# BRANCH BANKING IN ENGLAND

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Material prepared for the information of the
Federal Reserve System by the
Federal Reserve Committee on
Branch, Group, and Chain Banking

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The Committee was appointed February 26, 1930, by the Federal Reserve Board

> ". . . to assemble and digest information on branch banking as practiced in the United States, group and chain banking systems as developed in the United States and elsewhere, the unit banking system of the country, and the effect of ownership of bank stocks by investment trusts and holding corporations."

## LETTER OF TRANSMITTAL

To the Federal Reserve Board:

The Committee on Branch, Group, and Chain Banking transmits herewith a study of branch banking in England, its organization, safety record, and service to the public.

Respectfully,

E. A. Goldenweiser
Chairman

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# CHAPTER I

## ORGANIZATION OF THE ENGLISH BANKING SYSTEM

Since 1920 England has suffered even greater economic and financial difficulties than the United States. Industry as well as agriculture has been in a state of depression a substantial part of that time. Problems of public debt and taxation have been far more serious than in this country. Yet there have been practically no losses to depositors or serious upsets to business in England as a result of commercial bank failures in recent years.

The commercial banking systems in England and the United States differ widely in structure and organization. Compared with about 18,000 individual commercial banks in this country with close to $45,000,000,000 of deposits, the British Isles were served at the end of 1930 by about 40 domestic banks with more than 13,000 branch offices and aggregate deposits of about $12,000,000,000, exclusive of deposits at the Bank of England.

### Joint Stock Banks

There are sixteen commercial joint stock banks in England, but the five large ones far overshadow the rest of the banking system, having among them over $8,000,000,000 in deposits and more than 8,000 branch offices. The total commercial banking strength of the British Isles may be classified as follows:

Table 1 - British Commercial Banks, December 31, 1930[1]

| Number | Type of bank | Deposits (in millions) | Number of offices |
|---|---|---|---|
| 5 | Great English joint stock banks | $ 8,251 | 8,500 |
| 11 | Other English joint stock banks | 1,359 | 1,557 |
| 10 | Private and miscellaneous banks | 705 | 507 |
| 8 | Scottish banks | 1,262 | 1,781 |
| 9 | Irish banks[2] | 700 | 1,164 |
| 43 | Banks of the British Isles | $12,277 | 13,509 |

(1) Due to complications growing out of England's leaving the gold standard in 1931, figures as of the end of 1930 are used.

(2) In Northern Ireland and Irish Free State.

The importance of the "Big Five" is even greater than appears from the figures in the table alone, as several apparently independent banks in England, Scotland, and Ireland are owned by the "Big Five." Directly and indirectly these five large organizations control 75 per cent of the deposits and 73 per cent of the branches of all the commercial banks in the British Isles.

This summary tabulation shows the dominant position of the English joint stock banks in the British Isles as compared with those of Scotland and Ireland which have only a fraction of the banking strength. In view of this dominance of the English system and in order to avoid diverting the readers' attention from the main points by a discussion of differences in the various systems, this study will be limited to the English system. The overlapping of areas served by the banks of the different countries, as just indicated, is not sufficiently serious to distort the salient facts.

The treatment will be further limited to the joint stock organizations. Some commercial banking is still in the hands of a few small private banks, but their importance in the field in recent years has been negligible. The joint stock banks do the bulk of the general banking business in England and their function in the aggregate is most nearly comparable to the function of the more than 18,000 commercial banks in this country.

Table 2 below gives the name and size of banks in the British Isles according to the London Statist.

Table 2 - Banks in the British Isles(1)
(about December 31, 1930)

| Name | Controlled by: | Deposits (in millions)(2) | Number of offices(3) |
|---|---|---|---|
| England and Wales | | | |
| *MIDLAND BANK LTD. | | $ 1,945 | 2,100 |
| *LLOYDS BANK LTD. | | 1,775 | 1,900 |
| *BARCLAYS BANK LTD. | | 1,693 | 2,100 |
| *WESTMINSTER BANK LTD. | | 1,419 | 1,050 |
| *NATIONAL PROVINCIAL BANK, LTD. | | 1,419 | 1,350 |
| *Martins Bank Ltd. | | 382 | 570 |
| Co-operative Wholesale Society, Ltd. | | 265 | 7 |
| *District Bank Ltd. | | 255 | 400 |
| *Glyn, Mills & Co. | | 193 | 3 |
| National Bank, Ltd. | | 177 | 266 |
| *Williams Deacon's Bank, Ltd. | Royal Bank of Scotland | 156 | 205 |
| Yorkshire Penny Bank, Ltd. | "Big Five" + District | 139 | 153 |
| *Coutts and Company | National Provincial | 95 | 5 |
| *Union Bank of Manchester, Ltd. | Barclays | 87 | 170 |
| *Manchester & County Bank, Ltd. | | 86 | 191 |
| *Baring Brothers & Co., Ltd. | | 85 | 2 |
| B. W. Blydenstein and Co. | | 49 | 1 |
| S. Japhet and Co., Ltd. | | 30 | 1 |
| Thos. Cook & Son (Bankers), Ltd. | | 14 | 67 |
| C. Hoare & Company | | 13 | 1 |
| Grindlay and Company, Ltd. | National Provincial | 12 | 8 |
| *London Merchant Bank, Ltd. | | 5 | 1 |
| *British Mutual Banking Co., Ltd. | | 4 | 1 |
| Grace Bros. and Company, Ltd. | | 3 | 2 |
| Reliance Bank, Ltd. | | 3 | 1 |
| Total | | 10,304 | 10,555 |

Table 2 - Banks in the British Isles[1] (Continued)
(about December 31, 1930)

| Name | Controlled by: | Deposits (in millions)[2] | Number of offices[3] |
|---|---|---|---|
| Scotland | | | |
| Royal Bank of Scotland | | $ 247 | 243 |
| Commercial Bank of Scotland, Ltd. | | 166 | 343 |
| Bank of Scotland | | 162 | 244 |
| National Bank of Scotland, Ltd. | Lloyds | 157 | 177 |
| Clydesdale Bank, Ltd. | Midland | 150 | 199 |
| Union Bank of Scotland, Ltd. | | 142 | 212 |
| British Linen Bank | Barclays | 137 | 205 |
| North of Scotland Bank, Ltd. | Midland | 101 | 158 |
| Total | | 1,262 | 1,781 |
| Ireland[4] | | | |
| Bank of Ireland | | 162 | 135 |
| Munster and Leinster Bank, Ltd. | | 121 | 205 |
| Ulster Bank, Ltd. | Westminster | 105 | 212 |
| Belfast Banking Company, Ltd. | Midland | 75 | 86 |
| Provincial Bank of Ireland, Ltd. | | 71 | 140 |
| Northern Bank, Ltd. | | 69 | 192 |
| Hibernian Bank, Ltd. | | 57 | 114 |
| Royal Bank of Ireland, Ltd. | | 32 | 79 |
| National City Bank, Ltd. | Bank of Ireland | 8 | 1 |
| Total | | 700 | 1,164 |
| Isle of Man | | | |
| *Isle of Man Bank, Ltd. | | 11 | 9 |
| GRAND TOTAL | | $12,277 | 13,509 |

(1) Based on _Statist_, British Banking Section, May 23, 1931, p. 856.

(2) $4.8665 per pound is used as the rate of conversion throughout this study.

(3) In some cases includes sub-branches.

(4) Of these, six operate in both the Irish Free State and Northern Ireland, two in the Irish Free State only, and one in Northern Ireland only.

* These are the 16 banks usually included in lists of English joint stock banks doing a general banking business. They are the banks reported by the London _Economist_ under "Joint Stock Banks of England" and compose the group on which most of the statistics in this study will be built. Glyn, Mills & Co. and Coutts & Co., though joint stock organizations, both operate as unlimited companies. National Bank, Ltd., although having its head office in London and being a member of the London Clearing House, is essentially an Irish bank. Yorkshire Penny Bank, Ltd. is primarily a savings institution. The remainder of the English banks listed are not regarded by some authorities as doing a general banking business.

## Types of British Financial Institutions

In addition to the joint stock banks which have confined their activities largely to a general banking business, accepting deposits subject to withdrawal by check on demand or relatively short notice and granting the types of short-term credits characteristic of commercial banking, there are several other types of financial institutions in England. Their functions are briefly described in the paragraphs following:

Banks Financing Primarily Overseas Trade. - In London there is a large group of banks whose principal function is that of financing the trade with or between overseas areas. As the joint stock banks have broadened their activities in this sphere, especially since the war, this group is to be numbered among the competitors of the joint stock system, though only to a limited degree in the field of domestic deposits and loans. In this group are banks having offices in England and operating under dominion, foreign, as well as English law.

Savings Banks. - As competitors for the savings deposits of the English people, the joint stock banks have several types of depositories to take into account, among which are the post office savings banks, and a number of trustee savings banks and building societies. The aggregate deposits of all of these run into billions of dollars. Investment trusts are a medium through which capital investments are made by large and small investors.

Acceptance Houses. - In the investment banking field, a group of houses act as originators, underwriters, and dealers in securities and are the channels through which individual or institutional investors place some of the savings of England in capital securities. Operating in this field are a few special concerns as well as the merchant bankers or acceptance houses which take their name from their activities in connection with accepting bills of exchange both foreign and domestic. The acceptance business of any particular house is often of a specialized nature, either along geographical or industrial lines.

Bill Brokers and Discount Companies. - Other important elements in the financial structure are the three discount companies and the many bill brokers, who deal in high-grade bills of exchange, most of which arise out of foreign trade. The discount houses generally retain most bills to maturity, while the bill brokers resell bills coming into their possession to other institutions, including joint stock banks seeking an outlet for funds. The working funds of both discount houses and bill brokers are made up of their capital and demand or short-term loans from the commercial banks. This kind of money market loan is one of the most important avenues through which commercial banks adjust their position from day to day.

The acceptance houses and the discount houses, but not the bill brokers, receive deposits on which they pay a slightly higher rate of interest than the banks. Thus there are several types of specialists which compete to an extent with the banks but do not carry on a full line of banking activities.

## Bank of England

The central institution, the Bank of England, is the banker for the Government, and has special privileges. Except for small issues, especially for the Isle of Man, it is the only English bank of issue, and through long custom the joint stock banks have come to carry a large part of their cash reserves as balances with it, although this is not required by law.

As a holder of the ultimate banking reserves of the country, it must keep itself in an exceptionally liquid position. If the banking demands of the country at the moment require an expansion in credit, it becomes reflected in the relationships between the joint stock banks and the Bank of England. As the advances and deposits of the former expand, they will seek to build up their reserve balances at the central bank commensurably. To accomplish this, the banks usually call in their demand or short notice loans to the bill brokers and convert the proceeds to balances at the Bank of England or employ them for other purposes. At times, especially at the end of June and December, the bill brokers borrow at the Bank of England to replace the accommodation withdrawn by the joint stock banks. In the same way, if the joint stock banks are experiencing an increased demand for currency, they draw on the Bank of England for it, restoring their depleted balances by forcing the bill brokers into the central bank as described above. The Bank of England may, also, and frequently does, take the initiative in tightening or easing the market by voluntarily buying or selling securities or bills of exchange on its own initiative. When higher or lower rates are established by the Bank of England with respect to its own activities, their influence is ordinarily reflected in the rate structure of the money market.

In recent years, several of the joint stock banks have grown much faster than the Bank of England so that the deposits of any one of the "Big Five" now exceed those of the Bank of England's banking department. Nevertheless, the central bank has retained its position of leadership and the banks cooperate with it to carry out its policies.

By 1918 a body of opinion had developed in England, however, which believed that the great size of the joint stock banks was a threat to the Bank of England and its central functions, and in 1918 the Treasury Committee on Bank Amalgamations reported:(1)

> "Any approach to a banking combine or Money Trust ......would undoubtedly cause great apprehension to all classes of the community......... Moreover, the position of the Bank of England--which would, it may be assumed, stand outside any such Trust--would be seriously undermined by so overwhelming a combination, and the Bank might find it extremely difficult to carry out its very important duties as supporter and regulator of the Money Market. Any such result would, in our opinion, be a grave menace to the public interest."

## Scope of Study

An effort has been made in this study to determine, in so far as available data will permit: (1) the factors responsible for the development of the English system of branch banking, (2) the degree of safety achieved, (3) the availability of credit, (4) the extent to which effective competition is maintained, and (5) the costs of banking services. In making this study the Committee has relied solely upon information available in this country and has made no original investigation in England of banking conditions there.

