship between bank and industrial client is essentially an arm's length one. The merits claimed for such a system are those familiarly associated with competitive markets—if entry to the market is relatively free, accurate information widely disseminated, and trading conditions competitive, then market distribution will be efficient. Market competition will keep costs low and ensure a flexible, adequate supply of finance.

Of the criticisms, the one most directly relevant to this historical survey is the allegation of 'short-termism'. Here, the suggestion is that the ease with which investors can buy and sell securities in a well-developed market system means that they may have limited commitment to the long-term performance of a particular business and if dividend prospects look better elsewhere they will transfer their holdings. As a consequence, firms in such a system have to be careful to maintain current dividend and share values in order to retain investor loyalty. Where the possibility of hostile take-over also exists, concern for short-term contingencies to maintain share values is reinforced, perhaps to the detriment of longer-term investment projects.[3]

A bank-oriented financial system is characterized, as the name suggests, by the predominance of banks in the provision of external finance for firms, with the corollary (certainly in a historical context) of less well-developed formal markets for debt and equity. In such a system, banks maintain close, regular contacts with the industrial clients to whom they are making loans. This is essential in order for them to assess risk properly and to monitor the performance on the client's account and, particularly, to ensure the proper execution of loan arrangements. In a number of ways banks are likely to operate in a less formal manner than markets. There will be more personal contact between lender and borrower, banks often have privileged access to information about the bor-

[2] Rybczinski, 'Industrial finance systems'; *idem*, 'Financial systems and industrial restructuring'; Berglof, 'Capital structure'.

[3] Cosh, Hughes, and Singh, 'Analytical and policy issues'; Crafts, 'Productivity growth reconsidered'; Hutton, *The state we're in*. For a critical assessment of short-termism arguments see Marsh, *Short-termism on trial.*

rower, and there is greater potential for offering non-standardized contractual arrangements.

There are theoretical grounds for arguing that a bank-oriented system can be efficient. Efficiency derives from economies both of scale and of scope. Thus, economies of scale are feasible where a large bank, in effect, operates on behalf of its depositors by formalizing its information-gathering and monitoring functions with respect to loans and investments. The large fixed cost element of such activities would obviously magnify the total cost if the myriad savers were to act individually. The high costs associated with information-gathering may also give rise to economies of scope if—as is the case in this stereotyped model—banks engage in a broad range of activities associated with credit and investment banking such that information collected through one activity (e.g. organizing a share flotation for a client) can also be used to enhance decision-making in another activity (e.g. the provision of loans to the same client). The bankers' accumulated 'inside' knowledge of their customers' business and of the past operations on their accounts gives them information that is not available to individual investors making purchases in the market. Such privileged knowledge, in turn, reduces the various costs associated with the problem of asymmetric information which will be endemic in the absence of well-developed formal markets.[4] Thus, compared with individual investors, the banks generally would be in a better position to evaluate prospective income streams from proposed industrial loans, to make decisions about acceptable levels of risk, and—potentially—to adopt a flexible and dynamic stance towards industrial lending.[5] Superiority for the bank-oriented system is also argued on the grounds that firms tend to maintain an account with only one bank and the freedom from greater competition enables the bank to display greater commitment to the firm, supporting it in times of difficulty and concentrating on longer-term returns than is feasible for savers in a competitive market-oriented system.[6]

The main drawbacks of such a system arise from the close relationship between banker and borrower. This can lead to a distortion in the flow of funds—say, where both banker and industrial client give each other privileged status to the exclusion of other borrowers and/or lenders. Also, if greater bank commitment leads to the holding of illiquid securities and the tying up of a large proportion of bank assets in a small number of client firms, it could significantly magnify the consequences for bank stability of any subsequent customer default.

The historical debate may not always address these theoretical issues directly but their implicit acceptance underlies much of the disquiet about the role that financial institutions have played in modern English econ-

[4] Leland and Pyle, 'Information asymmetries'; Diamond, 'Financial intermediation'; Williamson, 'Costly monitoring'.

[5] Carrington and Edwards, *Financing industrial investment*; Binks, Ennew, and Reed, 'Information asymmetries and the provision of finance'; Cable and Turner, 'Asymmetric information and credit rationing'.

[6] Mayer, 'New issues in corporate finance'; *idem*, 'Financial systems'.

omic development.[7] An important part of the argument is that the practical operation of financial institutions and markets has worked against the best interests of industry, limiting the type and volume of financial flows and services available to industrialists. Attack on the banks has been part of the broader tradition that Supple has recently called the 'fear of failing'.[8] Adverse comment on the relationships between English banks and industry began around the turn of the century and, as part of the general anxiety engendered by the loss of English economic hegemony, it was often expressed in the form of a contrast between practice in England and in Germany. Increasing international rivalry around the time of the First World War and England's prolonged financial and industrial troubles in the interwar years helped fuel the debate,[9] and it is a debate that has persisted into the late twentieth century.[10]

Among the most influential contributions has been Gerschenkron's writing on relative backwardness.[11] It was his view that German banks played a critical role in economic development about the turn of the century by making good deficiencies elsewhere in the German economy:

> the German investment banks—a powerful invention, comparable in economic effect to that of the steam engine—were in their capital-supplying functions a substitute for the insufficiency of the previously created wealth willingly placed at the disposal of entrepreneurs. But they were also a substitute for entrepreneurial deficiencies. From their central vantage points of control, the banks participated actively in shaping the major ... decisions of the individual enterprises. It was they who very often mapped out a firm's paths of growth, conceived far-sighted plans, decided on major technological and locational innovations, and arranged for mergers and capital increases.[12]

More recently, commentators such as Elbaum and Lazonick have subscribed to the well-known hypothesis that English economic failure was due to institutional sclerosis, an explanation that incorporates criticism of the institutional structure and practice of financial markets.[13] Contributors to the debate have differed as to the period under study but there is general agreement that experience during the late Victorian, Edwardian, and interwar years (when English economic hegemony was conceded) was critical. A serious unfavourable outcome, it is claimed, was a relatively low rate of investment in industry and subsequent weaker international competitiveness and lower growth.[14]

[7] In particular, see Collins, *Banks and industrial finance*; Capie and Collins, *Have the banks failed British industry?*; Cassis, 'British finance'.

