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Assessment of information, uncertainty and risk: the strategies of English and Welsh joint-stock bank managements, 1826-1860.

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Assessment of information, uncertainty and risk: the strategies of English and Welsh joint-stock bank managements, 1826-1860[1]

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Following the crisis of 1825/6,[2] liberalising legislation led to the creation of 138 joint-stock banks in England and Wales between 1826 and 1844 (Collins, 1991: 24; King, 1936: 35-47; Pressnell 1956). This paper examines these new financial institutions that constituted the first wave of quasi-corporate bank formations in England and Wales. The flotation of such joint-stock banks marked an important stage in the development of more formalised English credit and capital markets and the banks will be considered within this context in order to consider the extent to which they differed from their private predecessors. Particular attention will be paid to the methods - obtaining and processing information - by which the managements of the new joint-stock banks attempted to reduce the uncertainty and risk in loan contracts.

The following discussion is based upon the banks' surviving documentation as opposed to the evidence collected by a series of parliamentary select committees between 1836 and 1841 that largely dwelt upon the most spectacular abuses. The ensuing sections draw upon 50 banks for which primary information is available. They were located in industrial regions of England and Wales, that is Lancashire, the Midlands, North Wales and Yorkshire, and thereby give a focus upon the issue of industrial lending in early nineteenth-century England.[3] The first section considers the necessity of assessing information,

1 The research presented in this paper is a part of a Leverhulme Trust-funded project, entitled 'The Constituencies of English and Welsh Joint Stock Bank, 1826 to c.1885'. Many thanks to all who have commented on previous incarnations of this paper: those attending the Business History Unit seminar, L. S. E., the Monetary History Group Meeting at Birmingham; members of the Business History Centre, Reading; and all those at the conference held at the Center for German and European Studies, University of California, Berkeley. Special thanks to Phil Cottrell, Francesco Galassi and Naomi Lamoreaux, whose detailed comments have been invaluable. All errors/omissions remain my own.

2 The crisis of 1825-6 resulted in the failure of 93 banks in England & Wales (approximately 15 per cent of the total).

3 All references/results in this paper are from HSBC Group Archives [HSBCGA], LloydsTSB Archives [LTSBA], Royal Bank of Scotland Archives [RBSA], National Westminster Bank Archives [NWBA] and Barclays Bank Archives [BBA]. I am indebted to the bank archivists who have been of such immense assistance: Edwin Green and Sara Kinsey (Midland Bank Archives), Alison Turton and Philip Winterbottom (Royal Bank of Scotland Archives), John Booker (Lloyds Bank Archives), Susan

uncertainty and risk by financial institutions, particularly with regard to industrial lending. The second section examines the introduction of joint-stock banks and the extent to which they differed from their predecessors: the private banks. Section 3 considers founding proprietors and directors of a selection of joint-stock banks, while the nature and extent of provincial nineteenth-century bank lending, in particular industrial lending, is analysed in Section 4. Sections 4 and 5 examine in detail the lending policies and practices of banks' managements, particularly the provision of credit to their shareholders. An attempt is then be made to draw some conclusions from this research.

1. The assessment of information, uncertainty and risk

One of the main functions of banks is to act as financial intermediaries, bridging saving and investment decisions in the markets for credit and capital. Banks allow the markets to operate more efficiently through being more aware than individual savers about investment opportunities. Nevertheless, inherent are the information asymmetries involved in loan contracts whereby borrowers are more informed than banks - the potential lenders acting on behalf of savers - regarding the likelihood of default.[4] In order to reduce information asymmetries, bank managements should acquire information about their potential borrowing customers, the nature of projects to be financed and the value of collateral security offered for the accommodation sought. This is the process of 'screening' which Galassi has summarised:

> The purpose...is...to exclude applicants whose personal characteristics, proposed projects, or asset ownership, are deemed unlikely to ensure repayment (Galassi, 1996: 6).

Furthermore, once accommodation has been approved, bank managements need to 'monitor' (that is continue to gather information about) borrowers, credits and their repayment in attempting to further reduce information asymmetries. This may also, potentially, reduce the possibility of opportunistic behaviour on the part of the borrower (Da Rin, 1996: 30). Initial screening of applications and subsequent monitoring of credits are undertaken to ensure the eventual repayment of loans and interest charges. During the early nineteenth century in England and Wales, information could be gathered most effectively at a

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Snell and Fiona MacColl (formerly of National Westminster Bank Archives) and Jessie Campbell and Josephine Horner (Barclays Bank Archives).

4 For a survey of the concept of information in risk management by banks see Pohle (1995) and Ross (1995).

local level, often via business networks, while risk could be reduced by the provision of collateral security. Da Rin has illustrated a similar system in early-nineteenth century Germany, whereby the Privatbankiers of the 1830s provided finance for industry which was 'grounded in personal relationships' and 'involved only local firms' (Da Rin, 1996: 32).

Screening and monitoring involve time and costs. Once incurred, the arising total costs may be constrained through repeated interactions between lenders and borrowers which provide information and facilitate monitoring. Furthermore, these contacts are likely to establish mutual trust and confidence (Galassi, 1996: 10; Fukuyama, 1995). The costs involved could also be controlled through the bank having information about customers and their creditworthiness from previous transactions. Such prior screening or 'vetting' occurred when applications were made for the shares of early nineteenth- century English and Welsh joint-stock banks, potentially reducing the banks' costs of, and uncertainty in, subsequent loan requests from such shareholders.

The reduction of lending risks and uncertainties is of importance for all banks, but was of particular significance for those in industrial areas during the nineteenth century. Potential exposure tended to be higher for these banks as loans to manufacturers were often larger and, relatively, less liquid than other accommodation granted. Furthermore, a greater number of such customers in these manufacturing districts tended to be firms within the same industry thus militating against any attempt by bank managements to diversify risk. Moreover, the provision of a large aggregate total of accommodation to the same branch of manufacturing, especially iron, made banks especially vulnerable to cyclical crises (Cottrell, numpora, ving

could involve further risks for a bank (Cottrell, 1979: 205-6). Therefore, increased uncertainty for a bank, arising from the practice of charging 'fixed' rates of interest on advances, made even more vital attempts by its management to lessen the hazards involved in industrial lending.

In order to examine more fully the screening and monitoring processes utilised in early-nineteenth century banking, the following sections will consider the nature and development of the new joint-stock institutions, including comparisons with their private predecessors, before examining the strategies by which they attempted to reduce the uncertainty and risk of loan contracts.

2. Changes in early nineteenth-century banking in England and Wales: private vs. joint-stock banks

Weaknesses in the structure of country banking and prevailing economic pressures saw recurrent financial crises before 1825. 1825 itself saw the banking sector in England and Wales experience a severe panic and 93 banks were unable to meet the demands of their customers for cash (Collins, 1988: 9). The crisis arose from general economic pressures but contemporaries blamed the Bank of England in particular and country bankers in general and called for an overhaul of the banking system. Prior to 1825 debate regarding the structure and stability of banking had been growing, particularly following the banking crisis in Ireland in 1820/1 and also as a result of the perceived need to meet the growing demands of commerce and industry (Cottrell and Newton, 1998). The 1825 banking crisis in England and Wales saw the culmination of such arguments. The consequent liberalising legislation of 1826 allowed the establishment of banks with more than six partners and freely-transferable shares outside a sixty mile radius of London and thus ended the Bank of England's monopoly of joint stock banking. The Act led to the creation of 138 joint-stock banks in England and Wales by 1844. However, with speculative excesses during the mid-1830s, a further Joint Stock Banking Act was passed in 1844 regulating more strictly joint-stock bank formation. Thereafter, until 1857, bank promotion was extremely difficult to the extent that only 12 new institutions were formed. The subject of this paper is the new joint stock banks that were established between 1826 and 1844.