A handicap has been the limited scope and detail of available statistics with respect to banking in England. In that country governmental agencies publish no material comparable to the extensive information as to condition and income collected by the supervisors of banks in the various jurisdictions in this country. The statements of English banks to their

(1) T. E. Gregory, Select Statutes, Documents and Reports Relating to British Banking, 1832-1928, Vol. II, p. 331.

stockholders and the public are meager indeed. The policy of English banking organizations to keep their business private presents a limitation on the degree of detail to which the English situation may be analyzed by an outside student.

In making any comparison of banking developments and services in England and the United States there are certain differences between these countries which should be kept in mind. One is the difference in geographical compactness and density of population. England and Wales have about 680 inhabitants per square mile as contrasted with about 40 for the United States as a whole and about 260 for the more densely populated Eastern States (New York, New Jersey, and Pennsylvania combined). One should bear in mind the relatively greater importance of industry as compared with agriculture in England, and her greater dependence upon overseas trade and upon commerce in general. as compared with production.

Another difference to be noted is between the public policies of the two countries with respect to commercial banking. A few outstanding British statutes with reference to the broad outlines of organization and the matter of currency emission represent a very small body of law compared to the voluminous banking codes of the Federal and State jurisdictions here. Statutory provisions in the banking codes of this country with respect to the amount and agency for carrying reserves against deposits, the minimum amount of capital, limitations on loans to one interest, provisions for the supervision and examination of banks by publicly appointed officials are things wholly unknown in British law and practice. Moreover, the surveillance by authorities of apstockholders and the public are meager indeed. The policy of English banking organizations to keep their business private presents a limitation on the degree of detail to which the English situation may be analyzed by an outside student.

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## CHAPTER II

## HISTORICAL DEVELOPMENT OF JOINT STOCK BRANCH BANKING

The rise of the great joint stock branch banking organizations in England in the modern corporate form with limited liability of shareholders followed upon a series of statutes passed during the last century, terminating in the law of 1879. The joint stock form of organization was authorized by the Act of 1826, but prior to the acts of 1858 and 1862 ownership of shares in these institutions carried unlimited liability under the law for all obligations incurred by the company. The Act of 1862, however, definitely permitted joint stock banks to be established with stockholders' liability limited to the capital subscribed. Subsequent acts clarified this right. Even after these acts stockholders of banking corporations remained unlimitedly liable for bank notes, but this fact was not particularly significant as note liability was becoming less important compared to deposit liability.

Most of the banks in England prior to 1862 had relatively few owners. At most they had about a hundred partners contrasted with the tens of thousands of stockholders in each of the large banks today. Where a person risked his whole fortune in the banking business, the tendency was to keep organizations small and compact enough to be constantly under the immediate eyes of the proprietors. With limited liability the shareholders no longer felt the necessity of following all the details of the banks and could turn over their operation to paid officials. The corporate form was then capable of expansion in size limited only by the point of diminishing returns. As a background for the development of the great banking corporations after the third quarter of the nineteenth century, it is useful to have in mind something of the course of English banking history in the decades immediately preceding.

Structure Prior to Introduction of Joint Stock Banking

In 1800 commercial banking in England should be viewed in two parts: the situation in London and in the country outside the metropolis. At that time, banking outside of London, commonly referred to as country banking, was in the hands of a large number of private firms which conducted their business as note issuing banks rather than as banks of deposit and frequently were primarily merchants, tradesmen, or manufacturers rather than bankers. These partnerships, in making loans, paid out to borrowers their own notes which comprised a large portion of the circulating medium of the day.

In the city of London, the Bank of England dominated the field. Under the terms of an act of 1708 it claimed a monopoly of the right to operate as a joint stock company, invoking the following provision: "During the continuance of the said corporation of the Governor and Company of the Bank of England, it shall not be lawful for any body politic or corporate whatsoever, created or to be created (other than the said Governor and Company of the Bank of England), or for any other persons whatsoever, united or to be united in covenants or partnership, exceeding the number of six persons, in that part of Great Britain called England to borrow, owe, or take up any sum or sums of money on their bills or notes, payable at demand, or at a less time than six months from the borrowing thereof."

Due to this provision, the Bank of England enjoyed the sole privilege of note issue among banks in the city of London. Moreover, the interpretation grew up in tradition that the Bank of England enjoyed the exclusive right in the whole of England to operate as a banking business in the form of a joint stock company, all other banks being partnerships with not more than six members. The Bank of England was operated for the benefit of its shareholders, was the banker for the Government, and operated in the field of commercial banking in competition with other London banks. It was not at that time charged with the general responsibility for the money market as it is today. That responsibility was to be assumed a great many years later as a result of public opinion and not because of legislative mandate.

Alongside the Bank of England a group of private banks existed in London at the beginning of the nineteenth century without issuing notes. These organizations were the precursors of the banking organizations of today which operate in the field of deposit without the note issue privilege.

## Origin of Joint Stock Banks

The number of private banks operating in England during the first quarter of the nineteenth century has been variously estimated as somewhere between 500 and 1,000 and no joint stock banking organization existed other than the Bank of England. In the year 1826 an act was passed allowing concerns, if not within 65 miles of London, to do a banking business, including the issue of notes, with an unlimited number of proprietors in contrast to the legal limit of six prior to that time. These new concerns were known as joint stock companies, but were in fact simply large copartnerships. In addition to the possibility of having an unlimited number of proprietors they had other characteristics of modern corporations, including continuity of existence and transferability of shares. Although this proved to be a more flexible and attractive form under which to conduct a banking business than a partnership limited to six members, the important privilege of limited liability, allowing banks to operate as real corporations, was not to be granted for more than three decades.

As soon as they were authorized by law, joint stock banks began to be organized either as new concerns or as conversions from the private form and were successful in attracting business, due to the unsatisfactory record of failures suffered by the private banks and to the success of the joint stock system as established in Scotland. It is estimated that between 1814 and 1816, 250 private banks failed and that during the panic of 1825-1826 about 80 more closed.(1) In the decades which followed, the banking situation was characterized by increasing numbers of joint stock companies and decreasing numbers of private banks.

The new banking companies were at first local copartnerships, but with the coming of the railway the joint stock banks soon became interested in branch banking. They were encouraged by the successful examples in Scotland. The private banks, on the other hand, did not at first evince any particular interest in this means of expansion. Many of the early branches among private banks came about through keeping both offices open when the fortunes of two banking houses were joined by the intermarriage of the controlling families. The result of this difference in policy was that by 1844 the joint stock system, though having fewer individual banks, had more branch offices than the private firms. The following table gives the

(1) Daniel Hardcastle, Banks and Bankers, p. 249.

comparative status of both banks and branches, joint stock and private, at important dates.

Table 3 - Decline of Private Banks and Growth of Joint Stock Banks

| Year | Private banks | | Joint stock banks(1) | |
|---|---|---|---|---|
| | Number of banks | Number of branches | Number of banks | Number of branches |
| 1825 | 554 | 681 | - | - |
| 1844 | 335 | 428 | 106 | 604 |
| 1870 | 255 | 517 | 113 | 970 |

(1) Exclusive of the Bank of England.

In the interval between 1826 and 1862, several dates are important in connection with the development of joint stock companies. In 1833 impetus was given the movement by granting joint stock banks the right of establishing offices in London provided they did not issue notes. On the other hand, the movement was retarded by the Peel Act of 1844, the purpose of which was ultimately to concentrate all note issues in the Bank of England through a gradual withdrawal of the privilege from other banks. This act provided that no bank subsequently organized should have the note issuing privilege. Since currency banking was then more important than deposit banking, this had the effect of reducing the number of new organizations, including joint stock banks. Conversions of private banks to joint stock were also discouraged by that provision of the act which withdrew the note issuing privilege from banks changing their form,while mergers with banks within the 65 mile limit also resulted in the abolition of the issuing privilege. The Peel Act, though slowing down temporarily the joint stock movement, made considerable contribution to the rise of modern deposit banking by restricting the note issuing privilege. Another act(1) passed that same year placed a more serious check on the progress of joint stock banking by permitting copartnerships to be formed only on obtaining a Royal Charter under very strict conditions. As a result few new joint stock banks "were established for many years or till that act had been repealed."(2) This repeal was passed in 1857, another date of importance in the development of joint stock banking.

The greater flexibility of the joint stock form of organization as against the private form has been referred to. The bringing together of the resources of many partners in one institution gave them greater strength than could be mustered by the private banking firms which were restricted to six partners. Moreover, a great number of the many new shareholders naturally transferred their banking business to the companies in which they were interested, to the advantage of these joint stock banks and at the expense of the private banks. The reputation of the new type of bank was enhanced during the depressions that occurred in the period, as they showed greater stability than private banks, which failed by the score. Moreover, many private banks were so weakened that they gladly accepted offers to merge with the joint stock banks, and during the period 1826-1861, approximately 100 private banks were absorbed by joint stock banks while no

(1) An Act to Regulate Joint Stock Banks in England (September 5, 1844) in T. E. Gregory, Select Statutes, Documents and Reports Relating to British Banking, 1832-1928, pp. 229-250.

(2) Walter Bagehot, Lombard Street, new edition, 1927, p. 239. Bagehot refers to the Act of 1845 but he apparently means the Act of 1844.

cases of private banks absorbing joint stock banks are on record. Daniel Hardcastle, an English writer on banking in those days, stated that:(1)

> ". . . the joint-stock Banks did not rise until the losses inflicted by the private Bankers had repeatedly shaken the confidence of the public. . ."

The joint stock banks also attracted public confidence by taking the lead in lessening the tradition of secrecy with respect to bank operations and by establishing a policy of making available some information as to their condition.

## Developments after 1862

Last Stages of the Struggle between Private and Joint Stock Banks, 1862-1900. - The preceding paragraphs have outlined the developments over the first sixty years of the nineteenth century away from the small private banking firm toward the present-day corporate form, away from currency banking toward deposit banking. The modern era may be said to begin with the Act of 1862 which applied the principle of limited liability to shareholders of banking concerns, thus paving the way for the emergence of large corporations in the banking field. For several years before that time, there had been agitation for limited liability for banking companies and acts actually were passed in 1857 and 1858 towards this end. It was not until 1862, however, that the legal status was sufficiently clarified by a new act to give the impetus to this form of organization, although even this law carried certain limitations which were not removed until 1879.

During the forty years subsequent to the introduction of limited liability among bank shareholders in 1862, more than 125 private banks disappeared because of merger with joint stock companies with almost no

(1) Banks and Bankers, p. 243.

compensating movement, as the accompanying table shows.

Table 4 - Amalgamations of English Banks(1)

| Period | Private absorbs private | Joint stock absorbs joint stock | Private absorbs joint stock | Joint stock absorbs private |
|---|---|---|---|---|
| Unknown dates | - | - | - | 17 |
| 1825-1843 | 23 | 6 | - | 76 |
| 1844-1861 | 11 | 10 | - | 22 |
| 1862-1889 | 31 | 40 | 1 | 67 |
| 1890-1902 | 37 | 51 | 1 | 64 |
| 1903-1924 | 1 | 60 | - | 34 |
| 1925-1930 | - | 4 | - | - |
| Total | 103 | 171 | 2 | 280 |

(1) Joseph Sykes, The Amalgamation Movement in English Banking, 1825-1924, Appendix I, p. 193. 1925-1930 data from Bankers' Almanac and Year Book, 1929-1930.

By the beginning of this century the joint stock banks were in complete ascendancy as to number of offices, and particularly as to banking strength measured in deposits. The London Economist reports that 77 joint stock banks existed in 1900 with approximately 3,800 offices and deposits of about $3,000,000,000. The private banks are given as 19 with deposits of about $200,000,000. Although the figures are not available, it is likely that in addition there were a small number of private banks operating in country districts, the aggregate banking strength of which was not great. The total offices of private banking firms could not have been more than a few hundred.

During the last quarter of the nineteenth century, the reduction in the number of private banks resulted not only from mergers but also from voluntary liquidations and failures. The greater facilities and larger resources of the joint stock banks attracted much of the banking business to them. The Baring failure coupled with great losses through foreign investments during the early nineties was particularly important in undermining public confidence in the private institutions, although this was to a great extent offset by the failure of a large joint stock organization, the City of Glasgow Bank. In an effort to stem the tide running against them, private bankers took up some of the innovations introduced by the joint stock banks, including the establishment of branch offices, the publication of balance sheets, and competition for savings, foreign and acceptance business. Nevertheless, the private banks found competition more and more difficult as time went on. The growing use of checks lessened the advantage of the note issuing private banks, and the expansion of industry was requiring larger banking institutions, which were more easily attainable in the joint stock form.