[8] Supple, 'Fear of failing'.

[9] Foxwell, 'Financing of industry'; Clay, *Postwar unemployment problem.*

[10] Hutton, *The state we're in.*

[11] Gerschenkron, *Economic backwardness.*

[12] *Idem*, 'Modernisation of entrepreneurship', p. 137.

[13] Elbaum and Lazonick, *Decline of the British economy*; Newton and Porter, *Modernization frustrated*; Olson, *Rise and decline*. See Kirby, 'Institutional rigidities' for a review of the general debate.

[14] Kennedy, *Industrial structure*; *idem*, 'Capital markets'. For an assessment of the relative merits of the international orientation of British financial markets see Pollard, 'Capital exports'. See Edelstein, 'Realized rates of return'; *idem*, *Overseas investment*; and Michie, 'Stock exchange' for criticisms of the allegations.

In its entirety, the debate embraces a wide range of financial institutions, including the Bank of England, merchant banks, the Stock Exchange, and the commercial banks. It is with the last group that this article is concerned. It was these banks that serviced the great majority of industrial firms. From at least the third quarter of the nineteenth century, the extensive geographical coverage of the country's commercial bank branch networks meant that every industrial firm of reasonable size and reputation had ready access to a range of commercial bank services. The convenience and accessibility of overdraft and other lending facilities at local commercial bank offices meant, in effect, that it was to these banks that industrialists most readily turned for their normal borrowing requirements. Yet there has remained a great degree of suspicion that the performance of these commercial banks also failed to support adequately the development of English industry, and a long-standing allegation is that compared with continental experience, English institutional factors and business practices were not conducive to optimum economic growth, especially in the industrial sector.

It is this allegation which is in need of serious reassessment. There have always been some who have questioned the efficacy of the continental alternative. Thus, as early as 1930, Barrett Whale was arguing that the large German creditbanks—with which English banks are most often adversely compared—rarely undertook the long-term 'participation[s]' in industrial firms which were often assumed to have occurred, 'at any rate in their modern period'.[15] A different form of attack came four decades later from Neuburger and Stokes whose econometric analysis found that 'the credit allocation policy of these banks was inhibiting rather than stimulating the German economy'[16] but, as Gille's survey of developments across Europe highlighted, at that time (in the 1970s) there had been little use by historians of primary bank archives.[17] Most recently, Edwards and Ogilvie have raised fundamental doubts about the significance of the role played by universal banks even during Germany's industrialization phase.[18]

In recent years, in fact, there has been a significant amount of research by a variety of scholars into banking developments in different parts of Europe, including England, and close examination of their findings shows a much greater degree of common practice in the workings of banks from different countries than the stereotyped contrasts imply. The fruits of the research have now made possible a more thorough comparison between English and continental developments. This is presented below, where the results of a range of specialist studies are summarized in such a way as to bring out the general implications for our understanding of the comparative role of English banks. Three main points are highlighted in what follows. First is the obvious, though not always fully acknowl-

[15] Barrett Whale, *Joint-stock banking in Germany*, pp. 46-7.

[16] Neuburger and Stokes, 'German banks and German growth', p. 717. See Fremdling and Tilly, 'German banks, German growth and econometric history' for a direct refutation.

[17] Gille, 'Banking and industrialisation'.

[18] Edwards and Ogilvie, 'Universal banks'.

edged, fact that England was not the only major European economy not to develop universal banking. Secondly, recent research has made it increasingly clear that there was a great deal of similarity in the provision of loans to industry by both English and continental banks. Finally, it is also clear that there were major systemic weaknesses with the universal banking system as it operated on the continent before 1939, weaknesses that contributed to banking instability which was widespread in Europe but absent from England.

II

At first sight, a summary by Teichova, Gourvish, and Pogány of the results from some of the recent research projects on banking developments in central Europe and Scandinavia apparently endorses the traditional view that English bank relationships with industry were exceptional:

> [Striking] similarities can be found in the activity of commercial and savings banks in financial markets, bank share holdings, and the conversion of short-term advances by repeated renewals into long-term loans. Above all, they can be found in the remarkable continuity of ties between banks and the industrial companies clustered around them, a process which created *Konzern*, or banking industrial groups, as well as long-term and unbroken personal relationships between bankers and industrialists. . . . With the exception of the UK and France, this type of banking became prevalent in continental Europe from the 1880s and a close relationship between industrial companies and the banks was established everywhere.[19]

However, the development path of national financial systems was much more varied than this quotation suggests. To begin with, one obvious but important point that needs to be highlighted is the fact that whereas the German-type banking system was common in Europe, it failed to develop in a number of important countries. In that sense, English banking was not unique. Thus on the continent, France (as the above quotation acknowledges), the Netherlands, Norway, and Greece were among the European countries in which bank-oriented financial systems did not evolve during the period under review.

For the most part, involvement in the provision of industrial finance by French banks remained restricted in this period (the more so after the industrial problems of the 1870s and 1880s).[20] A conservative banking orthodoxy resulted in the banks' non-interventionist, intermediary role channelling a high proportion of domestic savings into low-risk, overseas securities and, as in the traditional portrayal of English banks, credit provision for domestic industry was essentially short-term. In fact, the trend, first among the large national banks, and then—from the turn of the century—in the regional banks, was towards a more liquid asset structure and away from long-term commitments to industry.[21] There

[19] Teichova, Gourvish, and Pogány, eds., *Universal banking*, p. xi.
[20] Gueslin, 'Banks and state in France'.
[21] Lévy-Leboyer and Lescure, 'France'.

were exceptions to this general picture—for instance, some local banks in industrial regions such as Lorraine provided a greater degree of industrial finance—but, overall, interaction between French finance and industry was limited.[22]