During the first half of the nineteenth century, beyond London, the most important type of financial institution was the local bank, both private and joint-stock. A localised base avoided the still significant problems of transport and communications but was also

encouraged by a continuing emphasis on parochial and personal business. There were some regional banks but only one national commercial financial institution - the National Provincial Bank of England. The joint-stock banks were often established by members of the local business community in order to service their particular needs and those of the district economy. Frequently they had 'community managements' responding to community needs.

Yet there was little change in the structure and nature of banking between 1826 and 1844 so that the provincial joint-stock institutions that were established had a distinct continuity with the private country banks of the second half of the eighteenth century. Therefore, further developments in banking after the 1826 Act did not represent a radical new departure. Indeed, many of the new joint-stock banks were formed out of existing private houses.[5] This similarity has already been noted and, in his work on Lloyds Bank, Sayers commented that:

> The change that came when the joint stock-banks were founded in the 1820s and 1830s was not revolutionary, at any rate outside London; what happened in this phase was rather that the geographical gaps in the country's banking system were filled, the rapid expansion in the country's trade activity was matched, and the opportunities for banking business and the possible customers of the conventional types were more actively cultivated (Sayers, 1957: 22).

Similarly, in their history of the Midland Bank, Crick and Wadsworth remarked that:

> The first joint stock banks were local in origin and local in business. They were little more than a broadened and improved type of private bank, though speaking generally their business was on a larger scale (Crick and Wadsworth, 1936: 4).

Black has more recently argued that 'changes in the institutional and geographical organisation of banking between the private and joint stock forms led to both a deepening of regional activity and, simultaneously, a continuing dependence on the London money market for inter-regional business' (Black, 1995: 398). Thus, joint-stock banks during the first half of the nineteenth century were usually very localised institutions which serviced the communities in which they were situated and bore a strong resemblance to their forerunners, the private country banks.

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5 For example, The Halifax & Huddersfield Bank was formed from the private bank Rawson & Co.; the Coventry & Warwickshire Banking Company was based on a private bank that had been trading since 1790; the Glamorganshire Banking Company was based upon two private firms - one at Swansea and one at Neath; and the Northamptonshire Banking Company was formed from the private bank, Watkins & Co., established in 1783. See Sayers (1957).

Figure 1: joint stock bank offices in England and Wales, 1842

Source: P. L. Cottrell, 'Banking and finance' in John Langton and R. J. Morris (eds) *Atlas of industrialising Britain, 1780-1914* (1986).

Despite their congruency with their predecessors, the new joint-stock banks rapidly developed their own business and competed against them. Indeed, the joint-stock banks were so successful that, while there were 117 by 1844, the number of private banks decreased from 554 in 1825 to 311 in 1842 (Crick and Wadsworth, 1936: 21; Thomas, 1934: 656-62). Overall, 141 joint-stock banks were established under the 1826 Act and of these only 19 failed or closed before the new banking legislation of 1844. The failure rate of joint-stock banks established prior to 1844 - 13.5 per cent - was considerably less than that of the private country banks (Cottrell and Newton, 1999). The perceived stability of joint-stock institutions would have been a decisive factor in attracting depositors. The new joint-stock banks possessed further relative advantages over their private predecessors: the former were able to undertake business (most importantly the extension of credit) on a far greater scale than the latter. The ability of joint-stock banks to issue stock was the decisive factor in the larger scale of their operations, relative to private banks.

In particular, the joint-stock banks flourished in provincial industrial areas: 'the opportunities presented by the development of industry and trade were multiplied by reason of the weaknesses and failures of private bankers' (Crick and Wadsworth, 1936: 20). The focus of this study is the joint-stock banks that undertook business in industrial areas.

3. Bank shares, shareholders and managements

Shares of the early joint-stock banks were used to attract customers. Sayers states that 'the allocation of shares in the company was used as bait for customers, and this practise remained as a serious element of competition between banks'. Bank shares were 'very profitable investments and, especially when the company was based on private firms of acknowledged probity, there was an eager demand for them even at substantial premiums' (Sayers, 1957: 109-138; King, 1936: 159). A year after their establishment, the Nottingham and Nottinghamshire Bank, the Sheffield Union Bank and the York City and County Bank all declared an annual dividend of six per cent on their shares, making the purchase of such stock an appealing proposition.[6] Bank shares were also attractive to investors as they represented a possible way to gain access to credit at the bank (see below).

The allocation of shares to investors was deliberately utilised to encourage a nascent bank's business. At the first general meeting of the Huddersfield Bank, the provisional

committee declared that they had 'distributed 397 shares among persons likely to promote the interests of the bank',[7] whereas the founders of the Nottingham & Nottinghamshire Bank 'sent prospectuses out to influential people in Nottingham and in neighbouring counties'.[8] In like vein, the board of the Coventry & Warwickshire Banking Company resolved to allocate 50 shares to a local company on 'condition that they shall bring their account and keep with this company for 5 years'.[9] Moreover, many banks retained shares which were used subsequently by directors for attracting further customers. Consequently, it could take up to three years for all of a bank's 'original' shares to be allotted and taken-up.

The sale and distribution of shares was strictly controlled by bank managements and was undertaken only by directors at board meetings. However, the criteria used to judge share applicants are not usually stated explicitly. Many applications were rejected due to the 'unsuitable' nature of those seeking to buy shares but the reasons for rebuffal were, unfortunately, not usually recorded. The London & County Bank stated in its deed of settlement that shares were 'to be allotted when directors see fit and to such persons as they shall consider to be eligible shareholders'.[10] Bank managements frequently rejected applications for shares with, for instance, the board of the Nottingham & Nottinghamshire Bank stating that, of the 8,147 applications for shares upon its foundation, 5,596 applications were agreed and 2,381 were rejected but specific reasons provided.[11] The Bank of Liverpool had 18,000 applications for its original 25,000 shares, of which only 15,638 were approved by the provisional committee.[12] Such rejection rates, 29 per cent and 13 per cent respectively, were actually considerably higher for some institutions than the rejection rates for loans (see below).

Applications for the subsequent sale, or purchase, of shares in established banks were also authorised, or rejected, at board level. In 1844 the manager of the Sheffield Union Bank was instructed that share applications should be laid 'before the board for approval and terms'.[13] Thus, those applying to purchase shares were assessed or screened by bank

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6 NWBA: 574, Nottingham & Nottinghamshire Banking Company, Board of Directors Minutes [hereafter BDM] York City & County Bank, 23rd February 1831.

7 HSBCGA: H4, Huddersfield Banking Company, BDM, 23rd Apr. 1827.

8 NWBA: 574, Nottingham & Nottinghamshire Banking Company, BDM, 21st Jan. 1834.

9 LTSBA: 045, Coventry & Warwickshire Banking Company, BDM, 29th June 1836.

10 NWBA: 10050, London & County Banking Company, Deed of Settlement, 4th August 1836.

11 NWBA: 574, Nottingham & Nottinghamshire Banking Company, BDM, 21st Jan. 1834

12 BBA: 38/5557, BDM, Vol. 1, Bank of Liverpool, 17th March 1831.

13 HSBCGA: AD2, Sheffield Union Bank, BDM, 12th June 1844

managements. Moreover, once joint-stock banks were established, such screening policies were also applied to the transfer of shares and, therefore, the secondary market in shares was also controlled.