During the closing years of the century the merger movement not only served to diminish the number of private banks but of joint stock banks as well. During the seventies about 120 joint stock banks were in existence, and in the subsequent 20 years this figure was halved. The low money rates obtaining through these years induced the London banks to purchase country banks, which were able, as a rule, to maintain good incomes because of higher rates. The principle reason for many of the mergers, however, was that progressive country banks were anxious to secure a footing in London to avoid the expense and inconvenience of agency arrangements, while progressive London banks were desirous of widening their spheres of influence by extension in the provinces.

<u>The Amalgamation Movement, 1900-1930</u>. - Instead of a haphazard merger pattern, however, a few banks were taking the lead in the merger

movement, and outstanding units were beginning to emerge. Rivalry between them played an important role in the development of the next decades. With the turn of the century the movement lost some of its numerical force, since fewer banks were left to merge, but those fusions which occurred were of great importance because of their size. Instead of a successful bank absorbing a failing institution, or a London bank seeking provincial outlets, the strong banks merged with each other, thus concentrating rapidly the resources of the nation into the hands of a small group of banks.

The outbreak of the war accelerated this tendency and between 1916 and 1922 thirty-two banks were taken over by other institutions. The climax in the concentration of banking resources was reached in 1917 and 1918 when as a result of consolidations among large banks the "Big Five" emerged to dominate English banking. The Barclays Bank of today represents the bringing together over the years of 148 different banks. Lloyds absorbed over 170 banks; Midland, about 80 banks; National Provincial, about 120 banks; and Westminster, about 100 banks as direct or indirect composites of their present structure.(1) It is a curious fact that of the five banks which dominate English banking today, four had their roots in the provinces, and only the Westminster originated as a city bank. This reflects the effects of the longer duration of the prohibition against joint stock banking in London than in the provinces.

Public opinion had for some time been considerably alarmed, fearing that banking competition would be eliminated. This led to the appointment of a Treasury Committee in 1918 to study the English banking situation.

(1) Luther A. Harr, Branch Banking in England, pp. 134a-134d.

This committee felt that unregulated concentration had gone far enough and suggested that a law be passed making it compulsory to get the permission of the Treasury and the Board of Trade for further amalgamations. Although this bill was dropped, the sentiment of the public was so apparent that the banks, without legal compulsion, subsequently abided by Treasury decisions. Indeed in recent years the banks, realizing the strength of public opinion, have made few proposals for further amalgamations, and structural development has taken the form mainly of establishing affiliations with existing institutions in other parts of the kingdom through purchase of stock.

By the end of the nineteenth century, limited liability was the usual thing among English joint stock banks, having come about as Sir Felix Schuster, governor of the Union of London & Smith's Bank, Limited, described it before the National Monetary Commission.(1)

> ". . . There had been a great outcry after the failure of the City of Glasgow Bank, which was an unlimited concern, and there was a great feeling in the country against the unlimited liability.(2) The result was that many responsible holders of shares, however good the concern might be, showed a desire to sell out, and there was a fear that only those people would remain shareholders whose liability would not count. The feeling all over the country was so strong that an act was passed in 1880 enabling those unlimited companies to register themselves as limited companies with a very large uncalled liability, and we and all the other London clearing banks registered as limited companies at that time, and no joint stock banks in the country were unlimited."

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(1) Vol. I, p. 34.

(2) Note: In the failure of the City of Glasgow Bank holders of stock amounting to £750,000 out of a total of £840,000 in the hands of the public were completely ruined by the losses they were forced to meet. For years it had been urged that limited liability be applied to bank shareholders, partly because of the desire to encourage desirable stockholders, partly to discourage rediscounting on the strength of the unlimited liability of bank owners.

The statistical history of joint stock branch banking in England since the beginning of this century traces the record of the concentration movement which, of course, fed on the possibilities offered by the fact that neither British statute nor public opinion opposed the branch office system, by that time more than 50 years old.(1) Contemporary discussion during the nineteenth century had focused on the power of the Bank of England, the struggle between joint stock and private banking, the question of concentration or dispersion of note issues, and later, to some extent, on the superiority of limited over unlimited liability of shareholders. The public paid practically no attention to the growth of branch banking. An English author writing in 1930 points out:(2)

> "The branch system in England sprang up as a matter of course, and no one has ever seriously suggested any other system to take its place. The disappearance of the private banker may in some ways be regretted, but it was recognized as inevitable."

The passage of a century had greatly altered the banking structure of England. In 1825 commercial banking, exclusive of the Bank of England, was wholly in the hands of private partnerships, with no joint stock companies in existence. A hundred years later less than 2 per cent of commercial banking deposits were in the hands of private companies. Instead of the six partners or proprietors,(3) to which the private banks were limited, each of the "Big Five" was a national institution in which a large segment of the public was interested, and each had at the end of 1930 at least 40,000 shareholders.

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(1) Cf. James William Gilbart, A Practical Treatise on Banking, Vol. I, p. 165.

(2) L. Le Marchant Minty, English Banking Methods, p. 92.

(3) Has since been increased to ten partners.

Table 5 - Shareholders of the "Big Five" in 1930(1)

| Bank | Number of shareholders | Average holding |
|---|---|---|
| Barclays Bank | 56,426 | $1,368 |
| Lloyds Bank | 65,000 | 1,184 |
| Midland Bank | 76,055 | 912 |
| National Provincial Bank | 40,000 | 1,153 |
| Westminster Bank | 85,569 | 530 |
| Total | 323,050 | $ 975 |

(1) New York Times, July 18, 1931, p. 22, column 5, from American Banker.

The following table brings out the decrease in the number of joint stock banks and the increase in their average number of offices and deposits since 1900.

Table 6 - Growth in Size of Joint Stock Banks 1900-1930(2)

| Year | Number of joint stock banks | Average number of banking offices per bank (approximate) | Average deposits per bank (in millions of £'s) |
|---|---|---|---|
| 1900 | 77 | 50 | 8 |
| 1905 | 59 | 75 | 11 |
| 1910 | 45 | 115 | 16 |
| 1915 | 37 | 160 | 27 |
| 1920 | 20 | 380 | 98 |
| 1925 | 18 | 495 | 100 |
| 1930 | 16 | 630 | 124 |

(2) Based on Economist (London), Banking Number, May 9, 1931, pp. 18, 19.

In thirty years the number of banks had decreased mainly through amalgamation from 77 to 16, and the average size of each had increased about 15 times, both in deposits and the number of offices.

The increase in branch offices which has accompanied the concentration of banks in England has been more than proportionate to the growth in population. In the course of the past thirty years banking offices have more than doubled while the number of persons in England and Wales has grown but 22 per cent, inhabitants per banking office having decreased as follows:

Table 7 - Inhabitants per Banking Office(1)

| Year | Number of banking offices | Inhabitants per banking office |
|---|---|---|
| 1901 | 4,800 | 6,800 |
| 1911 | 6,300 | 5,700 |
| 1921 | 7,600 | 5,000 |
| 1930 | 10,100(2) | 3,900(3) |

(1) Joseph Sykes, Amalgamation Movement in English Banking, p. 113. The figures are approximate.
(2) Economist (London), Banking Number, May 9, 1931.
(3) 1930 population, estimated.

## Present Structure of the Large Banks

With the development of these large branch systems combining as many as 2,000 offices into one organization have come serious managerial problems. The banks have paid close attention to the development of internal organizations to cope with a business of such size and dispersion. Bank costs and profits depend upon the solution of the organization problem, which touches the interests of banking clientele because the quantity and quality of service as well as the safety of banking rests upon it.

The smallest form of banking office is a sub-branch which may be open for a limited number of days a week. Such offices are usually manned by officials from a nearby branch. A full fledged branch has a staff, headed by a manager, with one or many subordinates, depending upon its size. A group of branches is responsible to a district superintendent, who in turn reports to one of the leading officials at the head office. The chief executive officers are the joint general managers, each one having charge of a section of the bank's activities, and responsible to the board of directors.

The board, varying in size among the "Big Five" from about twenty-five to about fifty members, is elected by the stockholders of the bank and for the large banks the custom is to have it meet, as a committee of the whole, about once a week. It is also divided into permanent or rotating committees which deal with various phases of the bank's business, and these meet more frequently. For example, the finance committee passes on loans, investments, and other fiscal matters. The premises committee has to do with the buildings and real estate of the bank and the location of branches, and other groups have their special interests.

Barclays Bank has effected the largest degree of decentralized control. Instead of the one head office to which all branches must turn, Barclays has forty local head offices whose directors have wide powers of discretion. This form of organization was inaugurated with the formation of the bank in 1896 and has been successfully maintained ever since.

In the hierarchy of officials each has specific duties and powers, increasing in scope as the scale is mounted. Both titles and forms of organizations vary from bank to bank but there is some similarity between the institutions and they may be described in a general way. For example in the matter of the granting of loans, there is usually a pyramiding of responsibility. Each branch manager is limited as to the maximum loan he may make without referring the matter to his superintendent, who also has limits which he may not exceed. Officials at the head office including the general managers have their limits, loans of the largest size having to be approved by the board of directors, as a rule. The exact size of loan which each grade of official may approve is not published by the banks, but it is known that the maximum figure on loans which may be approved by the local manager varies from bank to bank and from branch to branch within the bank, depending upon the size of the branch and the business characteristics of the area served.

Generally, major officials of a bank are responsible for the open market loans and investments, determine funds to be held in cash or with the Bank of England, and keep the various classes of assets in proper proportion to each other. The lending activities of branch managers are restricted in general to loans and advances to their own customers. Some branches obviously have more deposits than acceptable applications for loans while other branches may have local loans exceeding deposits. The position of the branches in this respect may vary from season to season, but the widespread branch systems serving a variety of localities and businesses are an effective instrument for affording fluidity to banking funds. Unfortunately no statistics exist as to the deposit-loan position at different seasons of the year of branches with a variety of interests. In calculating the profits results of branches, those which supply a surplus of funds which are utilized elsewhere receive an interest credit at the head office while those lending in excess of their deposits are charged at a stipulated rate by the head office. The details with respect to these accounting arrangements have not been found in published sources.

Despite the size of the companies, officials at the head office are kept in constant touch with the detailed workings of the entire organization through an elaborate system of bookkeeping and reporting, including the general credit standing of borrowers. In most cases, the condition of the branches is reported daily, and it is subject to periodical audit from the head office. The law requires joint stock banks to make public twice a year a statement of condition, but these statements are of a much more condensed nature than those familiar in American practice.

The usual form is for the accounting system and procedure to be under the control of a chief accountant, an important official of the head office. An officer is responsible for the auditing procedures and upon the adequacy of his periodical check up of the branches rests in large measure the soundness and safety of the whole organization.

## Functions of Joint Stock Banks

The services of the joint stock branch banking system to the English public fall chiefly in the sphere of commercial banking, as these banks are much less the department store of finance known in other countries. Their detachment from the long time capital market and from the business of dealing in securities is noteworthy and will be elaborated in the section dealing with the availability of credit.

The banks receive subscriptions for stock issues, but do not "regard themselves except in very rare cases as fathering the issue or in any way responsible for it beyond seeing that the prospectus complies generally with law and that the issue is on the face of it responsible."[1]

(1) Great Britain, Committee on Finance and Industry (1931), Rt. Hon. H. P. Macmillan, K. C., chairman, p. 167.

Securities affiliates of commercial banks, such as are prevalent in this country, do not exist in England.

It has been shown in a previous section that the rise of the branch system has increased the number of offices compared to the total population, suggesting that accessibility of banking services to the banking public has been increased with the progress of concentration. As is true in other countries, competition has caused banks in England to engage in a variety of miscellaneous services in behalf of depositors, including investment advice, purchase of investments, making of foreign exchange, custody of securities, clipping and collecting of coupons, advice in connection with income tax returns and in connection with the drawing of wills, paying monthly bills, and a variety of like matters.

During the present century the joint stock banks have extended their interests in foreign fields, becoming more active competitors of the group of banks with London offices interested primarily in the financing of the trade of overseas areas. Since the war this expansion was intended to replace other accommodations in this field which became less important during the war. On the other hand, it was a reflection of the urge to expand in other fields when the growth in domestic fields through amalgamations was curtailed. Some of the banks have increased their facilities by opening branches abroad, but all of them have extended their foreign business. In some instances special corporations have been organized by one or more of the joint stock banks to operate in foreign fields. A list of these new concerns is to be found on page of the appendix.

The Midland Bank in contrast with some of the other banks has refrained from placing branches abroad and emphasizes the facilities which it offers through its correspondents in foreign countries, but it has today a large business in accepting sterling bills arising out of foreign trade.