General developments in the Netherlands, Norway, and Greece were similar to those in France in that the banks maintained an arm's length approach to industry. In all four countries the normal duration of loans was short-term (a matter of months) and industrial share-ownership by the banks was very limited. In general, too, the industrial problems of the interwar years led these countries (like Britain) to a move towards a greater degree of involvement with industry as the banks had to cope with prolonged periods of client distress. Even so, there was no fundamental change in the nature of bank aid to industry, even under the abnormal pressures of the interwar years. Indeed, in the two largest countries, England and France, the banks faced similar criticisms from those who wanted a more proactive role for financial institutions in the restructuring of industry at that time, namely that the response to industry's needs in troubled times was wholly inadequate.[23]

In the Netherlands, also, the immediate postwar years saw a temporary extension of loans to industry but, in fact, liquidity pressures early in the 1920s and during the international crisis of the 1930s reinforced the financial sector's aversion to long-term loans and investments.[24] In Norway a mixture of state-owned banks, commercial banks, and saving banks had evolved before the First World War. The commercial banks were, in essence, credit banks—they did not acquire share holdings, did not develop security issuing services, and concentrated on short-term credit provision to industry.[25] Again, however, widespread customer distress did mean that some of the banks became reluctantly embroiled to an unusual degree in industrial restructuring plans between the wars, but it did not provoke a fundamental change. In Greece, too, commercial bank involvement was very limited. Before the First World War the banks confined their business sector financing to short-term credits, mainly to the commercial sector. Between the wars there was some movement by the large, privately owned National Bank towards industrial finance but this remained very limited and concentrated on a handful of large industrial clients.[26] Universal banking did not develop in the period.[27]

So, the first point to stress is that the UK was not unique in failing to develop universal banking. Differences existed across Europe and, obviously, any simple equating of good economic performance with a bank-oriented system and poor performance with a market-oriented system is bound to be flawed.

[22] See Lescure, 'Banks and small enterprises' on bank provision for small-scale firms.

[23] Bouvier, 'French banks'; Collins, *Banks and industrial finance*, ch. 6.

[24] Jonker, 'Spoilt for choice?'.

[25] Lange, 'Norwegian banking system'; Knutsen, 'Norwegian banks'.

[26] Dritsas, 'Bank-industry relations in inter-war Greece'; *idem*, 'Networks of bankers and industrialists in Greece'.

[27] Mazower, 'Banking and economic development in interwar Greece'.

III

Nevertheless, it is a fact that in many other countries on the continent—particularly Germany, Austria-Hungary (and the successor states of the interwar period), Belgium, Sweden, Italy, and Spain—some sort of mixed or universal banking did emerge in the period. This section briefly summarizes the nature of the bank-industry link in those countries. Specific national characteristics differed but in general it is argued that, although there were undoubted differences in the approach of banks on the continent and in England, there was more similarity of approach than the traditional Anglo-continental contrast allows for. In particular, banks on the continent relied much more on short-term lending than is normally appreciated, and in this their practice was similar to that of the English banks.

As has already been noted, for English banking the contrast most usually drawn is that with Germany. In the 1960s Gerschenkron made one of the strongest presentations of the case for the importance of Germany's particular banking system. James has recently summarized this case:

> The Gerschenkronian tradition accords to credit banks the central role in Germany's economic development, since after the mid nineteenth century they mobilized large sums for industrialization that would otherwise have been unforthcoming. They took a sustained interest in companies by means of the *Kontokorrent* (loans through overdrafts on current account). When the capital market appeared receptive, they managed the issue of shares and flotation of companies on the Stock Exchange; and they used their influence on Supervisory Boards (*Aufsichtsräte*) to influence firms' policies and especially to regulate competition and promote cartels and mergers.[28]

For a long time there have been doubts about the validity of the comparison in its entirety, but a recent résumé by Tilly has strongly endorsed the view that the banks in Germany contributed in a significant manner to economic development before 1914.[29] By the beginning of the twentieth century the German banking system was dominated by joint-stock banks which were among the largest corporations in the country.[30] They operated as 'mixed' or 'universal' banks. The practice had been established much earlier by the private banks of the mid-nineteenth century and it combined features of both credit banking and investment banking. '[The banks'] contribution consisted [of] the financing of risky investments, particularly in heavy industry, and included entrepreneurial feats such as the formation of new enterprises, the implementation of mergers and the organization of cartels.'[31] It is Tilly's

[28] James, 'Banks and bankers in the German interwar depression', p. 263.

[29] R. Tilly, 'Banks and industry: lessons from history', conference paper, delivered at Munster, June 1994. Also see *idem*, 'Financial history' and *idem*, 'Germany' where he argues that the role of the universal banks owed more to political and institutional forces than Gerschenkron's economic backwardness hypothesis allows for.

[30] Riesser, *German great banks*, provides the classic description.

[31] Tilly, 'Banks and industry' (above, n. 29), p. 94.

judgement that, in most of its essentials, the traditional view of German universal banking before 1914 remains valid, with the 'banks closely monitoring their customers' activities, sometimes controlling the latter, always treating the relationship as an on-going (long-term) one'.[32] He argues that this benefited German industrial development, with the banks promoting and sustaining the market in industrial shares and industrial loans. He stresses the importance of the banks in 'shaping the timing and structure of German industrial growth'.[33] This is a view that closely coincides with that of one of the leading critics of English financial institutions, Kennedy, who is to the fore in emphasizing the comparative benefits derived from the German system's willingness to provide industrial finance before 1914, especially in sectors exploiting new technologies such as electricity.[34] Wixforth and Ziegler concur in this favourable judgement on the contribution of German universal banking (although they do not explicitly draw an unfavourable comparison with English banks) and point to the supplementary role played by smaller, localized banks.[35]

Swedish banking history embraced both English-style credit banking and universal banking. Credit banking developed first but was displaced in the second half of the nineteenth century by a universal banking system of the German type. According to a recent review by Larsson and Lindgren: 'The relative backwardness of Sweden at that time [from the 1870s] and the desire for industrial development gave rise to more demand for long-term rather than short-term credits . . . [and] . . . German universal banking was implemented into the Swedish system.'[36] However, as in England, the banking crisis of 1878-9 provoked a reaction against tying up too many resources in illiquid loans and investments to industry and, in fact, provoked the imposition of legislative restrictions on the ownership of shares by the banks. Nevertheless, to a large extent the banks were able to circumvent these restrictions and they continued to finance share underwriting and industrial restructuring operations. Significantly, continued pressure from both industry and finance to follow the German example of providing industrial capital eventually led to Swedish banks acquiring the right to buy shares under the general reforming Banking Law of 1911.[37] By the First World War the Swedish financial system was strongly bank-oriented.[38] Moreover, rapid wartime expansion was followed in the early 1920s by industrial problems of such severity that there was a further, sharp increase in bank involvement with industry. The banks established subsidiary issuing or investment compa-

[32] Ibid., p. 110.