What of the bank shareholders themselves? An analysis of bank shareholders, using a relational database, reveals that the geographical distribution of the shareholders' stated residences was predominately local. The social composition of bodies of shareholders was predominately middle class, consisting largely of those engaged in the professions, individuals of 'independent means' and manufacturers and merchants involved in local industries. The occupational structure of shareholders also reflected the complexion of the local economies in which banks were situated. Therefore, it is likely that, for any bank, its proprietors would have been involved in the same local business networks as its directors (Newton, 1997).

From examining the shareholders themselves, and the process by which they were screened, a hypothesis may be put forward that the provision of credit to shareholders could have reduced information asymmetries in bank lending. Firstly, shareholders' local residences and their likely involvement in district business networks would have enabled bank managements more easily to monitor them as customers. Secondly, information concerning potential borrowers had already been gathered during the screening procedure applied by the directors for the allocation of shares. Thirdly, the likelihood of moral hazard could have been reduced as a result of customers' shareholdings in the financial institutions from which they borrowed. They may have been less likely to default so as not to jeopardise the position of a bank in which they had an investment. Finally, if the screening and monitoring systems failed (as it sometimes did) and a bank shareholders defaulted on a loan, the bank was in possession of an asset which they could easily seize.

This has already been put forward by Galassi in his examination of the Italy's *Casse Rurali*, or co-operative banks, in the late-nineteenth and early twentieth century. As with applications for English and Welsh joint-stock bank shares, he argued that 'the screening process for the co-op takes place at the time when individuals apply for membership' (Galassi, 1996: 14). This was due to the particular characteristics of these Italian financial institutions whose members supplied labour free; held shares in the co-operative which were non-transferable and non-profit-making; were the only individuals who could borrow (although anyone could deposit); and were fully liable for the debts of their co-operative. Furthermore, he argues that it was in these members' interest not to transgress and, therefore,

risk the solvency of co-operatives, as 'the ability to borrow in the future depends on the continued financial viability of the co-operative' (Galassi, 1996: 14). In the same way, share ownership in joint-stock banks provided an incentive for such borrowing customers not to jeopardise their banks' solvency. The extent to which the joint-stock banks lent to their own shareholders, thereby utilising the advantages of prior screening, monitoring and such customers' institutional commitment, will be examined below.

Like the vast majority of shareholders in joint-stock banks, bank directors were generally drawn from local communities. The sphere of operations for the majority of joint-stock banks in the early nineteenth century was parochial - the provision of accommodation by banks, whether private or joint stock, very rarely extended beyond their immediate business hinterlands. The Ashton Stalybridge Hyde & Glossop Bank [hereafter the Ashton Bank] state the local nature of both shareholders and directors at a meeting of the bank's provisional committee in 1836.

> Any joint-stock bank founded as a local establishment should promote the prosperity of the district it embraces and should emanate and rely upon the support of a resident proprietary and directory'.[14]

A bank management's local knowledge and participation in area business networks was therefore of considerable significance in the decision-making process. Such involvement allowed directors to overcome the inherent information asymmetries involved in lending: they possessed, or could acquire, particular insight to reduce uncertainty about potential borrowing customers or monitor the progress of existing customers (Newton, 1996; Carnevali, 1995).

Boards of the new joint-stock banks comprised between six and ten directors. All directors held shares in the banks for which they were executives, this usually being a condition of their appointment to the board. They usually met weekly, or fortnightly, when decisions regarding the administration of a bank and lending were made. Managers were in charge of branches but did not make the final decisions about lending policy. These bank officials sometimes approved accommodation at a branch level but usually this was for small amounts while their activities were monitored by the boards. Thus, the banks had simple structures: generally, they operated at a parochial level and were run by relatively few

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[14] NWBA: 10144, Ashton Stalybridge Hyde and Glossop Bank, 2nd March 1836.

individuals who possessed and processed economic and financial information arising from the immediate district (Da Rin, 1996: 34).

Directors were usually members of local business communities but sometimes were specialist bankers, particularly when a joint-stock bank was formed through the conversion of a private banking house. Indeed, communities frequently established their own quasi-corporate financial institutions in order to service their financial needs - identified by promoters - and, more generally, those of the immediate area's economy. Bank managements thereby obtained to a substantial degree the necessary knowledge of the range of financial opportunities available within their particular business catchment areas and of potential borrowers' creditworthiness. The establishment and management of joint-stock banks by such groupings had the potential advantage that directors, due to their personal knowledge, could assess more effectively the standing of customers. In addition, the close monitoring of borrowers was possible due to the relative small scale of banks' businesses.

Furthermore, the reputation of a businessman was an important asset. Thus, the local business community and its associated networks could operate as a monitoring mechanism which provided a strong disincentive for potential defaulters who faced losing the trust, reputation and connections so vital to business success. As Carnevali found in the case of regional Italian banks, 'peer monitoring adds another element to the reduction of moral hazard' (Carnevali, 1996: 88). Furthermore, bank managements operating in tandem with more informal structures could reduce monitoring costs (Galassi, 1996: 14). This can be contrasted to the procedures of contemporary banking institutions in which lending decisions are usually made at some distance from the client and so require more formalised, and more expensive, methods of information collection and assessment.

Monitoring borrowers frequently involved continuing active or formal assessments of clients and their businesses by bank directors. Common strategies to obtain information involved the examination of balance sheets and interviewing a company's partners or directors in order.[15] Local banks had an advantage in not having to employ a specialist to assess the information gathered but rather their executives were equipped to evaluate such data. Bank directors were not only able to oversee implicitly their customers through mutual involvement in local business circles but also were able to monitor more formally their customers through using assessment criteria based upon their specialist knowledge. Board

minutes for the banks examined, where available, have been utilised to further examine the approaches of particular managements.

Some banks stated their intention of having directors involved in local trades or industry. For example, the deed of settlement of the Lancaster Banking Company contained the provision that:

> two of the directors at least shall be merchant traders or manufacturers actually carrying out business or trade for their own benefit either solely or in partnership.[16]

Tables 1, 2 and 3 display the local residences of the first directors of three newly formed joint-stock banks and their involvement in industry. These tables represent a static 'snapshot' of bank managements occupations but research of subsequent documents reveal that, despite developments in these directors career's and/or changes in personnel, the commercial or manufacturing interests of bank directors continued to lie in the sectors illustrated. Members of the board of the Halifax Joint Stock were active in the West Yorkshire textile industry, those of the Liverpool Union Bank in the port's commerce and shipping, whereas the management of the Ashton Bank were drawn from the Lancashire cotton industry.[17]

Table 1: First Directors of the Halifax Joint Stock Bank (1829)

Surname	First name	Village/ district	Town/City	County	Occupation
Binns	George	Norland		Yorkshire	Silk manufacturer
Haigh	John		Halifax	Yorkshire	Wool stapler
Holmes	Thomas		Halifax	Yorkshire	Dyer
Rothwell	William		Halifax	Yorkshire	Woollen & stuff merchant
Stocks	Michael	Northowram		Yorkshire	Esquire

Source: LloydsTSB Archives, 5354, Halifax Joint Stock Bank, Deed of Settlement, 1829

Table 2: First Directors of the Liverpool Union Banking Company (1835)

Surname	First name	Village/ district	Town/City	County	Occupation
Allport	Ben		Liverpool	Lancashire	Coffee Dealer
Firth	Thomas		Liverpool	Lancashire	Banker
Miller	John		Liverpool	Lancashire	Merchant
Robinson-Pim	Joseph		Liverpool	Lancashire	Steam PackageAgent

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15 For example, NWBA: 10145, Ashton Stalybridge Hyde and Glossop Bank, 4th Feb. 1860. See also Pohle (1995) p. 33.