## CHAPTER III

## SAFETY OF JOINT STOCK BRANCH BANKING

Failures among English joint stock banks have been comparatively few, and losses to depositors only a fraction of those suffered by depositors in the United States. No official data on bank failures are compiled and even the current English periodicals which have banking statistics give very limited material of this kind. It appears from the best evidence available, however, that only 8 joint stock banks in England have failed since 1900, and 6 of these were very small institutions.

Table 8 - Failures of Joint Stock Banks in England since 1900(1)

| Year of failure | Name of bank | Number of branches | Paid-up capital | Deposits(2) |
|---|---|---|---|---|
| 1901 | Cheque Bank, Ltd. | 1 | £ 58,000 | (3) |
| | Carlton Bank, Ltd. | 0 | 17,000 | £ 5,000 |
| 1903 | John Brown & Co.(4) | 0 | (3) | (3) |
| 1905 | Economic Bank, Ltd. | 0 | 50,000 | 86,000 |
| 1910 | London Trading Bank, Ltd. | 0 | 42,000 | 73,000 |
| 1914 | Civil Service Bank, Ltd. | 0 | (3) | (3) |
| 1920 | Farrow's Bank, Ltd. | 74 | 361,000 | 4,137,000 |
| 1925 | Western Bank, Ltd.(4) | 3 | 200,000 | 81,000 |

(1) Based on Hearings before a Subcommittee of the Committee on Banking and Currency, United States Senate, 69th Congress on S. 1782 and H.R. 2, pp. 119, 120. Brought up to date with the Bankers' Almanac and Year Book, 1929-1930. All banks other than English commercial joint stock companies have been eliminated from the list. The statistics given are usually for dates prior to failure, sometimes several months or a year prior to failure.

(2) Due to the violent fluctuations in exchange rates in post-war years, pounds are not converted to dollars in this study when a series covering a period of years is used.

(3) Not available.

(4) May not have been a commercial joint stock bank.

Only two failures, as noted in the above table, occurred from 1915 to 1931 inclusive, in spite of all the war and post-war financial disturbances. These were Farrow's Bank and the Western Bank. The deposit liabilities of the latter were very small and there is some doubt as to the nature of its business. Assuming, however, that it should be included among the commercial banks, the total deposits of failed banks have aggregated only a little over £4,200,000 during the past seventeen years. During this period average annual deposits in the active joint stock banks amounted to about £1,740,000,000, so that the ratio of deposits of failed banks to the average deposits of active banks in the seventeen years was less than one-fourth of one per cent, which contrasts with about 13 per cent for national and State banks in the United States. On the other hand, it is probable that some banks on the verge of suspension have been saved either through merger or through financial assistance. Unfortunately, it is not known how many of the seventy joint stock banks absorbed by others since 1900 were in difficulties.

The emergence of larger and larger banks and the extension of networks of branches have been accompanied through the decades by a decrease in the number of bank failures. A century ago failures were very common. From 1793 to 1818 about 1,000 failures of all types of banks in the British Isles were recorded,(1) or an average of about 45 a year. It will be recalled that in the early part of the nineteenth century banking was carried on by a large number of small concerns, but by 1872 the number of banks was less and the average size larger. It is estimated that 24 failures occurred in the

(1) H. T. Easton, History and Principles of Banks and Banking, p. 54.

following thirteen years,[1] an average of only 2 failures a year. In the thirty years of this century there have been no more than 18 bank failures in all of the British Isles, or less on an average than a bank a year. The table of bank failures given earlier in the chapter includes only those 8 which can be considered English joint stock banks, the remaining 10 being either Scotch, private, or non-commercial institutions.

## Causes of Failures

During the formative period of modern English banking, the nineteenth century, important causes of bank failures have been cited, such as limitation of capital investment through restriction of number of partners, unsound methods of banking, particularly the combination of trading and banking, the temptation to overissue, and the practice of rediscounting. Recent failures have usually been associated with internal irregularities, the importance of dishonesty or mismanagement being indicated by the following short description of the causes for several of the more recent failures.

The Cheque Bank, a small English joint stock concern which closed in 1901, had specialized in the issuance of small checks for remittance purposes. It suffered from the competition of the extended facilities of the post office and as its checks were easily imitated, continental forgers victimized the bank. The Economic Bank, Ltd., failed in 1905 as a result of the manipulation of its capital stock by its management, which had devised a scheme to buy up its own shares. The London Trading Bank, though conducted on a sound basis, was drained of its resources by the failure in 1910 of the Charing Cross Bank, a private bank run on highly speculative lines.

(1) Ibid., p. 114.

Farrow's Bank, Ltd., which suspended payment in 1920, was the largest English joint stock bank to fail during this century. At the time, opinion was expressed that the collapse was due to commitments in highly speculative ventures. The Statist said that "The charge of bad management and losses in trading, extending over a number of years, made officially, sufficiently account for the fact that the Bank was not helped over the crisis."(1)

Subsequent to the joint stock bank failures of recent years, the press has agitated for some form of governmental supervision for banking houses, depending more or less on the size of the institution involved. As the failures have been few and for the most part inconsequential in size, the demands have not been maintained either long or forcibly and banks are still subject to practically no public regulation beyond the matter of further amalgamations.

## Factors Relating to Safety

Size of Banks. - The high degree of safety attained has been attributed to the strength inherent in the large size of most banks, both in assets and number of branches. A chairman of one of the large English banks said:(2)

> "It would have been impossible for England to have weathered the financial storms of 1914 without branch banking. It was only the concentration of resources made possible by branch banking that enabled England to go through this critical period without a financial collapse."

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(1) December 25, 1920, p. 1237.

(2) Luther A. Harr, Branch Banking in England, Corn Exchange Bulletin, June-July, 1928.

In an editorial in the Bankers' Insurance Managers' and Agents' Magazine in 1901[1] the following arguments were set forth:

"The great reduction in the number of banks has doubtless in many ways been attended with very considerable advantages to the districts in which it has occurred. The substitution of a strong bank for a weak one is in itself no unimportant change. The branch of a strong bank has all the vigour of the strong bank at its back, and it is probable also that there will be less likelihood of dangerous advances being made, or of weak businesses, which should long ago have been wound up, being supported at an undue risk. The individual banker in a small town may find it difficult to refuse to make advances which his better judgment would lead him to decline. The branch manager, on the other hand, must put the case before his 'board,' which will go into the matter dispassionately and from the point of view of business suitability alone. Hence, bad local business is less likely to be undertaken by a large bank with a good system of management than by a separate individual concern. When large joint stock banks have failed in this country of late years, the catastrophe has almost always arisen from some very powerful customer having gained a mastery over the governing body, or from absolute fraud.

"We need not bring forward instances. The exercise of due care, a good system of supervision honestly worked, and a proper attention to the consideration of the security proposed for each advance, will be great safeguards against perils of this sort. And the bringing together the banking business generally into a few powerful institutions ought to assist in the safety of the whole number. Such questions as the maintenance of an adequate specie reserve are more likely to be decided on correct principles by a few men fully aware of the great risks involved, when the reserve is not adequate, than by a larger number to some of whom the responsibility of their position has not appeared as serious as it really is. In all these points there should be great advantages from the change."

The principal advantage of the large bank is that it enables the scattering and balancing of risks. The large organization, comprehending city and country banking and serving a variety of industries, can hope to have misfortunes encountered at one point balanced by better results at others. It is also assumed that the large bank is able to provide a higher

(1) July, 1901, pp. 1-5.

grade of management than the small bank. Most of the officers of each bank have spent their entire careers in the service of the bank and have thoroughly absorbed its special traditions and methods.

The large branch organizations have protected depositors from losses in still another respect. Under a unit banking system an unsuccessful bank is in many cases forced to close its doors, usually with losses to both depositors and stockholders, but with the branch banking form of organization, an office unable to support itself can be discontinued with no loss to depositors and without demoralizing the economic community. Any losses which may have been incurred can be absorbed by the bank because of its size and the diversification of its assets, and the losses due to forced liquidation are eliminated. Some indication that banking losses in England have been mitigated in this fashion is brought out by the large number of offices closed as contrasted with the small number of actual bank failures, cited above. The <u>Bankers' Almanac and Year Book</u> indicates that 3,993 offices were closed in England between 1876 and 1914, as compared with 8,942 which were opened during the same period. The number closed was almost half as large as the number opened. In 1915, 154 new branches appeared, while 53 were closed,(1) but during 1916, when the war made the banking situation very difficult, more offices were closed than were opened.(2) This indicates that adjustments to changing economic conditions and expansions into new fields have been made in England as in other countries, but the results have not been disastrous to depositors, due to the balancing of profit and loss within the systems and the avoidance of forced liquidation.

With banking institutions reduced to a few of very large size, public policy no doubt feels the necessity of taking a more active interest

(1) 1917, pp. 26, 27.
(2) 1918, p. 25.

in the safety and solvency of any particular one when the occasion arises. A hint of this possibility is to be found in a discussion concerning the Farrow's Bank failure in 1920.(1)

> ". . . Immediately upon the announcement of the suspension, the Board of Trade issued a brief announcement stating that 'From information available to the Board, it is clear that the closing of the bank is due to losses in trading and errors of management extending over a series of years, and is not due to any causes of a general nature arising out of the circumstances of the present time.' The same evening the Chancellor of the Exchequer repeated this statement in the House of Commons, and added that while the probability of suspension had been known to the Government for some little time, *he had satisfied himself that the Government could not usefully or prudently take any steps to support the bank.*"

A point of view often expressed by British observers of their banking system holds that the large banks are practically national institutions and that the Government could not allow one to fail without first exercising every resource of Government credit and of the rest of the banking system to save it.

*Auditing*. - The rigorous systems of audit used among the joint stock banks also contribute to their safety and solvency. There is in the first place the internal auditing and inspection by especially organized departments whose representatives periodically check up on all branches and activities. Part of the inspection system includes the making of a variety of reports at stated intervals by the branches to the head office.

Corporation procedure in England for a long period of time has placed much reliance in audits on behalf of shareholders by accounting firms. As a result there has developed a group of reputable and experienced accountants, whose audit and certification of the state of the companies' affairs carries a high degree of moral responsibility as well as the reputation for a conservative presentation of the facts. The customary employment of these

(1) *Bankers' Magazine*, January, 1921, p. 38. Italics added.

large accounting firms by the shareholders of banks is an assurance to the depositor. Joint stock companies must under the law be audited once a year in this fashion and a former chairman of one of the "Big Five" has said:(1)

> "No self-respecting bank could possibly face anything less than an absolutely clean certificate from its auditors; they have to lay down the conditions under which they are prepared to give it. In short, the names of the auditors are the ultimate guarantee to the public that a bank is being conducted on sound lines."

Responsibility of Directors. - In the banking tradition and standards which have developed in England, the responsibility of directors has been emphasized and the interest which those accepting bank directorships have taken in their institutions has no doubt had its influence upon the solvency record of English banks. The Companies Act of 1908 held that the directors are liable for loss due to wilful neglect or default or actual dishonesty:(2)

> ". . . if they (the directors) appear to the court not to have acted as men with any ordinary degree of prudence would have acted on their own behalf, they have been guilty of such negligence and misconduct as to make them liable to the company."

In 1929 this was made still stronger.(3)

> "Subject as hereinafter provided,(4) any provision, whether contained in the articles of a company or in any contract with a company or otherwise, for exempting any director, manager or officer of the company, or any person (whether an officer of the company or not) employed by the company as auditor from, or indemnifying him against, any liability which by virtue of any rule of law would otherwise attach to him in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company shall be void."

In 1903 a court said:(5)

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(1) Walter Leaf, Banking, pp. 233, 234.

(2) First Earl of Halsbury, Laws of England, Vol. 5, p. 232.

(3) The Companies Act of 1929, Sir R. M. W. Chitty, The Complete Statutes of England, Classified and Annotated in Continuation of Halsbury's Laws of England . . ., Vol. 2, pp. 873, 874.

(4) In certain cases, not pertinent here, relief may be applied for--author.

(5) Economist (London) November 21, 1903, p. 1974.

". . . Since the trial of the action, the 'Right Hon.' Lord de Morley, as he is described in the literature of the 'bank', has written stating that, although managing director of the advisory board, 'I do not give instructions, nor am I responsible for the bank's management, that duty being placed entirely in the hands of the general manager, who is appointed or dismissed by the shareholders only, and to them responsible.' The managing director of this concern cannot, however, divest himself of his responsibility so easily. He has lent his name to the institution with the full knowledge of what that entails, and it is useless for a person placed in his position to try to evade the consequences of his action."