[33] Ibid., p. 104.

[34] Kennedy, *Industrial structure*; *idem*, 'Capital markets'; *idem*, 'Portfolio behavior and economic development'.

[35] Wixforth and Ziegler, '*Bankenmacht*'. Also see Wixforth and Ziegler, 'Niche in universal banking system for a discussion of the role of the smaller private banks.

[36] Larsson and Lindgren, 'Political economy of banking', p. 342. More generally see Larsson, 'State, banks and industry in Sweden'.

[37] Björkegren, 'Role of banks in Sweden'.

[38] Larsson, 'Overcoming institutional barriers'.

nies and continuing economic distress increased industrial indebtedness to the banks.[39] In combination, these developments meant that by the 1920s the banks had become the 'owners of a substantial part of Swedish industry'.[40] However, this proved to be the turning point in the development of Swedish bank-industry relations. Liquidity problems were such that for the decade as a whole commercial bank lending actually fell as the banks struggled to write down the value of their assets and avoid liquidation.[41] Government also intervened to re-impose restrictions on share ownership, although it took the crisis of the early 1930s to ban banks once again from owning industrial shares.

From the closing decades of the nineteenth century the Austrian universal banks began to shift their business towards industry—including the issuing and placement of shares and the granting of credits.[42] According to Teichova:

> The Austrian banking system performed the usual functions of accumulating and mobilizing capital like that of other developed countries but it played a much greater active role in employing resources in industry and trade. Banks not only provided advances but they conducted an extensive business of promotion of industrial enterprise; they secured their credits by acquiring equity preferably in the largest and soundest enterprises, mainly in those they had changed into public companies and in those whose comparatively frequent share issues they organized; they strengthened their supervision through interlocking directorships, and they were initiators or mediators of mergers.[43]

Even so, before the First World War, according to her co-author (Mosser), the provision of finance from the banks to industrial companies was mainly in the form of short-term loans (most capital—as elsewhere in the developed world—was, in fact, raised from companies' own internal funds). By the interwar years the largest banks had well-established *Konzern*, or clusters, of favoured industrial clients, often associated, and overlapping, with extensive networks of interlocking directorships between banks and the larger industrial companies.[44] Growing difficulties following the break-up of the Austro-Hungarian empire apparently forced industry to rely more on the banks. Even so, the banks became still keener than before the war to confine their lending to short-term credits, although they did continue to assist with share issuing and helped in raising foreign loans.

For Hungary, Pogány has shown that the Hungarian General Credit Bank from its inception in 1867 had an extensive list of industrial customers.[45] Most assistance was given in the form of current accounts,

[39] Lundström, 'Continuity and change in Swedish banking'.
[40] Larsson and Lindgren, 'Political economy of banking', p. 349.
[41] Larsson, 'Government subsidy or internal restructuring?'.
[42] Verdonk, 'The Wiener Bank-Verein'.
[43] Mosser and Teichova, 'Industrial joint-stock companies in interwar Austria', p. 135.
[44] D. Stiefel, *Finanzdiplomazie und Weltwirtschaftskrise*, p. 97, cited in Mosser and Teichova, 'Industrial joint-stock companies in interwar Austria'; and Eigner, 'Interlocking directorships in interwar Vienna'.
[45] Pogány, 'Industrial clientele'.

with regular overdraft facilities, many of which were routinely renewed. By the 1880s it was the first Hungarian bank to participate in the promotion of industrial companies and from the turn of the century it was beginning to establish *Konzern* of milling and sugar-refining companies, and it had growing connections with the engineering and textile sectors. The bank held shares in a small cluster of industrial companies for which it had provided assistance when they were first incorporated. Importantly, though, connections with the vast majority of industrial clients were not normally very close, being confined to the provision of credit. For the most part, entrepreneurial responsibilities for industrial clients were minimal and close ties were restricted to the largest of industrial concerns.[46] In a general appraisal, Péteri suggests that while industrial problems led to greater bank involvement in the affairs of a small number of industrial clients, on the whole the power of Hungarian banks *vis-à-vis* industry declined in the 1920s.[47] He reiterates the fact that the main business for Hungarian banks was the financing of commodity trades, not industrial finance, and that they rarely held industrial securities in the role of long-term institutional investors (confining their dealings in shares largely to providing issuing facilities). He also argues that in the 1920s there was a contraction of long-term lending to industry in favour of short-term loans on current account as the banks adjusted to the shorter-term nature and the increased foreign origin of their deposit liabilities. Indeed, it was the inadequacy of opportunities in the home market that encouraged more diversification.

Other parts of the Austro-Hungarian empire also developed universal or mixed banking. This emerged at the turn of the century in Czechoslovakia.[48] Individual banks remained small and a persistent feature was the degree of specialization by these banks in lending to firms from only one or two sectors. Nevertheless, the banks maintained lines of credit with industrial clients, assisted flotations, had board representation in some instances, and held equity. Even so, in Czechoslovakia, as elsewhere in Europe, long-term loans and investments by the banks were rare. Lacina claims that 'the vast majority of credits were made up of short-term credits'.[49]

Spain also developed a mixed banking system, most notably from the second decade of the twentieth century. Wartime neutrality helped boost the economy and the banks played a more significant role from 1918 until the outbreak of the civil war. Many see the banks' role as critical at that time—providing loans, undertaking company promotion activities, establishing interlocking directorships with industrial concerns, and hold-

[46] Rudolf, *Banking and industrialization in Austria-Hungary*, p. 104.