16 NWBA: 12084, Lancaster Banking Company, Deed of Settlement, 1st Feb. 1826.

17 For the role and importance of the banks managements' in local networks see Newton (1996)

Rodick	Thomas		Liverpool	Lancashire	Merchant

Source: LloydsTSB Archives, 3540, Liverpool Union Banking Company, Deed of Settlement, 1835

Table 3: First Directors of the Ashton Stalybridge Hyde and Glossop Banking Company (1836)

Surname	First name	Village/ district	Town/City	County	Occupation
Binns	John		Dukinfield	Lancashire	Cotton Spinner
Buckley	Abel		Ashton	Lancashire	Cotton Spinner
Carr	John		Ashton	Lancashire	Brewer
Jowett	James		Ashton	Lancashire	Esquire
Kenworthy	Ben		Ashton	Lancashire	Esquire
Lees	James		Ashton	Lancashire	Cotton Spinner

Source: National Westminster Archives, 10143, Ashton Stalybridge Hyde and Glossop Banking Company, Deed of Settlement, 1836

4. The sphere of bank operations and industrial lending

Having examined the shareholders and directors of the first commercial joint-stock banks, and established their local origins, the nature and extent of their lending activity will now be examined to consider further the screening and monitoring of borrowers.

The local sphere of operations for the majority of joint-stock banks has already been emphasised. Such banking resulted in a provision of finance that very rarely extended beyond the immediate area of an institution. Very few instances have been found where credit was extended to customers located beyond a bank's parochial hinterland. For example, 37 per cent of credit granted by the Barnsley Banking Company between 1831 and 1833 went to customers resident in the town itself and the remainder was extended to borrowers giving addresses in towns or villages no more then 10 miles from Barnsley. The Sheffield Union Bank provides an even more localised picture as 91 per cent of its lending between 1843 and 1846 was to customers residing or working in Sheffield. Borrowers in Ashton and Stalybridge dominated the geographical distribution of credits granted by the Ashton Bank lending: 75 per cent of credit was supplied to such customers.

Due to their location in industrial areas, a sizeable proportion of advances of the banks examined went to customers involved in manufacturing. However, the main source of their funds was deposits, potentially subject to withdrawal at short notice. Therefore, in order to match such liabilities, industrial lending consisted of short-term loans and discounting bills, with long- and medium-term credit arising from the renewal of short-term facilities. Given such lending profiles, information regarding existing and potential

customers was required to ensure a basic liquidity of the banks' assets. The proportion of accommodation extended to manufacturing industry by the Ashton Bank was 69 per cent, a sizeable share of their total lending yet typical of all banks located in industrial areas.[18] The economy of Ashton and the towns surrounding it were dominated by cotton manufacturing, a sector that suffered from varied fortunes as the century progressed. The Sheffield Union Bank, located in a region dominated by the iron, steel and secondary metal trades, provided 64 per cent of it's total lending to local manufacturing companies.

The Ashton Bank itself had a nominal capital of £500,000, divided into 50,000 shares worth £10 each. In order to provide a more accurate picture of the banks' size and business, a copy of the bank's first balance sheet from 1837 has been reproduced. This illustrates approximately the volume of lending undertaken by the bank.

Table 4: Balance Sheet of the Ashton Stalybridge Hyde & Glossop Bank, 1837

Liabilities	**Value (£)**	**Assets**	**Value (£)**
Due to proprietors to be paid	25,980	Due to the bank by customers in current a/c's & in bills of exchange on hand	46,072
Due to proprietors for balance of deposit on share account	60	Due to the Bank by London and Liverpool agents & on a/c of cash and stamps on hand	8,022
Due to public for lodgements & for interest on deposit receipts	26,666		
Balance in favour of the bank	1,387		
Total	**54,094**	**Total**	**54,094**

Source: NWBA: 10144, Ashton Stalybridge Hyde and Glossop Bank, 28th July 1837.

Like shareholders and managements, bank customers were local in origin and, consequently, the lending profiles of banks in manufacturing districts reflected the economies in which they operated: manufacturing firms were important borrowing customers. Such borrowers tended to reflect the industrial 'make-up' of the locality where the banks operated. An analysis of the credit extended to manufacturers by the Ashton Bank between 1836 and 1838 show that 89 per cent was granted to cotton manufacturers while much of the remainder was extended to other textile or clothing producers. In the case of the Sheffield Union Bank,

18 This is probably an underestimation as it has not been possible to identify the occupation of all customers of the banks and therefore it is likely that some industrial customers have been omitted in the figures presented.

40 per cent of credit granted to manufacturing customers was received by those in the town's main metal trades.

Thus, the borrowing customers of joint-stock banks were usually active participants in the local economy of the district where an institution was situated. It is likely that information about many of such clients, whether enterprises or their owners, would be available to bank managements through directors' involvement in business networks and, thus, the uncertainty of lending to such concerns could, theoretically, be reduced. Moreover, the effectiveness of monitoring such accounts would be increased. As a result, joint-stock banks, operating at a local level, had significant informational advantages with regard to borrowers' characteristics and assets. Next it is important to consider the screening and monitoring of these customers by examining banks' lending policies and practices, based upon an analysis of data collected from archival sources.

A detailed examination of lending policies and practices utilising the banks' own records has certain problems, most especially typicality. Surviving files only arise from the activities of those banks that survived to become constituents of the 'Big Five' that coalesced through merger activity during the early twentieth century. The findings presented here are also based upon the analysis of board minutes, themselves a very subjective record. Lending policy in this source is not clearly stated whereas the 'safety', 'reliability' or 'responsibility' of a customer, or account, or advance or security is referred to by directors but not explicitly so defined. No formal or informal questionnaire, or set of criteria, is provided by which judgements, and consequently lending policy, were determined. Yet those bank directors being considered appear to have utilised very clear, if implicit, stances by which they assessed customers' proposals for business and likely outcomes (Newton, 2000). To apply current assumptions to nineteenth-century men, or to judge their assessments, would be dangerous and so reference below to conservatism or 'safety' is based very much upon the contemporary views of directors. Pohle warns against a retrospective definition of risk and risk perception in her examination of French and German banks in the nineteenth century (Pohle, 1995: 30-1).[19] Moreover, the sources themselves present an incomplete picture regarding the screening of credit applications. An element of screening probably took place through a customer's initial consultation with a bank manager, which may have been either

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[19] Pohle argues that decisions of nineteenth century bankers, and consequent successes or failures, should be assessed carefully by contemporary historians, asserting that 'Arguing backwards means that such a

formal or informal.[20] It is likely that the manager would advise on the possible success of failure of a credit application to the board of directors. Thus, some potentially unsuccessful applications were probably 'sifted out' before reaching directors. The reliance of this research upon board minute books, therefore, does not take such initial screening into account. However, the choice of source depends upon the survival rate of documentary evidence and minute books are one of the few available classes of records for gaining an insight into lending undertaken in the early nineteenth century. Bearing in mind the lack of formal assessment criteria concerning banking practice and the nature of the sources examined, lending data will now be considered in further detail.

The efficiency of a district/regionally-based financial system could be increased, and lending uncertainty reduced, by the provision of credit to those businesses for which bank directors, through their involvement in industry, had knowledge or those for which information could be gained through directors' participation in local networks. Such customers may have included owners of enterprises who were bank shareholders and so had often been previously assessed when they had applied for these securities (see above). In addition, requiring collateral security lessened risk in the banks' provision of accommodation to industry.