Nature of Assets. - The safety of banks rests in the last analysis on the soundness of their assets and the suitability of these assets from the viewpoint of the banks' liabilities. For this reason, some analysis of the balance sheets of the joint stock banks at various dates seems desirable. The liabilities of the banks consist chiefly of deposits, mostly payable on demand or notice of a few days only. The commercial banking philosophy of England holds that in order to meet such liabilities, bank assets must possess a high degree of liquidity, and should not be subject to broad fluctuations in value. Short-term paper is favored to achieve this end.

Under the law, the joint stock banks must publish statements of condition twice a year, but not much detail is required. As a matter of practice these reports are usually made as of about the end and the middle of the year. The Economist (London) has for years been publishing consolidations of these balance sheets and as of the end of 1930 gives the figures for the 16 joint stock banks as follows:

Table 9 - Assets and Liabilities of English Joint Stock Banks
December 31, 1930(1)

| | (in millions) |
|---|---|
| **Assets** | |
| Cash in hand and at the Bank of England | $ 1,585 |
| Cash at call and short notice | 714 |
| British Government securities (where separately stated) | 1,341 |
| Bonds, stocks, and other investments | 261 |
| Bills discounted (where separately stated) | 1,540 |
| Advances and loans | 4,694 |
| Buildings and sundries including cover for acceptances | 842 |
| Total | 10,977 |
| **Liabilities** | |
| Capital paid up | 389 |
| Reserve funds | 313 |
| Undivided profits | 30 |
| Notes in circulation | 1 |
| Acceptances and endorsements | 623 |
| Deposit and current accounts | 9,620 |
| Other liabilities | 1 |
| Total | $10,977 |

(1) Economist (London) Banking Number, May 9, 1931.

The English joint stock banks have no legal reserve requirements, but at the end of 1930 they had about $2,300,000,000 or 21 per cent of their funds easily available. In the neighborhood of one-half this sum was in cash and in deposits with the Bank of England and other banks, while the remaining was in money at call and short notice. There was some $1,600,000,000 or 15 per cent in investments, said to be mainly short term; $1,500,000,000 or 14 per cent in Treasury and commercial bills discounted; and the remaining $5,600,000,000 or 50 per cent was composed largely of advances and loans to customers. Although the bulk of the latter were granted originally as short-term credits, quite a number of non-liquid items are believed to be included in them at the present time owing to the difficult position of British industry.

The balance sheet figures given above are as of a certain day, but it has been the general belief for a long time that most of the English banks have indulged in "window-dressing" on balance sheet days.(1) The Macmillan Committee on Finance and Industry referred to this as follows:(2)

> ". . . It is evident, therefore, that the clearing banks do not maintain from day to day so high a proportion of cash as is shown by the monthly statements, and although we have not available all the data required to make an exact calculation, it seems probable that the balance maintained by those banks (excluding the half yearly periods) is appreciably below £60 millions or less than $3\frac{1}{2}$ per cent. of deposits. It is probable therefore that the total cash reserve kept (apart from balances with other banks and items in transit), is over all about $9\frac{1}{2}$ per cent., against the published figure of nearly 11 per cent."

Against this tendency of published balance sheets to overestimate highly liquid items is a known disposition to hide completely a large body of assets. Some of these undisclosed assets relate to bank premises which have been written down on published balance sheets below their true worth although some English bankers have stated that their total commitments in office real estate were higher than desirable. Conservatism causes the banks to write off loans or investments which, though partially in doubt, may be recovered in whole or in part.

On the liability side of the balance sheet the joint stock banks have $13 of deposits for every $1 of book invested capital. Eighty-seven per cent of liabilities represents deposits, while about 6 per cent consists of contingent liabilities arising out of acceptances and endorsements.

Although the small proportion of less than 7 per cent shown for

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(1) The Committee on Finance and Industry recommended that this practice be given up at once and it is believed that since then many banks have acted on this recommendation.

(2) Op. cit., Report, p. 36.

proprietors' liability includes capital paid up, book reserves, and undivided profits, it does not account for hidden reserves spoken of above nor indicate the extent of the subscribed, but not paid-up, capital for which the shareholders are responsible. The unpaid stock liability bears some analogy to the "double liability" provision familiar in American banking statutes. Among the joint stock banks two-thirds of the subscribed capital is at present unpaid and part is subject to call at any time and the remainder callable in case of liquidation.(1)

Policy Regarding Liquidity. - The distribution of both assets and liabilities has shown little change over a long period of years, as indicated in Table 10.

Table 10 - Distribution of Assets and Liabilities(2)
of English Joint Stock Banks
1900-1930

| | 1900 | 1905 | 1910 | 1915 | 1920 | 1925 | 1930 |
|---|---|---|---|---|---|---|---|
| | In millions of £'s | | | | | | |
| Total assets | 699 | 759 | 862 | 1,147 | 2,200 | 2,074 | 2,256 |
| | In per cent of total assets | | | | | | |
| **Assets** | | | | | | | |
| Cash in hand and money at call and short notice | 20.7 | 23.6 | 23.0 | 22.9 | 20.4 | 21.3 | 20.9 |
| Investments | 18.3 | 17.3 | 16.0 | 27.0 | 16.7 | 15.3 | 14.6 |
| Discounts and advances | 56.6 | 52.9 | 54.3 | 43.9 | 57.4 | 56.3 | 56.8 |
| Buildings and sundries | 4.4 | 6.2 | 6.7 | 6.2 | 5.5 | 7.1 | 7.7 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| **Liabilities** | | | | | | | |
| Capital and reserves | 11.3 | 10.8 | 9.4 | 7.1 | 5.8 | 6.5 | 6.4 |
| Deposits | 84.0 | 82.6 | 83.6 | 86.4 | 89.0 | 87.1 | 87.6 |
| Acceptances | 3.0 | 5.2 | 6.0 | 5.5 | 4.7 | 6.0 | 5.7 |
| All other liabilities | 1.7 | 1.4 | 1.0 | 1.0 | 0.5 | 0.4 | 0.3 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Number of banks | 77 | 59 | 45 | 37 | 20 | 18 | 16 |

(2) Economist (London), Banking Number, May 9, 1931.

(1) Barclays Bank Ltd. is the only one of the "Big Five" having no uncalled capital.

For some years in the early part of this century an increasing proportion of resources was represented by money at call and short notice, but by 1917, the peak of this tendency was reached and the present status is about the same as thirty years ago. The increase and decrease in the cash and money at call were compensated by opposite changes in discounts and advances. The increasing ratio of cash cut into the discounts and advances until 1917 when the release of funds from the cash account found its way into advances and discounts. Investments which were of much greater relative importance during the war than before or since, represent today a lower proportion of resources than thirty years ago, while in the same time buildings and sundries have come to occupy almost twice as important a position on the balance sheet.

For several decades capital funds did not keep pace with the growing resources of the banks, and by 1920 capital and reserves were only half as important as they had been in 1900, having shrunk from 11.3 per cent to 5.8 per cent of total liabilities. This failure of capital to keep pace with the growth of resources resulted in part at least from a conscious policy, many companies having reduced book capitalization in order to show a higher rate of earnings. A feeling of dissatisfaction with these developments was entertained in some quarters and the Treasury Committee expressed itself in 1918 quite frankly as follows:(1)

> "The proportion of capital to deposits is now so small in the case of English joint stock banks, even excluding the temporary war increase in the amount of deposits, that any further shrinkage of bank capital is clearly undesirable, in the interest of depositors, if it can be avoided. Attention has been drawn to the fact that amalgamation schemes usually mean a reduction in the total paid-up capital and uncalled liability of the two pre-amalgamation units. This has frequently been the case in the past, and it has also been a feature of recent amalgamations and proposed amalgamations. The amalgamation of the National Pro-

(1) Report of the Treasury Committee on Bank Amalgamations, 1918, in T. E. Gregory's <u>Select Statutes, Documents and Reports Relating to British Banking, 1832-1928</u>, Vol. II, p. 329.

vincial Bank of England, Ltd., with the Union of London and Smith's Bank, Ltd., resulted in a reduction of over £1,000,000, or 16 per cent., in the total paid-up capital, and of over £9,000,000, or over 48 per cent., in the uncalled liability of the Union shareholders. The amalgamation of Parr's Bank, Ltd., with the London County and Westminster Bank, Ltd., while it resulted in an addition of £243,000, to the total paid-up capital, brought about a reduction of nearly £1,770,000, or 17 per cent., in the uncalled liability of Parr's shareholders. The proposed amalgamation of the London City and Midland Bank, Ltd., with the London Joint Stock Bank. Ltd., would effect a reduction of nearly £1,000,000 in the total paid-up capital, and of over £9,000,000, or over 50 per cent., in the uncalled liability of the Joint Stock Bank shareholders. In each of these three cases, therefore, substantial benefits to shareholders are purchased at the expense of some of the security of the depositors. But the reduction of capital (as opposed to the reduction of uncalled liability) resulting in two of the cases appears to be only nominal, the sum written off, or some sum approximating to it, being added to the inner reserves, at any rate at present."

The prevalence of opinions of this sort has no doubt had its effect for the ratio of capital and reserves to total resources increased somewhat after this report and in the last few years has held constant around or just under 6½ per cent.

During the past decade a larger proportion of all deposits has become subject to periods of notice before withdrawal rather than being demand deposits. A classification of deposits along this line for the ten London clearing banks since 1919 is given in the report of the Committee on Finance and Industry.(1) In December of that year 66.9 per cent of the deposits were repayable on demand and since then the proportion has fallen rapidly, being 58.7 per cent in December, 1925, and 53.9 per cent by the end of 1930. The Midland Bank states that:(2)

"The significance of these figures becomes apparent when we remember that demand deposits are essentially money in active use in business of all kinds, while time deposits have more of the

(1) Op. cit., pp. 284, 287, and 289.

(2) Speech of the Right Hon. R. McKenna, chairman, Ordinary General Meeting, Midland Bank Limited, January 22, 1929, p. 6.

character of money awaiting investment and money for which no no trading use can be found at the moment. . ."

A large part of time deposits are withdrawable under the terms of the contract upon such short notice as 7 to 14 days, but banking practice permits the withdrawal of time deposits generally without the required notification on forfeiture of part of the interest.

The London clearing banks publish monthly statements in more detail than those published semiannually by all of the joint stock banks, which have been the basis of the discussion in the preceding paragraphs. Moreover, the Committee on Finance and Industry procured from these clearing banks still more detailed information with respect to the assets held by them over a period of years as well as a split up of deposits between demand and time referred to in the preceding paragraph. These figures form a better basis for gauging the degree to which deposit liabilities are covered by the more liquid styles of assets. The London clearing house has 10 members,(1) 9 of which are numbered among the joint stock banks doing a general domestic business, and these 9 have 95 per cent of the business of all the 16 joint stock banks of England and Wales. What is typical of the clearing banks, therefore, is typical of joint stock banks in general. The following tabulation gives monthly averages for the years 1926 through 1930 of certain assets expressed as dollars per $100 of total deposits.

(1) Barclays; Coutts & Co.; Glyn, Mills & Co.; Lloyds; Martins; Midland; National; National Provincial; Westminster; Williams Deacon's.

Table 11 - Distribution of Assets of London Clearing Banks per $100 of Deposits,(1) 1926-1930

| | 1926 | 1927 | 1928 | 1929 | 1930 |
|---|---|---|---|---|---|
| 1. Cash in hand | $ 6.41 | $ 6.33 | $ 6.11 | $ 6.00 | $ 5.95 |
| 2. Balance at Bank of England | 5.35 | 5.14 | 4.89 | 4.77 | 4.85 |
| 3. Money at call | 1.55 | 1.52 | 1.66 | 1.66 | 1.90 |
| 4. Money at short notice to money market | 3.92 | 4.55 | 4.55 | 4.37 | 4.60 |
| 5. Money at short notice to stock exchange | 2.00 | 2.38 | 2.81 | 2.50 | 1.64 |
| 6. Treasury bills discounted | 6.27 | 6.79 | 6.30 | 5.66 | 7.39 |
| 7. Commercial bills discounted | 6.70 | 5.93 | 6.92 | 7.07 | 7.30 |
| 8. Investments | 17.68 | 16.44 | 16.11 | 15.82 | 16.17 |
| Total | $49.88 | $49.08 | $49.35 | $47.85 | $49.80 |

(1) Based on Report, Committee on Finance and Industry, pp. 287-289.