[47] Péteri, 'Financial change in Hungary'. See Boross, 'Financing of Hungarian industry', for an alternative view.

[48] Hájek, 'Banking system in interwar Czechoslovakia'. See also Štiblar, 'Universal banking in the Slovene region'.

[49] Lacina, 'Banking system changes', p. 139. See also Faltus, 'Bank-industry relations in interwar Slovakia'.

ing corporate securities.[50] For instance, in 1921 the largest seven banks had membership of the boards of 274 companies which collectively accounted for almost one-half of corporate paid-up capital. As in many other countries the links were strongest with the largest industrial and public utility corporations.

In western Europe, a strong tradition of mixed banking had been established early in Belgium, with banks from the 1880s providing loans to industrial clients, holding shares and taking up directorships on the boards of client companies.[51] The war and the need for industrial restructuring in the 1920s reinforced bank-industry links. However, as in other universal banking systems, the banks tended to concentrate their efforts on a small number of 'favoured', large industrial firms and tended to neglect smaller businesses. A handful of the largest banks established dominant shareholding positions in a number of basic industries such as coal mining and iron and steel. In fact, Belgian experience during the troubled 1920s and 1930s provides a telling contrast between the relative merits of the continental mixed banking and the English credit banking systems. Heavy commitments to industry sapped the liquidity of the Belgian banks, provoked bank failures, and seriously undermined public confidence. This led to extensive state regulation of banking activities which, by the decrees of 1934 and 1935, prohibited commercial banks from holding industrial and commercial securities, and ultimately resulted in the abolition of mixed banking in Belgium. Moreover, in ironic contrast to the criticisms levelled at English banks, contemporary Belgian critics attacked the failure of their banks to restructure industry or encourage new technology sectors. As Vanthemsche puts it: 'The mixed banks . . . seem to have contributed to a growing rigidity and obsolescence of Belgian industrial structure. They clung to the basic, heavy industries, and did not stimulate the creation or development of younger, more innovative sectors.'[52] As is well known, in Britain there were also major industrial problems which had an impact on the banks but, significantly, the period was marked by substantial structural change—including the rapid expansion of 'younger, more innovative sectors'—and continuing bank stability.

In Italy, as Cohen's path-breaking study showed, universal banking activity had begun after the banking crisis of the early 1890s, when German-led syndicates established banks on the German model.[53] These large banks lent to industry, rolled over short-term credits, underwrote and bought industrial securities, and provided board directors. However, a recent assessment by Forsyth has suggested that their industrial participations were motivated largely by short-term concerns over the profits from the activities associated with flotations rather than a desire to gain

[50] Tortella and Palafox, 'Banking and industry in Spain'.
[51] Kurgan-Van Hentenryk, 'Finance and financiers in Belgium'.
[52] Vanthemsche, 'State, banks and industry', p. 106.
[53] Cohen, *Finance and industrialization.*

a controlling influence over industrial clients.[54] They also hoped that early association with a new company would help secure its normal banking business in the future and—as elsewhere—they tended to concentrate business on a limited number of industrial clients. Another striking feature was the relative instability caused by the close association with industry. As in Belgium, Germany, and Austria this became intolerable in the 1930s and, in Italy, led to large-scale nationalization of the banks and the end of private-sector mixed banking.[55]

IV

Although it is clear from the above accounts that there was a fair degree of variation in the development path taken by individual national banking systems, it is none the less possible to draw generalizations pertinent to the comparison with new work on bank-industry relations in England. To this end it is useful to distinguish three aspects of a bank's function *vis-à-vis* industry: provision of loans; support or commitment given to industrial clients as debtors; and investment bank functions. Within the British financial structure of well-developed capital markets and specialist institutions, English commercial banks did not perform the functions of an investment bank, of course, but in the first two regards there was a great deal of similarity in the practice of English and continental banks.

Thus, the first relevant finding from recent research is that the main form of bank lending to industry on the continent was through the granting of short-term credits, often rolled over and renewed over a long period. Tilly particularly stresses the use by German banks of rolled-over short-term credits, and Teichova, Gourvish, and Pogány together highlight the importance of such short-term loans within general European development. Their significance should not be underestimated: '[it has] long been recognised that the rolling short-term credit, perpetually renewed, could be the equivalent of long-term capital, or could be used to free the firm's resources for long-term investments'.[56] And, as has been shown, short-term credits were the prominent means of lending to industry in Austria, Hungary, Czechoslovakia, and Italy.

Here, there is a great deal of similarity with England where the use of rolled-over short-term loans (regularly in the form of overdrafts) was a central characteristic of bank provision of finance for industry throughout the period. In an early study, Cottrell looked at the lending practices of a small group of English banks in the period 1840-90, noted the common practice of rolling over short-term loans, and concluded that the banks concerned were generally supportive of industrial clients in their flexible use of the overdraft system. He also stressed the stability of English banks relative to their German counterparts.[57] More recently, for the

[54] Forsyth, 'Rise and fall of German-inspired mixed banking'. See also Webster, 'A mixed investment bank'.

[55] Ciocca and Toniolo, 'Industry and finance in Italy'.

[56] Pollard and Ziegler, 'Banking and industrialization', p. 21.

[57] Cottrell, *Industrial finance*, pp. 210-47.

period between the wars, Ross has highlighted the full, positive contribution made by the English commercial banks in the provision of credit to industry whose capital requirements could be met elsewhere in Britain's large, sophisticated financial markets,[58] and even studies such as those by Tolliday on the steel industry—which is less sanguine about the bankers' efforts—none the less point to the high degree of involvement in managing industrial clients' indebtedness.[59]

More recently, extensive examination of the internal records of 3,466 accounts of industrial firms held at 17 individual banks (with most reliance on the provincial records of Lloyds Bank and the Midland Bank) over the period 1866-1914 has revealed that English banks offered a very flexible and convenient financial facility for their industrial customers.[60] Overdrafts were the most common form of bank loan and over half of these were made available without the industrial firms involved having to deposit collateral. Commonly the banks depended upon the judgement of their officials as to the reliability of the borrowing firm, its directors or partners, and their assets. Such loans were routinely rolled over for industrialists and though the great majority were granted as 'working capital' and were normally repaid within months, they could result in loans being extended over a number of years.