The board minutes of 12 banks formed between 1826 and 1844 were examined in order to discover more fully lending policies and these are listed in Table 5.[21] Due to the volume of material involved, information was collected for sample years, chosen to coincide with lists of shareholders collected for the same banks in order to cross-reference the two sets of data and identify shareholding/lending links. Data were collected for the periods of the banks' establishments and 20 years later in order both to examine the banks at their inception and to compare this with the situation when their businesses had 'matured' or developed more fully. The survey addresses applications for advances/credits (between 1827 and 1864) that in aggregate total £4,905,570. Of these, 82 per cent (£4,009,230) was approved, nine per cent declined and, with regard to the remaining nine per cent these were undecided or the outcome unknown. The average size of advances varied between the banks but was

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commentator attributes a knowledge advantage to a bank which the institution cannot possibly have had *a priori*.'

20 Thanks go to Richard Coopey and Edwin Green for highlighting this issue.

21 The small sample is a result of the problems of finding suitable surviving data and the density of lending information that makes analysis of such material difficult. Three years were sampled.

generally of the order of £600 to £2,000 and so adds confirmation that much of English bank lending in the early nineteenth century was relatively small- to medium-scale.[22]

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22 The board of directors minute books were consulted in order to collect lending data for these banks, unless otherwise stated. Their archival locations are listed below.
LTSBA: Halifax Joint Stock Bank (Securities notebook, 1668), Liverpool Union Banking Co. (93, BDM)
HSBCGA: Barnsley Banking Co. (A12 and A 16, BDM), Bradford Banking Co. (B2 and B28, BDM), Huddersfield Banking Co. (H4 and H7, BDM), Coventry & Warwickshire Banking Co. (45 and 47, BDM), Sheffield Union Banking Co. (AD2, BDM),
NWBA: Ashton, Stalybridge, Hyde & Glossop Bank (10144 and 10145, BDM), Bilston District Bank (11342, BDM), Nottingham & Nottinghamshire Banking Co. (574, BDM).
RBSA: Sheffield & Rotherham Banking Co. (SR/1/1, 01095S and SR/1/5, 01097S, BDM).

Table 5: Banks Surveyed for lending data

Bank	Sample Years	Total applications for credit (£)	Total advances approved (£)	Advances approved - % of total applications

applications through an initial formal or informal enquiries to a bank manager, mentioned above, may also have influenced the subsequent success of credit applications at board level.

It is also interesting to note changes in credit approvals in the four cases where comparisons may be made for the same bank over a period of time. Both the Sheffield & Rotherham Bank and the Huddersfield Union experienced a sharp increase in the share of approved application for credit when their early years of operation are compared to those 20 to 30 years later. The proportion of credit applications approved by the Sheffield & Rotherham rose from 71 to 98 per cent of total applications between 1836 and 1863 and those of the Huddersfield Bank increased from 58 to 90 between 1827 and 1847. These outcomes imply that the ability of the two banks to supply credit increased with their success as financial institutions; or that they had managed to successfully attract customers to whom they were willing to lend; or that the confidence of directors in the mechanisms by which they assessed information, uncertainty and risk had increased over time. If the latter were the case, the managements of these banks had presumably established successful systems whereby information regarding customers was collected efficiently. This was assessed and arising action taken to grant, or refuse, a credit application. Indeed the amount of credit extended by both banks in the twenty year period increased over time, but more substantially so for the Huddersfield Union (from £329,000 to nearly £2 million).

In contrast, the records for the Bradford Bank and the Ashton Bank show that the number of successful credit applications decreased over time. The Bradford Bank's approved advances declined from 60 per cent of total applications in the banks' founding years to 48 per cent when bank had reached greater maturity - a 12 per cent decrease. The number of advances approved by the Ashton Bank declined by 18 per cent - from 76 per cent of total applications in the 1930s to 58 per cent in the late-1850s/early 1860s. The actual volume of credit extended by the Bradford Bank also declined - from £112,000 to £97,000 - whereas that extended by the Ashton Bank remained at relatively static at £92,901 and £94,553 respectively. The decrease in credit extended by the Bradford Bank may be due to its restricted sphere of operations as it did not open any branches during its lifetime. The bank experienced 'trials common to all country banks during the early years of the nineteenth century' although subsequently enjoyed 'a career of uninterrupted prosperity' (Crick and

Wadsworth, 1936: 237).[23] The relatively static nature of the Ashton Bank's lending activity may be explained by the period in which the second sample of lending data was collected since 1859-1862 coincided with the outbreak of the American Civil War in 1861 and the consequent cotton famine (Farnie, 1979: 135-170). The board of directors' minutes refer to the condition of the economy in their AGM of 1861:

> The state of trade in this neighbourhood, and Lancashire in general, has been very unrenumerative during the last 12 months, and it still continues in an exceedingly depressed condition' and that 'the pernicious effects of high-priced cotton, and a limited demand for our manufacturers, has rendered losses almost inevitable.'[24]

There were several occasions during 1861 when applications for credit were declined due to 'the present depressed condition of the cotton trade' but the directors reported at the 1861 Annual General Meeting 'that the bank has not sustained any bad debts during the period.'[25] This example also illustrates the impact of the condition of the local economy upon the business of the local bank.

It is difficult to generalise about trends in bank lending due to the number of banks examined, the differing circumstances of each individual bank (uncertainty) and the region in which they operated (risk), and the prevailing national economic conditions (risk). Thus, the mechanisms to reduce uncertainty and risk that were established by the Huddersfield Bank and the Sheffield & Rotherham appear to have improved over time whereas the Bradford Banking Company provides the counter-factual as the volume of its lending decreased over time. The lending levels of the Ashton Bank appear to have been effected by local economic conditions and are therefore difficult to assess the effectiveness of its monitoring mechanisms.

5. Industrial lending: the reduction of risk

Risk on lending could be diminished by receiving collateral security (Newton, 1991; Ross, 1995) and this usually took the form of property and land, guarantees, mortgages, and promissory notes. Another important type of collateral security was the use of a banks' own shares to secure accommodation by its proprietors.

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23 The board minutes do not reveal why the volume of credit extended by the bank decreased therefore the answer may lie in an inherent distortion due to the samples years selected.

24 NWBA: 10145, Ashton Stalybridge Hyde & Glossop Bank, BDM: 26th July 1861

25 *ibid.*, 14th Sept. 1861 and 26th July 1861

Collateral offered to secure accommodation was not always recorded in the board minutes and when noted, its value rarely given. An attempt has been made to analyse the types of security offered by the customers of 12 sample banks where information was provided. The total value of applications for credit, where security was named, amounting to £2,191,796, which accounts for 54 per cent (over half) of total credit applications. The following section reviews these credit applications only.

The main types of security offered to the 12 banks examined are listed in Table 6. There were a wide variety of types of collateral security offered.[26] One of the most frequently occurring types is 'without security' or a customers 'own responsibility' and therefore 14 per cent of credit applications by customers (£315,483) had no form of collateral security. A further 16 per cent of accommodation was secured by personal bonds or guarantees, usually signed by those involved in the enterprise requiring credit, their business colleagues, or their friends or relatives. Thus, 30 per cent of credit examined did not involve the formal deposit of collateral security and these findings again coincide with those of Capie and Collins. In examining English bank lending between 1860 and 1914, they found that 'somewhere over half of the industrial overdrafts made in the provinces did not involve the formal deposit of securities - they were either wholly unsecured or relied on the signing of personal guarantees' (Capie and Collins, 1996: 35; idem, 1999: 42). This indicates a fairly flexible approach towards lending, of which much was to industrial customers. However, it should also be noted that the proportion of credit extended without collateral security was typically much higher in America (Lamoreaux, 1994).