Important asset items which do not appear in the above tabulation include balances with other banks in the United Kingdom, checks in course of collection, bank buildings and real estate, and the very important item of advances or customers' loans. The items given in the tabulation, however, are the assets usually regarded by the banks as most easily convertible for the purpose of meeting deposit demands on the part of the public. The aggregates show that during the past few years the clearing banks have averaged per $100 of deposits $50 in assets which do not rely on the customer relationship. All of these assets with the exception of investments are of the short-term variety and it is said that a large part of the investment account is also of this class. In addition to the cash and call items, the money market loans, the discounted bills and the investments are highly regarded by any one bank as a support to its liquid position on the theory that these assets can be shifted in the open market in contrast to customer loans and advances which are not so shiftable. From 1926 to 1930 there has been a tendency for the proportion of cash in hand and balance at the Bank of England to decline from year to year. They were about $11.75 per $100 of deposits in 1926 as against $10.80 five years later. Advances to customers in the five years have ranged from $53 to $55 per $100 of deposits.

It is said that English bankers aim to keep their various types of assets in certain proportionate relationships, one to the other, in accordance with their views of liquidity developed and maintained over a long period of years. The relative stability of the averages of various items over five years, as given in the foregoing table, is consistent with that principle.

## CHAPTER IV

## THE AVAILABILITY OF CREDIT

It is not easy to measure statistically the effectiveness with which commercial banks perform their function of financing goods and services on the way to the consumer or to the point at which they become a part of fixed capital. Whether such banks extend too little credit or too much is largely a matter of opinion, colored by the personal interests of him who ventures it.

### General Supply of Credit

Most of the discussions with respect to the adequacy of the joint stock branch banking system of England have centered around the question of the availability of credit, and arise from two charges sometimes made: first, that the large branch systems have concentrated their loans in the large centers at the expense of the small urban and rural communities; and second, that the banks have been unduly niggardly in the extension of credit to industry and have maintained the position of short-term creditors rather than participants in industry, as in Germany. The merits of the opposing contentions are especially hard to determine because of England's difficult economic situation. When so many factors are involved, as in the case of a stagnant industrial situation, it is difficult to say how much of the condition, if any, is due to the method and degree of credit extension by the banks. An analysis is further hampered by the fact that little or no evidence can be adduced other than personal impressions.

The weight of opinion appears to hold that the joint stock banks of England supply an adequate volume of short-term credit and that by and large all classes of borrowers entailing no more than a reasonable risk are accommodated. Concentration of banking resources in the hands of a few concerns makes for the fluidity of banking funds, and this does not appear to have prejudiced the position of outlying communities nor of the small borrower who is a legitimate credit risk. The banks have held that their function is that of furnishing short-term credit; that they cannot afford to lock up their depositors' money in the financing of fixed capital. Responsible authority appears to think the position of the banks in this respect is well taken, and leans to the view that more harm has been done on the side of leniency of credit extension, by way of keeping weak concerns in existence, than would have been the case had they been forced to liquidate promptly. Although the weight of opinion with respect to these matters may lean one way, the contrary view has its exponents as many of the citations to follow will show.

The findings of the Committee on Industry and Trade with respect to this question are of outstanding importance. This was a committee of business men under the chairmanship of Sir Arthur Balfour, provided for by Parliament to make an extensive study and report. After holding hearings for over three years the committee published its findings in 1929. In connection with the sufficiency of the supply of bank credit in general the report said:[1]

> "The weight of the evidence of representative traders and trade associations was to the effect that

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(1) Final Report, pp. 47, 48.

there is no lack of loan capital available for the use of British industry, at moderate rates of interest, provided that reasonable security is forthcoming. Generally speaking, and with certain exceptions noted below, the testimony of the traders was that the facilities provided by the banks to industry are satisfactory, and many witnesses expressed the view that industry is better served by the great amalgamated banks than was the case before the amalgamations took place.

. . . . . . . .

"We find, therefore, that on the whole, and subject to certain exceptions noted below, the existing machinery for supplying British industry with financial facilities to meet its legitimate needs is adequate and suitable."

Another governmental commission of investigation, the Macmillan Committee on Finance and Industry, reporting in 1931 corroborated the position of the Balfour Committee on the general credit supply by saying:(1)

"Every industrial and commercial company has a double financial problem, namely, to provide itself with adequate permanent capital and to obtain, as occasion warrants, temporary or seasonal credits, either of a self-liquidating character or to be repaid ultimately out of the issue of more permanent capital. It may also have--and perhaps in increasing measure--a third problem, namely, to provide itself with what are known as intermediate credits. Short-dated credits are endless in the variety of their conditions, and to provide them is the principal function of the banks. As such advances form the most lucrative part of their assets the banks indeed are very willing to do so, so long as their total lies within their customary percentages and within the limits set by general credit policy. In this direction British industry certainly suffers under no handicap in comparison with its competitors. The great English banks, undoubtedly among the strongest financial institutions in the world, use and have used their resources freely, sometimes too freely, in the provision of advances to industry. In general we are satisfied that, subject to the conditions imposed by the necessity of accommodating ourselves to the outside world, our banking system is adequate and satisfactory in the provision of the normal short credits to industry and their distribution."

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(1) <u>Report</u>, p. 169.

Credit to Small Borrowers

The Balfour Committee also dealt particularly with the question of the service of the large banks to the small borrower, a problem generally associated with the process of the concentration of banking resources in the hands of a few organizations:(1)

> "....the opinion was expressed by some witnesses that bank amalgamation has led to the standardising of the rules governing bank advances and has been unfavourable to local elasticity.
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> . . . . . . . .
>
> "The last of the specific complaints made to us as to the results of bank amalgamations is that the rules governing the making of advances have been standardised, that the local bank manager has no longer the same discretion as in the past to lend upon personal knowledge of character and local conditions, and that the decision of questions of advances is more and more centralised in London.
>
> "It should be said at once that this complaint was by no means generally made by the trade witnesses who appeared before us. On the contrary, the general trend of the evidence was that on the whole industry is better served by the banks than before the amalgamations, provided of course that reasonable security is available. No doubt the real trouble is that the greater part of the period which has elapsed since the amalgamations has been marked by a prolonged depression of trade, and a consequent heavy fall in the average rate of profit on industrial undertakings, which circumstances have greatly impaired the power of certain industries either to obtain more capital from the public or to offer attractive security for bank advances. That a distressed industry to-day cannot obtain as good financial facilities as the same industry in the former days of its prosperity is no reflection on the effects of bank amalgamations. On the contrary, the evidence before us gives a good deal of support to the view that, without amalgamation, the power of the banks to give support to industry would have been considerably less than at present, especially in view of the increased size of the average business unit.

(1) Final Report, p. 47.

"It would be a natural effect of enlarging the unit of banking business that the general principles on which advances are made should become more carefully co-ordinated and more uniformly applied. Such a change is by no means generally to the disadvantage of sound business, for the attractive phrase 'local elasticity' sometimes in the past covered undesirable preferences and personal discriminations. According to our information, however, it is not the case that local managers have been deprived of discretion to act (of course within limits) on their own knowledge of local conditions and personal character."

The Balfour Committee thus under the term "local elasticity" deals with the problem of the contact of the small borrower with the large banks and does not believe that the process of concentration has brought about a net loss in this respect. Sometimes it is stated that the large network of branches absorbs deposits throughout the country, but makes loans primarily from the head office to the city borrower, who may be a large one. Unfortunately, current data showing the distribution of loans either by branches or size of loans are not available. The great banks have had occasion to take note of the contentions with respect to discriminations against the small man as is shown by the following statement in the Statist in 1927 which includes a pertinent quotation from the head of Lloyds Bank:[1]

"As regards the question of the 'small man' there may be some justification for complaints raised in respect of the larger branches, but investigation is obviously very difficult. It may be mentioned, however, that in 1923 the late Chairman of the Westminster Bank gave figures relating to the loans of the bank to the farming community which showed that 28 per cent. of the loans were wholly unsecured, and 13 per cent. only partially secured. This is, of course, an example of lending to 'small men' on the security of personal character. Again, in the current year, Lloyds' Chairman offered an analysis of the overdrafts of the bank, showing that 84 per cent. of the borrowers fell within the categories of Personal and Professional, agriculture and retail, and

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(1) May 14, 1927, p. 857.

had between them an average overdraft of only £614. He added 'Although we have been described as huge capitalistic institutions, it is "the small man" with whom we are chiefly concerned, and it is "the small man" who figures most prominently in all aspects of our business.'

"In general, there is no evidence to show that the very large banks, equally with the small banks, do not endeavour to extend up to the safety limit in the direction of profitable loans, advances, and discounts, and, as the figures furnished by Lloyds' Chairman show, to ignore 'the small man' would be to reject something like 57 per cent. of the total of sound business going in the form of overdrafts."

In the case of Lloyds Bank, the Statist said:(1)

"....An analysis of loans and advances given by the chairman at the annual meeting showed that 'professional and personal loans,' broadly classified, still lead both in number of accounts and in the aggregate amount involved. These loans showed an increase last year of over £2,250,000, whereas loans to 'agriculture,' the next largest category, fell slightly in consequence of the continued stagnation in that industry. The same factor accounted for a reduction of about £1,000,000 under each of the headings, 'engineering,' 'shipping and shipbuilding,' and 'coal' and for a decline of no less than £1,750,000 under the heading of 'cotton.' It is indicative of the attention given by the company to the 'small man,' that in nearly 85 per cent. of the total number of overdrafts granted the average overdraft is only about £600."

The Midland Bank gave the distribution of its advances on June 30, 1928, and indicated that 6½ per cent were "professional and private."(2) "Loans and advances were extended" by the Midland Bank "to 180,000 borrowers, the average amount outstanding being £1,200."(3) In the following year, Lloyds Bank found its average overdraft was £1,151. The chairman of the bank said:

(1) Statist, Banking Supplement, May 11, 1929, p. 890.

(2) Speech of the Right Hon. R. McKenna, chairman, Ordinary General Meeting, Midland Bank Limited, January 22, 1929, p. 23.

(3) Ibid., p. 26.

"The average overdraft in agriculture amongst all our accounts is £840 only, and in the largest item there, the 'Personal and Professional' item, it is only £561."(1) Another joint stock bank, Martins, said that 85 per cent of its 31,000 loan accounts outstanding were for amounts of less than $5,000.(2)

The Economist (London), commenting in 1929, said:(3)

> "There is much truth in the complaint that the small man, living in the provinces, is neglected. A customer who banks at Head Office in London has direct access to one of the joint general managers of the bank, whose powers are very much wider than those of the manager of the small country branches, and he is therefore able to conduct his negotiations directly with one of the men with whom final decisions rest. A provincial customer has to submit his application to his own branch manager, who can do no more than forward it 'through the usual channels.' Even so, if the would-be borrower and the branch manager take the trouble to put the application into the form required by Head Office, they will usually find that the bank is just as ready to earn its living by making small advances to the province as by big operations in the City of London. It must be borne in mind that competition between the 'Big Five' banks is a potent factor safeguarding the small man from undue neglect. Further, the scrutiny in London of provincial applications for loans has this advantage, that it makes for more uniform banking policy and precludes the abuse of local influence in support of applications for loans not justified on their merits."

## Cost of Credit

The cost of credit to the borrower is, of course, no small element in the general problem of the availability of credit, for as the Macmillan Committee expressed it, high interest rates diminish possibilities for profit-making, which in turn discourages borrowing. Because of the lack of detailed

(1) Minutes of Evidence, Committee on Finance and Industry, p. 128, par. 2157.
(2) Statist, Banking Supplement, May 11, 1929, p. 895.
(3) Economist (London), October 19, 1929, p. 701.

earnings statements of the joint stock banks over a period of years, which would show the average rate of return on advances, a statistical analysis of the effect of the rise of large branch banking organizations on the costs of commercial credit is lacking. The Macmillan Committee reports that the clearing banks charge on loans and overdrafts from ½ per cent to 1 per cent above the Bank of England rate, with an agreed minimum of 4 to 5 per cent, as a rule, which they maintain to meet expenses.(1) The Balfour Committee concluded that:(2)

> "....the evidence available shows that the rates of charge for these facilities compare favourably with those obtaining for similar services in any competing country....."

A more critical point of view in connection with the interest charges of banks is expressed by Francis W. Hirst, former editor of the Economist (London), who, writing in 1930 in the New York Tribune, avers:(3)

> "Banks, by the way, are not philanthropic institutions, and that is a reason why the public, their customers, are, or ought to be, averse to anything like a banking monopoly. Up to a point, the elimination of small banks in England and their amalgamation into larger units was defensible and desirable from the standpoint of security. A century ago in England, as now in the United States, a commercial or stock exchange crisis would bring about a panic, during which numbers of small banks would close their doors.
>
> "The danger now is that with five great banks and only a few smaller ones, there may be a gentleman's agreement not to give the public the full benefit of cheap money. For example, during this year the bank rate has fallen rapidly and is now only 3 per cent. At the same time the open market rate for short loans has been until quite lately only about 2 per cent. and the discount rate for three months' bills about the same. But the banks

(1) Report, p. 32.
(2) Final Report, p. 48.
(3) August 12, 1930.

are still charging most of their customers 5 per cent. for overdrafts, although their charge is supposed to be only 1 per cent. above bank rate. Big customers, we are told, can get lower rates; but why should not ordinary people, on depositing sufficient security, be able to get accommodation at rates more nearly in accordance with the official minimum of the Bank of England? If there were real competition between the banks the small trader and the small customer might have better treatment."