Illustrative accounts that show how flexible the overdraft system could prove in providing longer-term financing are those of two large industrial firms, Oakes & Co. and Kynock & Co. The former was an iron and steel and coal producer with an account at the Wirksworth office of the Capital & Counties Bank at the beginning of the century.[61] When the firm ran into serious difficulties in 1910, the bank carried it by continually renewing the overdraft over a three-year period, with the total amount going as high as £160,000 in 1912.[62] Kynoch & Co. was a firm of armaments manufacturers with an account at Lloyds Bank in Birmingham.[63] It ran into serious development and production problems in the late 1880s when the bank carried it over a five-year period by rolling over its overdraft which remained continuously in debit (within the range of £28-40,000).

Apart from the rolling over of loans, the close monitoring of industrialists' accounts is said to be another important feature of universal banking. Such scrutiny supplied the banks with privileged information on clients,

[58] Ross, 'Commercial banking'; *idem*, 'Clearing banks and industry'; *idem*, 'Information, collateral and British bank lending'.

[59] Tolliday, *Business, banking and politics*. See also Holmes and Green, *Midland*, ch. 7; Collins, *Banks and industrial finance*, pp. 58-85.

[60] A large variety of records have been used, but a particularly rich source for the operation of individual accounts are the 'Private memoranda' and similar confidential records kept by branch managers and other bank officials. The research into bank lending practice (see above, n. 1) has been largely archive based. The following companies have been particularly helpful: Midland Bank plc, National Westminster Bank plc, Barclays Bank plc, Lloyds Bank plc, and the Royal Bank of Scotland plc.

[61] Lloyds archive, ref: Capital & Counties, Wirksworth, 1902-14, LBA/B1590a/10-1.

[62] Multiply by 40 to get a rough conversion to today's value: i.e. a £160,000 loan then would be worth about £6.4 million now.

[63] Lloyds archive, ref: 3, Lloyds, Birmingham Colmore Row, 1876-1914, LBA/B360a/37-8, 40-51.

providing for better decision-making on future loans and risk-taking on particular accounts. But, again, this characteristic was not confined to the continent. English banks, too, closely monitored transactions on a firm's debit account once a loan was granted and used past performance on the account (turnover, reliability on meeting payment deadlines, the use to which a loan was put, etc.) when assessing applications for new loans or renewals. In England it was normal practice for bank managers to scrutinize clients' balance sheets and annual reports (though this was frequently informal or not forthcoming for private partnerships), to receive reports from large debtors, and to arrange site inspections when required.

Thus, the workings on the account of Hunt & Mitton, a general engineering firm which banked with Lloyds at Birmingham, are fairly typical of the use made by the banks of audited balance sheets on the accounts of industrial companies.[64] Throughout the 1880s when this firm was pressing for bank overdraft facilities (in the region of £200-500), balance sheets were routinely submitted to the branch manager and at the end of 1887, when an extra £500 was being sought, the bank conducted a site inspection of the firm's works before giving its consent. Examination of balance sheets could also alert the bank to client difficulties, as in the case of another account at Lloyds, held by the Leeds Engineering & Hydraulic Co. Ltd at the beginning of this century.[65] Here, successive balance sheets began to reveal poor trading profits and under-capitalization, which made the bank question the wisdom of its outstanding £800 overdraft. Even so, the amount on loan was allowed to stand while the company submitted to the bank (and subsequently implemented) re-capitalization plans.

Moreover, individual bank-client relationships were long-lived in England, as they were on the continent. The records reveal that while some English firms changed their accounts, most stayed with the same banker, often for decades. Significantly, the records also show that in the pre-First World War period English banks showed a high degree of commitment to industrial clients during periods of client distress, with the banks continuing to lend afresh, renew loans, and offer advice during difficult times—characteristics lauded by the supporters of a bank-oriented system of finance. It is also a fact that English banks, before 1914 at least, rarely refused to grant a loan to industrial customers.[66] It was the case, however, that the loans themselves often remained formally short-term and there was an undoubted reluctance to lend at the outset for projects that would tie up the bank's resources in illiquid assets. To this extent the traditional view of English credit banks is correct, but—as has been shown—judgment must be tempered by the fact that short-term lending was also commonplace on the continent.

Differences are more obvious when comparison is made of investment bank functions. Continental universal banks, to varying degrees, did offer

[64] Lloyds archive, ref: Lloyds, Birmingham Five Ways, 1881-1913, LBA/B477a/4-6.
[65] Lloyds archive, ref: Leeds, 1900-14, BA/B793a/3-9.
[66] Capie and Collins, 'Industrial lending'.

facilities for the issue of securities such as shares and debentures. They also—again, to varying degrees—held the equity of some of their corporate clients and nominated directors to the boards of industrial clients. Such proprietorial functions seem to have been particularly strong in Germany (especially before 1914), Sweden, Belgium, Spain (between the wars), Italy and Austria. Normally, such relationships were restricted to a limited number of (often large) firms, which collectively formed *Konzerns* whose members had privileged access to bank credit.