The practise of providing unsecured credit, or credit with no 'formal' securities, reinforced the need for banks to carry out effective screening and monitoring of borrowing customers. Presumably, information about such customers was available and thus uncertainty was reduced. Obtaining unsecured credit would therefore favour customers about whom information, trust and confidence could be obtained, the most likely sources of these criteria being mutual customers/management participation in local business networks or via an established customers/lender relationship (Capie and Collins, 1996: 35). However, this applied to the uncertainty attached to the customer rather than the risk attached to extending the credit.

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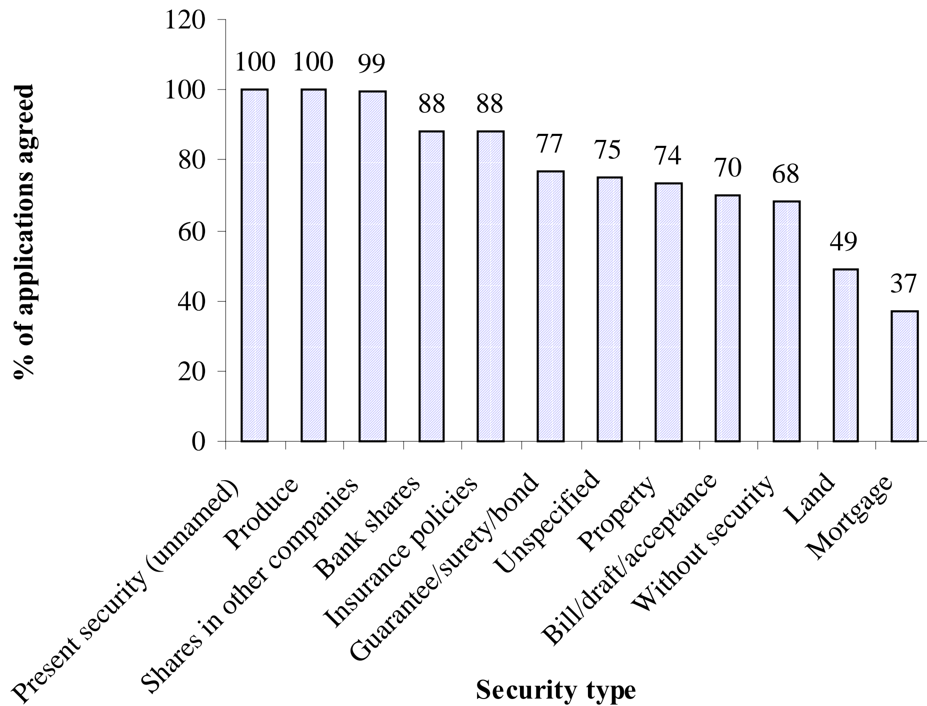
26 The table includes 90 percent of applications with named collateral security, the other applications having types of named security which did not fit into any the above categories and were too multifarious to quantify here.

Table 6: Types of collateral offered to secure accommodation

Primary security type	Value of credit applied for(£)	% of total credit applications where security named
Guarantees/sureties/personal bonds	430,099	16.5
Property and/or land	348,288	15.9
Without Security/own responsibility	315,483	14.4
Unspecified	273,020	12.5
Bank shares	148,305	6.8
Bills, drafts, acceptances and notes	147,547	6.7
Present Security (unnamed)	111,421	5.1
Shares or stock in other companies	109,508	5.0
Mortgage	91,500	4.2
Produce (tobacco, cotton, indigo, corn, yarn etc.)	36,079	1.6
Insurance policies	10,150	0.5

Some applications for credit were rejected by the banks' directors and Figure 2 displays the percentage of applications, by security type, which were successful. The most successful form of collateral security appears to have been 'present security' held by the bank or 'produce'. It should be noted that produce was very infrequently offered as a form of security and, in this case, covers several credits with a total value of £36,000, a small amount in this sample. As for the credit granted on 'present securities', it may be assumed that such accommodation resulted from applications for the extension of credit already granted to a firm or individual, i.e. where credit had already been agreed by the directors and possibly some form of security had already been supplied. The willingness of the bank to extend such credit was also likely to be a result of the opportunity to monitor such accounts over a period of time and consequently the uncertainty of lending to them was reduced. Thus, it appears that established customers were highly successful in their applications for credit: the willingness of the bank to extend such credit was probably a result of the ability to monitor such accounts over a period of time and thus reduce the uncertainty of lending to them.

Figure 2: Credit Application agreed - percentage of total applications by security type



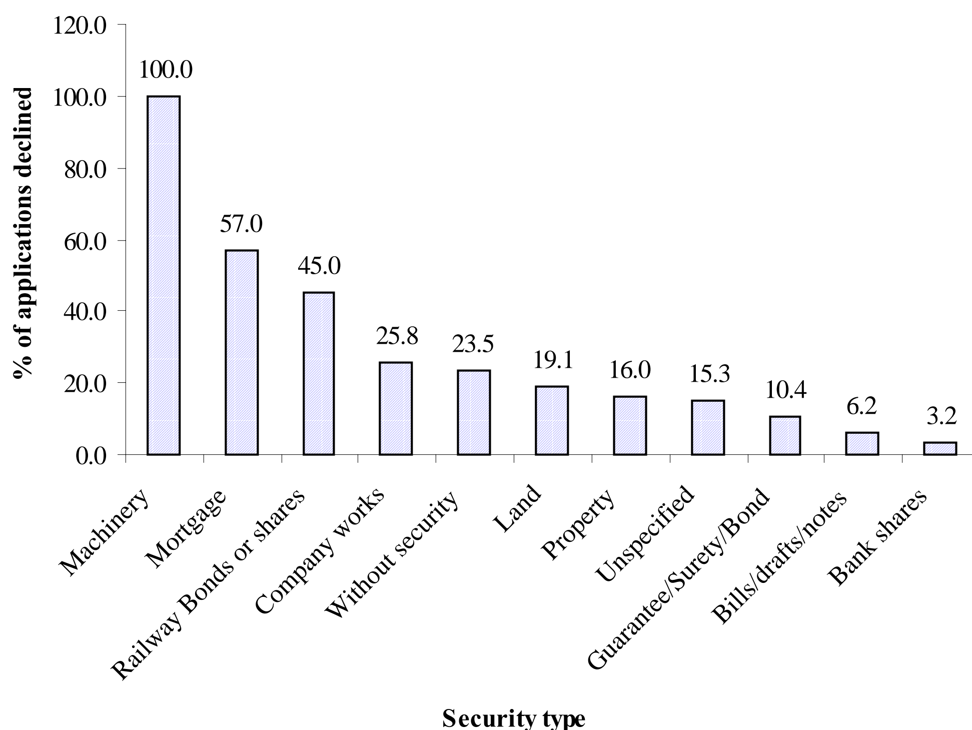
Other forms of collateral security on which accommodation was frequently granted were shares in companies other than those of the applicant, bank shares, insurance policies, personal security such as guarantees and bonds (often from business associates or family of the applicant), bills and drafts and property. Moreover, 68 per cent of credit applications on which no security was provided were agreed, a high figure considering the 'cautious' reputation of English banks regarding industrial lending.