The overdraft system of borrowing in England results in the nominal rates charged reflecting more nearly the actual cost of accommodation than is the case in this country. Banks of the United States, especially in the large centers, require a borrower to leave a portion of his borrowings on deposit which serves to raise the effective rate charged for the loan. In England, a customer enjoying a line of credit often borrows by overdrawing his account, paying interest only on the amount used. It is said that of recent years in London there has been a tendency away from the overdraft system and in the direction of a loan and compensating balance system, but this tendency is not so apparent in other parts of the country.

To quote still another Government investigation upon the subject of the adequacy of the credit supply as well as the level of interest charges, the Departmental Committee on Financial Facilities for Trade as long ago as 1916 said:(1)

"A careful study of the evidence . . . and our own knowledge of banking arrangements and facilities, lead us to the conclusion that there exists to a considerable extent at the present time in this country the machinery and facilities for the finance alike of home trade and of large overseas contracts, and for carrying through much of the business which has been done by foreign banks. The British banks afford, we believe, liberal accommodation to the home producer. British bankers are not shy in making advances on the strength of their customers' known ability and integrity, and the charges for accommodation are we

(1) August 31, 1916.

believe often lower than the corresponding charges in foreign countries. Similarly, the Colonial Banks and British Foreign Banks and Banking Houses render immense assistance to British trade abroad, and certainly in the Far East and in many parts of South America British banking facilities do not fall short of those of any other nation."

## Credit to Industry

Much dissatisfaction with the facilities of joint stock banks has been voiced in recent years by those who would have them grant greater facilities to industry in the form of long-term loans for fixed capital financing. Those wishing to see banking policy take this course have cited the example of German banks whose managerial and long-term commitments in industry are heavy. The joint stock banks have resisted these suggestions on the grounds that they are banks of deposit, whose liabilities are payable on demand or short notice and whose assets should conform to the short-term commitments generally associated with commercial banking, and the weight of responsible opinion appears to support the banks in their position. The analysis of the asset items of the banks given in an earlier chapter brought out the small proportion of portfolio represented by investment securities and gave some indication of the ideals of English joint stock banking with respect to short-term liquid paper. It is true, nevertheless, that some of the assets of banks accounted for under the head of "advances" have become frozen because of the condition of industry and really represent long time commitments.

A current financial column recently expressed the issue with regard to the relation of banks to industry as follows:[1]

"The chairmen of the 'Big Five' have made their annual speeches and, with the exception of Mr. McKenna, whose position as a member of the present Banking Committee imposed

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(1) Banks and Industry in England and Germany, Economist (London) March 1, 1930, p. 449.

silence in this respect, all touched on the burning question of the relation of banks to industry. Their views were remarkably unanimous. They repudiated the suggestion that the banks had not granted sufficient facilities to industry, and rightly pointed out that it was not the function of the banks to find the permanent funds required for capital expenditure. Mr. Goodenough restated the view so often expressed by bankers in England that it lies with industry to reorganise itself, this question being outside the province of the banks, and Mr. Beaumont Pease also refused to entertain the idea that banks should dictate the steps to be taken towards reorganisation. While it is difficult to quarrel with any of these views per se, the cumulative effect was rather that of a general repudiation of responsibility, and suggested a disinclination on the part of bankers even to reconsider their position in this issue, notwithstanding the widespread feeling that there is a gap in the British financial system which in some way or other ought to be bridged."

The Balfour Committee dealt with the problem of long-term advances and supported the position taken by the banks:[1]

"....Certain complaints were also made of the . . . inadequacy of the facilities available for financing long-term business, . . . The last-mentioned complaint is not a reflection on the joint stock banks, which do not, and in our opinion ought not to, lock up their depositors' money for long periods of time. It rather points to a gap in the machinery available for the financing of industry.

. . . . . . . . .

"To avoid all possibility of misunderstanding, we desire to make it perfectly clear that the statement made above to the effect that the machinery for supplying the financial needs of industry is on the whole adequate and suitable must not be understood to imply that an adequate supply of new capital is actually being absorbed by British industry for essential purposes such as the reconditioning and modernisation of industrial plant, buildings and equipment. On the contrary, it was shown clearly in one of our volumes[2] that there is a great deficiency, probably in the neighbourhood of £150 millions, in the annual amount of the national savings as compared with the period just before the war, after allowing for the change of price level. In the same volume it was indicated that (after making the same allowance) the aggregate amount of trading profits has largely declined, and that there

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(1) Final Report, pp. 47 and 50-53.

(2) Factors in Industrial and Commercial Efficiency, p. 55.

has been a great increase in the uncertainty of the results of business as shown by the much wider 'dispersion' of the recorded rates of profit and loss(1). The prospect of profit is the most important security an industry can offer, both to the public as investors in its shares and debentures and to the banks. It is clear, therefore, that, particularly in the case of the great basic industries of cotton, steel, and coal, failure in dividend-earning power has made it impossible for them to get additional capital from the general investing public, while their capacity to furnish security for advances which a bank would consider adequate has been seriously impaired. At the same time, the source from which alone new capital can be created is by no means yielding so plentiful a flow as before the war. The situation (the causes of which are discussed in other sections of this Report(2)) can only be expected to improve as and when the general position and prospects of British industry become more stable and satisfactory. All that can be said here is that, <u>given existing conditions and prospects</u>, the current financial requirements of industry from the existing banking system are for the most part adequately met.

"Nor would any measure of bank nationalisation by itself alter in any material respect the fundamental conditions which determine the scope, limits and cost of the financial assistance that can be given to industry by banks and similar institutions if, as is usually and rightly stipulated by its advocates, such a measure were administered on a self-supporting basis without imposing a burden on the taxpayer.

"At this point in our analysis it becomes evident that the problem of the insufficient capital equipment of industry merges in the wider problem of industrial recuperation, which forms the main subject of our reference.

"The attitude of the joint stock banks towards the financing of industry has been also criticised from a point of view diametrically opposite to that discussed above. It has been suggested that in many cases their support has been not too niggardly but too lavish, and that injury has been done to the permanent interests of British industry and trade by the nursing of weak undertakings by the banks in the vain hope of an early recovery. These critics urge that it would have been much better to let the weaker concerns go into liquidation, and to concentrate production in the hands of the stronger, or at least the more efficiently equipped and managed, undertakings; and they contend that the action of the banks, however well intended, has only served to prolong the agony, and to delay the inevitable day of reckoning,

(1) <u>Ibid</u>., pp. 52-54.

(2) See particularly pp. 182-184.

which will be all the more serious in its economic effects for the postponement.

"It cannot be doubted that injudicious assistance may do harm by bolstering up undertakings which had much better come to an end. On the other hand, it must never be forgotten that a widespread industrial collapse always has very disastrous effects on employment, and that great efforts to avoid it may therefore be justified if there is any reasonable chance of success. It is easy to be wise after the event, and if it be the case that the banks have from time to time especially in the early post-war period, taken too optimistic a view of the prospects of trade recovery, they have certainly erred in good company. In judging of the policy or impolicy of according financial assistance in any given circumstances it is impossible to lay down rules of general application. It is in fact the essence of a banker's business to form sound judgments, with a full sense of responsibility, but often on very imperfect data, of the relative merits of alternative financial policies, in their application to particular cases. All that can be said is that those who criticise the banks for not taking a stronger line must be prepared to face the inevitable suffering that would follow, at least for a time, the adoption of a more stringent policy. On the other hand, those who consider that the banks should be yet more generous in supporting industry must accept the consequence that the survival of the unfit necessarily tends to industrial deterioration and the weakening of competitive power. Certainly if in the early post-war period there had been a general restriction of bank credit instead of a general willingness to help, such an attitude on the part of the banks would have been very strongly resented by industry and trade.

"No doubt, as in so many cases, the path of wisdom is somewhere between these two extremes. Probably on balance the more dangerous temptation to the banks in present circumstances is to do too much rather than too little to keep weak concerns in being. Possibly the scales have sometimes been weighted by the fear of offending valuable customers by withdrawing facilities from concerns in the preservation of which they are interested. In some degree this particular danger has been accentuated by the increase in the unit of banking business, which has greatly enlarged the circle of customers whose views a bank has to study. On the other hand, the added financial strength due to amalgamation should pro tanto make for independence of judgment."

Many short-term advances of the banks to weak organizations have developed into long-term or frozen commitments. Short-term advances to prospering companies have, due to the subsequent years of industrial depression, become indefinitely tied up in profitless activities.

These developments, together with capital shortage owing to the decline in national savings, have drawn the banks closer to the problem of reorganization and modernization of industry. The Bank of England, acting on the belief that the machinery of investment banking needed supplementing so as to aid the rationalization of large industries, has formed two subsidiaries, the Securities Management Trust, Ltd. (1929) and the Bankers' Industrial Development Company, Ltd. (1930). The latter has the leading financial organizations including the "Big Five" as stockholders. These organizations do not originate or distribute capital securities, but they do investigate and sponsor projects with respect to reorganization or new flotations and turn the final long-term financing over to other agencies. In some cases provision for temporary short-term financing is made through the banks.

A third institution, the Agricultural Mortgage Corporation, was established with the aid of the banks, but, unlike the other two, grants credit directly on farm lands and other agricultural assets. Although the banks have been unwilling themselves to enter directly the field of long-term financing, they have been ready to cooperate in making the existing machinery more serviceable in helping industry to reestablish itself.

## Credit to Agriculture

The relationship of banks to agriculture has been a subject of investigation by Government commissions and experts. In supplying the short-term credit requirements of farmers who own their land and are good risks the banks are reported to afford an adequate service with competition keener than before the concentration movement. Tenant farmers, who have no security to offer other than growing crops and cattle, are not so attractive as credit risks to the banks. Following out their policy of not locking up their depositors' money in long-term commitments, the bankers do not care to purchase long-term mortgages, but many examples exist of overdrafts the proceeds of which were used to purchase farm lands. Although the maturities of these were fixed in the original agreements at from six to twelve months, in many cases circumstances have required that they be renewed a number of times.

Nevertheless, considerable criticism has been levied against the joint stock banks to the effect that they have been indifferent to the current needs of agriculture, receiving deposits from rural communities yet emphasizing urban loans. The Committee on Agricultural Credit of 1923 recited these objections and then said:(1)

> "It is important to realise that these charges of unsympathetic policy, unfamiliar managers and discrimination in favour of commercial investments are not of recent origin, but have been preferred, in a general way, against the Joint Stock banking system. They are not, therefore, special features of the crisis through which agriculture is now passing.
>
> "On behalf of the Banks, it has been pointed out that relatively more agricultural loans are, in fact, outstanding to-day than in the days of the small private Banks. The fact that all applications for overdrafts are referred to the Head Office for approval no doubt accounts for some of the criticism to which the Banks have been subjected, though, in actual practice, the older and more experienced managers are allowed considerable latitude. Moreover, where applications are refused, it is possible that the local managers seek refuge from the unpopularity of adverse decisions by throwing the onus on to the Head Office. The Banks have always regarded the farmer as a good customer and they are anxious to maintain and, where possible, to develop their agricultural connection, there being very keen competition between them for that purpose. They claim to appreciate fully the farmer's difficulties at the present time, and their policy is to be as helpful as possible, consistent with their responsibility to their depositors. With the great majority of farmers an overdraft is a routine arrangement for a part of the year. The farmer who is enterprising, keeps books and knows his way about the world, has little difficulty in obtaining credit, and even the less enterprising type of farmer is more afraid of the Bank than the Bank is shy

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(1) Report of the Committee on Agricultural Credit (1923), pp. 12, 13.

of him. In some cases of complaint, it transpires that the farmer is carrying on some other business, doing badly at it, and trying to play off one Bank against another. To any ordinary farmer, of whom the Banks have personal knowledge, they would, if necessary, give credit on his crops alone, although they can take no legal charge. In the fruit-growing districts of Evesham and Pershore, for instance, growers obtain credit from the Banks on what the manager can see for himself on the trees. The Banks realise that the liquidation of agricultural loans is a longer process, as a rule, than the repayment of purely commercial advances, but there is a constant ebb and flow of money from and into the farmer's account which means good business, although the loan account may not be cleared rapidly. In the country districts, an overdraft, unspecified as regards purpose, is more common than definite loans for particular requirements. The overdraft is reduced or extended according to the daily or weekly alternations of receipts and expenditure of the farmer concerned. It is an essentially elastic arrangement, affording both secrecy and simplicity, and one pre-eminently suited to rural conditions. . . . . With regard to managers, there is admittedly a tendency for more changes to be made in the managerships of the country branches than in the days before amalgamation, as these appointments are now open to a wider field. A large number of the old managers are, however, still in office. As far as promotion difficulties will permit, the Banks endeavour to retain the staff in the districts to which they belong, and even in those cases where a townsman is appointed to a county branch, he is first attached in a supernumerary capacity to study the local characteristics of the business before he is allowed to take over. Admittedly, the old country banker has disappeared, but some of the Banks have local directors who live in the district and know a good deal about the farmers' business. Finally, from the point of view of the agricultural community, it is important to realise that, notwithstanding the absorption of the small country Banks, there is, in fact, far keener competition for rural business than ever before; while, in the matter of security to depositors, the amalgamation of the Banks has also been of very great advantage. The old private Banks were always heavily involved in the fortunes of a restricted area and this was a source of weakness at times of local crisis. The Joint Stock Banks spread their risks over a wider area and a greater range of industries, and can better carry periods of depression."