In England, the credit banks would nurse the accounts of prized industrial clients, but they appear to have offered a less discriminatory lending service than some of the continental banks, with the English offering a service which imposed the same terms for most industrial accounts (whether the firm was large or small, and regardless of the sector in which it was based). However, the proprietorial tie with industrial clients did not exist because English banks did not own industrial shares. They did occasionally take equity and debentures as collateral, and as payment in cases of default, but they did not make investments in industrial enterprises as part of their portfolio strategy. No legal barrier existed (as in some other countries) but the records have not revealed a single example of an investment decision of this nature. In fact, it is clear from both published and confidential records that there was a commitment to a strong orthodoxy that debarred the English credit banks from providing 'investment funds'.[67]

Even in this area, though, significant convergence of European banking practice may have been taking place over time and, in particular, Edwards and Ogilvie have stressed the much greater reluctance of German universal banks to buy industrial shares after the depression of the 1870s.[68] Moreover, by the closing decades of the nineteenth century the large English commercial banks did see it as a legitimate part of their business to facilitate forays by their industrial clients into the capital market. They offered advice and temporary finance for such activities as new company flotations, the sale of debentures, and the raising of mortgages. There are numerous examples of such activity in the banks' own internal records—by the turn of the century it was commonplace on the accounts of joint-stock companies. The banks did not provide such capital themselves. They offered an essentially short-term, bridging service—lending money until longer-term arrangements had been made—although, in some cases, rolled-over credits meant that companies had access to bank loans for a period of years. Again, as Edwards and Ogilvie show, this was true also of the type of help being offered to industrial customers by the German universal banks.

The English credit banks did not offer a full underwriting and issuing service, but in England (unlike much of the continent) such services were

[67] In addition to the banks' internal records, a thorough search has been made of published contemporary banking opinion.

[68] Edwards and Ogilvie, 'Universal banks', p. 439.

available to industrial firms from specialist financial institutions.[69] Recent work by Watson has suggested, in fact, that there were few supply-side difficulties for the English brewing and iron and steel industries in issuing market securities.[70] In London, specialist merchant banks managed a number of large flotations although the great bulk of their business was concerned with overseas governments and public utilities (even in the interwar years there was only a slight shift in the balance of their business towards the domestic industrial market).[71] But the low incidence of domestic industrials on the formal stockmarkets reflected the nature of demand in the period. Most industrial firms were still small, family-owned organizations (even when incorporated) and their capital requirements were relatively modest. It was inappropriate, therefore, for such firms to seek financing through issues to the general public on formal markets, because this would have involved relatively high transactions costs, the divulging of greater quantities of information, and the dilution of the control exercised by existing proprietors. Although hard information is difficult to come by, it seems that small and medium-sized firms seeking external capital were able, in fact, to raise funds from a miscellany of small-scale, locally based suppliers—friends, acquaintances, solicitors, local brokers, and so on—rather than from the formal capital market.[72]

In concluding this section on how similar or otherwise the two banking systems were, it should be plain that it is an exaggeration to say that English banks were not involved with industry. For the most part there appears to have been little difference in the nature of loans granted to industry by banks in England and on the continent, or in how industrial debtors were normally treated by their banker. The reality is that English bank lending was much closer to continental practice than traditional criticisms have admitted, the more so when cognisance is taken of the fact that Britain was not alone in not experiencing universal banking. Nevertheless, it is also apparent that there were some significant differences in bank-industry proprietorial relationships. The next section questions whether this was a weakness of the English system.

V

In a fundamental sense the comparison that is often drawn between English credit banking and continental universal banking in the period 1870-1939 is not legitimate, in that it is not a comparison of like with like. Before 1914 certainly, there is a serious danger of comparing economies and financial systems at different stages of development, and even into the interwar period most would agree that the relative sophistication of the English financial system was maintained within Europe. In particular, it could be argued that the English credit banks' neglect of

[69] Thomas, *Finance of British industry*.
[70] Watson, 'New issue market'; *idem*, 'Banks and industrial finance'.
[71] Burk, *Morgan Grenfell*; Roberts, *Schroders*.
[72] Edelstein, *Overseas investment*; Michie, 'Stock exchange and the British economy'.

investment bank activities was evidence of the strength, scale, and maturity of the financial system as a whole, not a weakness or 'failure'.

In this respect, criticism of English banks is perverse. At the centre of the Gerschenkronian tradition is the argument that universal banking developed in those countries highlighted in this article as a response to inadequacies in existing financial provision, in relatively backward economies.[73] In other words, universal banking in Europe is associated with economic immaturity. In particular, German and other credit banks in the late nineteenth and early twentieth centuries held industrial shares because of the lack of alternative sources of long-term capital for industrialists. In fact, as the German economy developed, the influence of the banks began to wane, certainly by the 1920s.[74] Moreover, the apparent connection between universal banking and relative economic backwardness has been reinforced by what has happened in Germany since 1945. According to Edwards and Fischer, in the modern Germany financial maturity has been accompanied by the commercial banks relinquishing much of their universal bank character, with many of the characteristics considered central to universal banking being entirely dissipated or only partially present.[75] History does not suggest, therefore, that the German model is the final stage on the development path for commercial banks, and it may not be an appropriate model against which to judge English financial markets.

The corollary is that English markets were more mature at an earlier date and, at the turn of the century, were more effective in the range of services offered.[76] They were certainly on a much bigger scale than continental markets, permitting greater sophistication in the services offered and greater specialization among financial institutions. Greater scale alone made division of labour more feasible, and dissipated the need for generalized provision within a single institution. Thus at an early date in England, institutions emerged that specialized in bill discounting business, bill acceptance, issuing and underwriting services, mortgage provision, and, of course, the credit banks concentrated on the development of a rapid remittance service, of retail deposit services, and of the provision of short-term loans. In the capital market, active new issue and secondary markets existed. As has been suggested, large industrial issues could be floated on the provincial and London stock exchanges, and smaller demands might be met from a miscellany of local suppliers of capital.[77]

Partly because of the nature of its origins, universal banking, of course, had many faults and any comparison with the alternative English system

[73] In its detail Gerschenkron's general hypothesis has been the subject of much searching analysis and subsequent modification, but the relationship between the emergence of universal banks and inadequacies elsewhere in the capital markets is still generally valid. For a pertinent appraisal of Gerschenkron's contribution see Sylla and Toniolo, eds., *European industrialization*.

[74] Feldman, 'Banks and banking in Germany'; James, 'Banks and bankers'.