The role of property as a collateral security had both advantages and disadvantages for the bank. If the property consisted of company premises or works, as it frequently did, the penalty for defaulting on a loan would be high as the owners could loose control of their business. Thus, the incentive for the customers to continue repayment to the bank would be high. Such security also had disadvantages for the bank as it was highly illiquid: it was in the banks' interests for such companies to continue in operation as the realisation of these assets in the event of default could, potentially, have involved considerable costs and delays (Capie and Collins, 1996: 37-8).

Figure 3 displays the percentage of applications, by security type, on which credit was refused. The results indicate that the most unattractive forms of security were machinery (100 per cent of application declined), mortgages (57 per cent) and railway bonds, stock or

shares (45 per cent).[27] Industrial machinery was a relatively illiquid asset, often specific to a firm's operation both technically and physically, and therefore unattractive. Some banks also referred directly to the undesirability of railway shares as a form of collateral security. Mortgages were likely to be unpopular as they were often subject to a previous charge by another party. Indeed, applications for credit secured by these three types of collateral were more frequently rejected than those applications offering no security at all: only 23 per cent of application which offered no form of collateral security were refused.

Figure 3: Credit applications declined - percentage of total applications by security type



Bank managements also accepted shares in their own institutions as collateral security. Some banks announced their intention to lend upon their own shares upon their establishment: the North & South Wales Bank declared that every shareholder would be able to draw upon the bank in terms of cash credit to the extent of half of their paid-up capital. Crick and Wadsworth, in their history of the Midland Bank, comment that this was 'a dangerous offer but by no means unusual' (Crick and Wadsworth, 1936: 177). The Bradford Banking Company proceeded with caution, ruling that advances could be made to the

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27 These results contrast with those of Ross in a study of industrial lending by clearing banks in the inter-war period where mortgages were the most common form of collateral security. See Ross, 1995.

company's proprietors but 'not £1,000 beyond the value of their stock'.[28] In 1831 the deed of settlement of the Knaresborough & Claro Banking Company stated that directors could:

> give credit upon cash accounts to any shareholder of the company to such an extent of his or her advanced capital, as the directors may think proper, without further security, except the security arising from the right of retention upon his or her share or shares; but no shareholder shall be entitled to demand a cash or other credit to any amount whatever but the same shall be given or withheld at the discretion of the directors.[29]

Moreover, the use of bank shares by bank proprietors as security for accommodation was not an unusual practice. Table 6 shows that bank shares were offered to secure accommodation totalling £148,305, or 6.8 per cent, of credit supplied by the 12 banks surveyed. Moreover, only 3.2 per cent (£4,800) of credit applications on which bank shares were offered as security were refused.

Bank shares could readily be reclaimed on bad debts. When a customer failed to pay off his overdraft, as demanded, the Coventry & Warwickshire Bank 'ordered that ten shares which he holds of this company be forfeited.'[30] The Barnsley Banking Company informed Joseph Baldwin & Co. that 'unless the balance of their account be paid off Mr Baldwins' advance of 20% on his shares will be transferred to the credit of their account.'[31] (This demonstrates that the application of local knowledge to reduce uncertainty about borrowers did not always work.) Moreover, it appears that the possession of shares in a bank, although not always stated in board meetings as constituting collateral security, could have been used by directors as a further, implicit form of security when granting accommodation. This is may demonstrated by the practise of granting of accommodation to bank proprietors from the financial institutions in which they held shares. (It should be noted that forms of security other than banks shares would often be provided for such advances.) Indeed, bank shareholding/lending links were common, as can be demonstrated by examining shareholding and lending data. The results from cross-referencing such data for the sample of 12 banks show that bank proprietors were frequently borrowing customers of the same institutions in which they held shares. Some of this credit would have been awarded to bank directors as all of the banks' managements' held shares in their own institutions. This

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28 HSBCGA: B2, Bradford Banking Company, BDM, 1st June 1827.

29 NWBA: 2034, Knaresborough & Claro Banking Company, Deed of Settlement, 31st August 1831.

30 LTSBA: 045, Coventry & Warwickshire Banking Company, BDM, 3rd Feb. 1837.

31 HSBCGA: A12, Barnsley Banking Company, BDM, 23rd Apr. 1829.

practice has been termed 'insider lending' by Lamoreaux (Lamoreaux, 1994). A survey of accommodation received by bank directors from the institutions they managed ('insider lending') has not been considered here, but previous work shows that this practice was commonplace in provincial banking throughout the nineteenth century (Newton 1996). The provision of credit to shareholders and directors by English and Welsh joint stock banks in the first half of the nineteenth century corresponds with the findings of Lamoreaux's study of insider lending in New England banks during the same period. She concluded that 'insider lending was widespread during the early nineteenth century and most conspicuously differentiates early banks from their twentieth century successors' (Lamoreaux, 1994: 4)

It is also important to remember that bank shareholders had already undergone a process of screening when applying to purchase shares in these banks and thus managements appear to have been making efficient use of information concerning a potential borrower that had been ascertained in a previous exercise.[32] Moreover, in purchasing bank shares, the borrower had already proved that they possessed capital. Lending to shareholders was thus a method of reducing uncertainty and information asymmetry.

By examining the credit applications of bank shareholders, both successful and unsuccessful, a key aim has been to attempt to detect the extent of this type of lending. Firstly, application for credit by bank shareholders were examined by cross-referencing shareholding and lending data. Figure 4 displays the frequency with which bank shareholders applied for credit from the institutions in which they held shares and shows that such applications range from 10 to 62 per cent of total application for credit. Though the figures vary between banks, these data illustrate that shareholders frequently attempted to make use of the credit facilities offered by the banks' in which they held shares.

Having examined the extent of shareholder applications for credit, it is vital to examine the frequency with which these applications were successful or unsuccessful. Figure 5 shows applications that were approved by bank directors, as a percentage of total applications, and illustrates that a considerable proportion of credit was granted to shareholding customers.

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32 It is likely that the creditworthiness of a potential borrower would change over time, and therefore further investigation by banks' managements would be necessary, but corresponding shareholding and lending data have been gathered for as similar dates as possible in order to present results that, it is to be hoped, are relevant to this hypothesis.

Figure 4: Applications for credit from bank shareholders - percentage of total applications