[75] Edwards and Fischer, *Banks, finance and investment in Germany*.

[76] A similar argument has been applied to France; see Roehl, 'French industrialization' (for an early contribution); and Lévy-Leboyer and Lescure, 'France'.

[77] Michie, 'Finance of innovation'; *idem*, 'London stock exchange and foreign bourses'.

needs to take full cognisance of these. Thus, the underdeveloped nature of capital markets in many of the countries concerned—with very thin markets in industrial securities and with major information asymmetries facing would-be investors—accounts for the fact that the universal banks concentrated their financial services on a limited number of firms, on a cluster of industrial customers on which a bank could accumulate specialized knowledge and personal contacts. Supporters of universal banking claim this as an advantage, in that it enhanced the chances of mutual commitment by creditor and debtor in the long term and it enriched the information on which the banks' decisions were taken. But the disadvantages are just as obvious. Historically, it tied banks to particular clients. There was a clear hazard of severe distortion to market signals, especially with banks and industrial firms biasing their decisions in favour of members of the privileged clique. Firms outside the *Konzern* could be neglected and denied access to funds.

For the banks, there was also the danger of illiquidity if they should tie up too large a proportion of their assets in long-term loans and investments to privileged industrial clients. Indeed one of the most striking features of a comparison between English and continental banks is how much more stable was the English system of credit banking. The contrast is particularly noticeable in the interwar years.[78] Everywhere, long-term industrial problems increased dependency on the banks. In the universal banking systems this led to major distortions in financial markets. The extreme was Austria where the Credit-Anstalt became, in effect, a giant holding company, so that by 1929 it had substantial shareholdings in companies, accounting for almost 70 per cent of the total capital of all Austrian joint-stock companies.[79] More generally, Mosser argues that the Austrian universal banks tried to limit their industrial lending to the short term, although he does not believe this was a significant constraint on Austrian industrial investment. In fact, he puts the responsibility for low investment, industrial stagnation, and widespread failure at reconstructing squarely on industrialists. Austria provides just one example of universal bank difficulties between the wars, but it does provide an interesting contrast. In England, too, there was a debate about the relative responsibilities of banks and industrialists, and criticism of the banks, but the difference is that the banking system remained stable. In Sweden (as was noted above), industrial problems also led to the banks becoming major holders of industrial stock and problems of instability provoked government intervention to restrict their activities. Yet, in the UK, despite a number of traumas in domestic and overseas financial markets, there was no important bank failure, no widespread intervention by the authorities, and no danger of systemic collapse. Moreover, English economic growth between the wars was quite respectable, both historically and internationally. On the continent, in contrast, a number of the domestic

[78] See Kindleberger, 'Banking and industry between the two wars' for the diversity of experience in those years.

[79] Mosser and Teichova, 'Industrial joint-stock companies in interwar Austria', p. 140.

banking systems, including those of Germany and Austria, suffered serious collapse.[80] In others the weaknesses of the financial system incurred state intervention, with nationalization of the banks in Italy, and curtailment of their investment activities in Sweden and Belgium.

In fact, one of the ironies of the interwar years is that bankers faced criticism in all countries, irrespective of the system of financing industry. Those who professed an arm's length approach to industry—such as in Britain, the Netherlands, and France—were attacked for not doing enough to aid industry; but the continental universal banks were criticized just as strongly for being too closely involved with their industrial clients and, thus, endangering their own liquidity.

The contrast between Belgium's universal banks and the credit banks of its neighbour, the Netherlands, is instructive.[81] The Belgian system suffered much instability, while the Dutch did not. As we have seen, universal banking did not develop in the Netherlands, yet there was somewhat more emphasis on industrial loans from the banks in the years immediately following the First World War. A number of features were similar to those in England: Dutch banks were criticized for their lack of support for industry, yet the banks remained stable and the economy underwent significant industrial development during the interwar period. A recent survey draws the contrast with the Belgian universal banking system: 'The present state of historical research limits us to the mere assertion that the Belgian industrial structure, dominated by the banks, had not developed . . . new dynamic activities, whereas the Dutch one, notoriously independent of the banks, effectively did so.'[82]

In summary, recent research into the history of European banking has added to our knowledge of the weaknesses of continental universal banking. Instability in the interwar period is particularly noticeable and, although other factors contributed to the instability, deeper involvement with industry proved to be a systemic weakness. Universal banking was far from ideal. It is not legitimate, therefore, to contrast English banking with the 'myth' of universal banking, rather than with the imperfect reality. A realistic comparison of this sort is more favourable to England's banks.

VI

The overall conclusion is that there was an unexpectedly large degree of similarity in the lending practice of banks from many parts of Europe. England was not alone in not developing universal banking and, in many respects, English bank lending to industrial customers was not unlike that on the continent. In Britain and on the continent most lending to industrialists was short term, commonly rolled over; and in both systems

[80] Feldman, 'Political disputes about the role of banks'; James, Lindgren, and Teichova, eds., *Banks in the interwar economy*, ch. 1.

[81] Jonker, 'Spoilt for choice?'.

[82] Vanthemsche, 'State, banks and industry', p. 110.

the banks closely monitored industrial clients' accounts and offered support in difficult times. This stress on the similarity in lending practice does not, of course, deny that were significant structural differences in the financial arrangements and markets of different countries—Germany had a universal bank system and England a credit bank system. Thus, English retail banks did not engage in the type of investment banking activities pursued by some of the continental banks. But this is not as damning to the English banks as some have claimed. A case can be made for the greater sophistication of British financial markets, for greater convergence over time in European banking practice (including that of the UK) and, on trend, for the relative withdrawal of German banks from industrial involvement. Besides, in England's market-oriented financial markets the capital investment requirements of industry were the responsibility of other institutions, not the commercial banks. Moreover, many of the continental universal banks were discriminating in their support (largely in favour of select groups of large industrial firms); the English banks less so. In addition, the English banking system was extremely stable compared with most continental counterparts. It is not claimed that the relationship between English banks and industrialists was without fault, but international comparison calls for greater realism in assessing the part played by the banks.

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