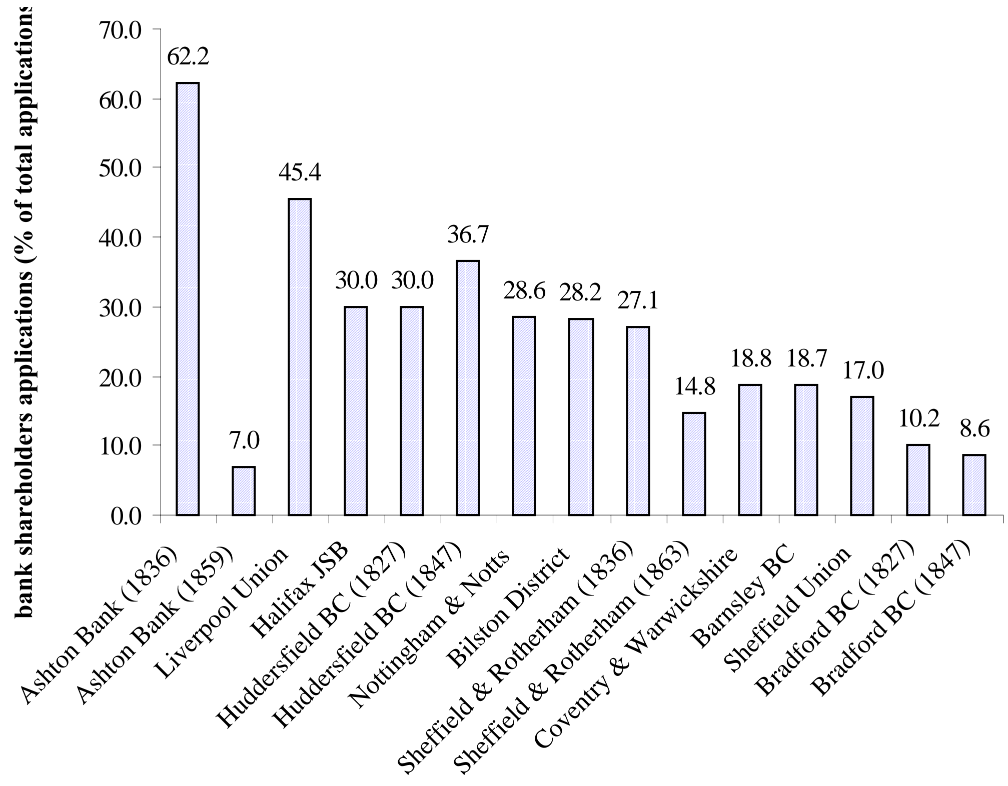
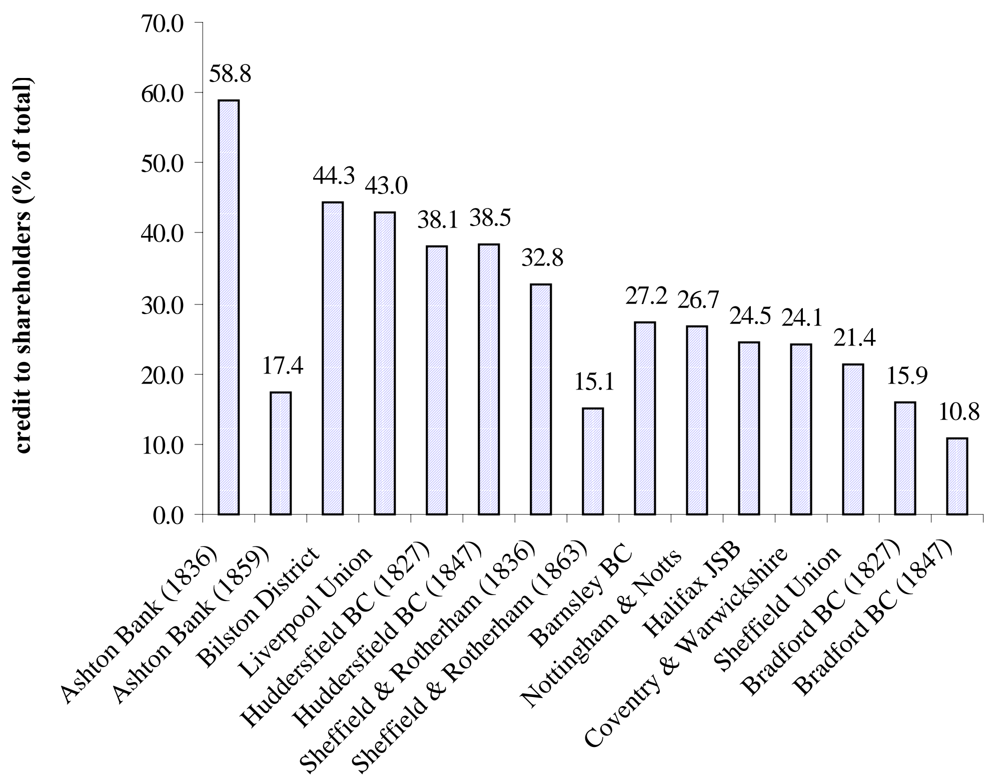


Figure 5: Credit received by bank shareholders - percentage of total credit granted



Approved applications were as high as 58 per cent of total credit extended by the Ashton Bank in the 1830s, though the overall average for the banks in this sample was 29 per cent of total lending per bank. Those banks for which lending data have been examined at their inception and their maturity show varying results. In the case of the Sheffield & Rotherham Banking Company and the Bradford Banking Company the approval of credit to shareholders in the former bank declined over time from 32 per cent to 15 per cent and in the latter bank from 16 to 11 per cent. The decrease of lending to bank proprietors was even more dramatic in the case of the Ashton Bank: from 58 per cent to 17 per cent. In contrast, the level of credit granted to the Huddersfield Bank shareholders remained constant at 38 per cent in both the 1820s and the 1840s. The level of this type of lending was likely to be related to the internal mechanisms by which these banks gathered information regarding customers, assessed this information, and took action from the information, to grant or refuse a credit application. If banks no longer chose to lend large amounts to their own shareholders, this could have been a reflection upon the increasingly successful mechanisms that they used to screen 'outside' borrowers. The impact of the local economy, as has already been mentioned in the case of the Ashton Bank would also effect the banks' borrower selection.

Thus, it appears that a notable proportion of the total accommodation granted by early nineteenth century joint stock banks was received by bank shareholders. By granting shareholders accommodation, the banks were making efficient use of the information already gathered when bank shareholders were screened; were able to effectively monitor such customers due to their participation in local business networks; and, due to their 'stake' in the bank, the moral hazard on loan contacts with shareholders could potentially be reduced by the disincentive to jeopardise their 'investment' in the company.

6. Conclusions

It appears from the sample of banks examined that joint stock banks formed in England and Wales between 1826 and 1844 were local organisations in terms of their shareholders, managements and customers. They generally consisted of a community management responding to community needs. Even the banks that operated on a regional level, such as the North and South Wales Bank and the Yorkshire Banking Company, had a limited sphere of operations. Thus, even by 1844, the structure of banking does not appear to differ greatly

in structure from that existing before the 1826 legislation: the new joint stock banks were very similar from the private country banks that went before them.

However, the new joint-stock institutions had a competitive advantage over their private predecessors: the ability to raise capital by the selling of shares enabled them to operate on a far greater scale than the private banks. Moreover, competition between local banks, both private and joint stock, was often considerable and banks shares were often used to entice customers, especially with the possibility of obtaining accommodation by using bank shares to secure loans. Indeed, the banks often provided credit to their own shareholders and even their own directors. Both lending to their own proprietors and the local nature of early nineteenth century banks were means by which, theoretically, uncertainty and information asymmetries within loan contracts, especially to industrial customers, could be reduced. Finally, the provision of collateral security for credit was used as a means to further reduce risk for the banks, the use of a banks' own shares being a readily convertible form of security. Thus, the joint-stock form of organisation had a further advantage over the private institution: it not only provided banks with capital but also the means to reduce informational asymmetries to a variety of lenders (both shareholders and non-shareholders) and therefore allowed them to expand their customer base beyond what was possible for the private banks.

In conclusion, the involvement of bank managements' and proprietors in local business networks and the provision of accommodation on flexible terms, often without collateral security, to local enterprises, indicates that English banks were not passive, conservative suppliers of credit with weak links to industry, as has been previously perceived. The English financial system has often been compared unfavourable with the German system, most especially when considering the finance of industrial clients, yet it could be argued from the findings of this paper that the joint-stock institutions of early nineteenth century England and Wales were not dissimilar to their Germany counterparts: both frequently supplied unsecured credit to industrial customers and developed a close knowledge of their customers and their businesses (James, 1992; Capie and Collins, 1996; Da Rin, 1996). Moreover, it appears that the mechanisms to reduce information asymmetries and risk used by managements of the English and Welsh banks sampled were relatively successful, given that all the banks examined survived.

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