Nor did the committee feel that credit to agriculture was restricted through unduly high charges:[1]

> "Moreover, it is the cheapest way of obtaining money; the normal rate of interest is 1 per cent. above Bank rate, though it is understood that a minimum of 5 per cent. is almost invariably fixed; interest is only charged on the net amount outstanding from day to day and there are no legal or procuration charges such as are usually associated with the advance of money from other sources. If the account is remunerative, no charge for keeping it is made. If it bears an overdraft, the charge, apart from interest, is only the bare cost of keeping it. The complaints that incidental Bank charges are excessive are generally without foundation."

Short-term Credit to Agriculture. - In 1926 Mr. R. R. Enfield of the Ministry of Agriculture and Fisheries made a report on agricultural credit based in part on the responses received to a circular letter sent to all parts of the country. This report corroborated the general findings of the Committee on Agricultural Credit with respect to the services of the joint stock banks in the matter of short-term credit to agriculture.[2]

> "The position is, therefore, that the banks frequently lend on their personal knowledge of farmers without a definite charge upon their property, but the extent to which this is done is limited. The farmer who has title deeds, share certificates or a life insurance policy to deposit with his bank as collateral has no difficulty in securing substantial advances against these securities. The small tenant farmer, however, whose main assets are his growing crops and other stock, has difficulty in obtaining adequate bank accommodation.
>
> "It should not be overlooked that since the private country banks began to be absorbed by the joint stock banks, other changes have been taking place. It has been affirmed that there has been a very considerable growth in recent years of the practice of farmers borrowing from tradespeople--merchants, auctioneers and dealers--indeed more than one witness have asserted that farmers whose banks have been unable to make advances to them upon their stocks and crops have been compelled to resort to merchants, who are prepared to do so on

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(1) Ibid., p. 21.

(2) Report on Agricultural Credit, Economic Series No. 8, pp. 30, 31.

the basis of undertakings by the farmers to sell the produce to them. Some have even expressed the opinion that the gross indebtedness to the latter class exceeds the indebtedness of farmers to the banks. Whatever may be the truth of this it is obvious that substantial development in this direction must have a bearing on the operations of the banks particularly as it is not always an easy matter for the banks to know what their farmer customers owe to others. Moreover, it is hardly open to doubt that there are farmers who while complaining of the attitude of the banks are themselves often to blame for the difficulties they complain of. They keep inadequate books or no books at all, and in the absence of books it must be more difficult for the banks to form a correct idea of the amount of their debts to tradespeople. In such circumstances can it be wondered at if banks require 'good' security for their loans, or appear to be unsympathetic?

"Again, it has to be remembered that persons who compare the services to agriculture of the old private banks with those of the joint stock banks, are sometimes comparing a time when agriculture was more prosperous with the present time, when it is still suffering from the effects of depression. There seems to be no evidence that the present attitude of the banks does more than reflect the want of confidence in the industry to which farmers themselves give frequent expression.

"To sum up, there is nothing in the evidence which has been available to suggest that the banks, within the limits of the present credit system, are unduly rigid or unsympathetic with the needs of agriculturists, nor is there anything to suggest that hasty marketing by the farmer is due to pressure being exerted upon him by the banks at harvest-time. On the contrary, there are many reasons to think that consistent with reasonable business prudence, the banks administer the present system as generously as the system permits."

In order to make loans to farmers on the security of livestock and crops more attractive to the commercial banks, the Agricultural Credit Acts of 1928 provided for the official registration of liens against crops and livestock. This type of lien is known as an "agricultural charge." It is said that since 1928 farmers have been able to receive added accommodation from the commercial banks on this type of security.

Capital Loans for Agriculture. - The Committee on Agricultural Credit, also, specifically recognized that the joint stock banks could not be expected to make permanent capital loans to agriculture, saying:[1]

> "At the same time, it has to be borne in mind that the Banks are not in a position to lend money on long-term mortgages. Having regard to their obligations to their depositors, they are bound to keep their money within reasonably short call. They realise, however, that agriculture is in a bad way, and that its revival will be later than that of other industries. Moreover, to call in their loans too drastically would probably involve the Banks in heavy losses. Their present policy is, therefore, to nurse farmers by reducing interest whenever possible and generally to keep them going, even though, in some cases, the Banks are receiving no interest and no repayment of principal. They would, however, naturally prefer to see the outstanding loans paid off as soon as possible, and, if a farmer is doing well, they will probably suggest, after a time, that he should effect a permanent mortgage elsewhere for the amount of his loan outstanding."

Owing to the fact that it had been believed for some time that the facilities for furnishing long-term capital to farmers on mortgage security were deficient in England, the Agricultural Credit Acts of 1928, referred to above, established the Agricultural Mortgage Corporation, Ltd. Four of the "Big Five" (Barclays, Lloyds, National Provincial, and Westminster), Martins, Williams Deacon's, Glyn, Mills and Co., and the District Banks cooperated with the Bank of England in subscribing to the capital, and the Government loaned, interest free, a sum equal to the whole of the capital. The corporation makes mortgage loans to farmers, and raises funds through the sale of debentures. The joint stock banks interested in the corporation receive applications from prospective borrowers.

> "....it is looked upon by the British public as a step toward the solution of an acute agricultural problem which exists in the United Kingdom as well as in other parts of the world. The scheme when first launched was attacked by the opposition party in the House of Commons on the ground

(1) Report of the Committee on Agricultural Credit (1923), p. 12.

that it constituted a heavy government subsidy to agriculture, and that the real benefit would not come to the farmer but to the landlord through increased rents. Leading economists and bankers of the country, however, are of the opinion that the plan is working successfully and that it provides a sound system of agricultural credits with a considerable degree of relief to British farmers."(1)

(1) Frederic Edward Lee, Britain's Farm Credit Plan, American Bankers Association Journal, November, 1930, p. 467.

CHAPTER V

EFFECTIVE COMPETITION

Apprehension exists in certain quarters that the degree of concentration which has been reached in the English banking system tends to break down effective competition. It is argued that when the units of enterprise become so large and so few as in the English banking system, gentlemen's agreements may effect unity of action. However, the concensus of responsible opinion appears to be that effective competition for deposits and commercial loans has not been lessened as a result of the concentration movement, though the latent possibility for such a tendency exists.

As indicated in previous chapters, the Treasury Committee of 1918 was concerned directly with this problem and subsequent to its report merger activities have been slight. This committee said:(1)

> ". . . we have received representations from certain municipal corporations to the effect that banks vary very much in their willingness to allow reasonable overdraft facilities to corporations, and that sufficient money, and cheap enough money, has only been obtained hitherto by resorting to different banks, the number of which is now falling steadily. On this ground a number of resolutions have been forwarded to us by corporations protesting against further amalgamations, and suggesting that it is not in the national interest that large funds belonging to the public should be in the hands of a few companies.
>
> "Strong representations have, on similar grounds, been made to us on behalf of the Stock Exchange and the Money Market. It is claimed that the world-wide fame of the London Market before the war was due to the freedom with which London bills could be negotiated, owing to the ease with which Discount Houses obtained ample funds from a wide number of banks,

(1) Report of the Treasury Committee on Bank Amalgamations, 1918, in T. E. Gregory, Select Statutes, Documents and Reports Relating to British Banking, 1832-1928, Vol. II, pp. 330-332.

and that the fewer the lending constituents in the Discount Market, the less flexible is the market and the less fine the rates. It is added that the number of members in the Clearing House is already becoming very small, and that any further decrease in the number of its constituent members, or any greatly preponderant power on the part of particular members, might impair confidence in its smooth working and raise apprehensions in the market. Moreover, it is pointed out that a reduction in the number of important Banks must mean, and has already meant, a reduction in the number of first-class acceptors of bills, and that if this reduction proceeded very far, it would become a question whether the Bank of England would not have to place a limit on the amount of acceptances which they would take from any particular bank doing a large accepting business, and whether Continental buyers would not limit the number of bills taken by them.

. . . . . . . . .

"While we believe that there is at present no idea of a Money Trust, it appears to us not altogether impossible that circumstances might produce something approaching to it at a comparatively early date. Experience shows that, in order to preserve an approximate equality of resources and of competitive power, the larger English banks consider it necessary to meet each important amalgamation, sooner or later, by another. If, therefore, the argument from size, referred to . . . above, is to prevail, it can only lead, and fairly rapidly, to the creation of a very few preponderant combinations; and if those combinations amalgamated, or entered into a joint agreement as to rates and policy, &c., the Money Trust would immediately spring to birth.

"Such are the main arguments laid before us against further amalgamations. Undoubtedly some of the dangers feared are somewhat problematical and remote, and we should very much have preferred to avoid the necessity for any interference by Government with the administration of banking. But on a careful review of all the above considerations, we are forced to the conclusion that the possible dangers resulting from further large amalgamations are material enough to outweigh the arguments against Government interference, and that, in view of the exceptional extent to which the interests of the whole community depend on banking arrangements, some measure of Government control is essential. Our conclusions on this point were confirmed by the resolution passed at the recent annual meeting of the Association of Chambers of Commerce, in which it was proposed that steps should be taken to guard against amalgamations, &c., shown to be injurious to commercial interests.

"We therefore recommend that legislation be passed requiring that the prior approval of the Government must be obtained before any amalgamations are announced or carried into effect. And, in order that such legislation may not merely have the effect of producing hidden amalgamations instead, we recommend that all proposals for interlocking directorates, or for agreements which in effect would alter the status of a bank as regards its separate entity and control, or for purchase by one bank of the shares of another bank, be also submitted for the prior approval of the Government before they are carried out."

Although no legislation resulted from this recommendation, the Government has been an advisor in connection with all subsequent moves toward concentration, which has been minimized of recent years.

The Balfour Committee reporting in 1929 felt that "up to the present there has been little or no attempt on the part of the amalgamated banks to exercise any monopoly powers, or to suppress competition by 'districting' or other working agreements," but expressed themselves as adverse to further amalgamation or to the "subtler process of agreements to avoid competition."(1) According to Lavington, "Competition among the banks has increased in a marked manner during recent years."(2) Sykes(3) came to the conclusion that competition is more acute as a result of the concentration movement, and the Statist has said that "it is a

(1) Final Report, pp. 52, 53.
(2) F. Lavington, The English Capital Market, p. 145.
(3) Joseph Sykes, The Amalgamation Movement in English Banking.

commonplace that competition is keener in banking today than ever before."(1)

Banking Offices

The close watch which each bank apparently keeps on the activities of the others is manifested by the rapidity with which any move on the part of one, particularly in the establishment of new offices, is matched by other banks. An often cited example of this occurred when in April, 1914, the new Midland Bank, upon learning that Lloyds Bank had extended its activities into a new section of the country through a merger, arranged within twenty-four hours to open new branches in the same area.(2)

The large banks have branches and sub-branches spread over practically all England and Wales in competition with each other. Usually a town which needs banking facilities has two or more banking offices (branches or sub-branches) representing two or more of the joint stock banks. Twenty towns were selected at random in various shires, and the number of banking offices in each town was taken from the Bankers' Almanac and Year Book. The results are shown in Table 12. It will be noted that in practically every case where the number of offices is five or less, each office represents a different bank. Each town on the list, with one exception, is served by two or more banks.

(1) Statist, May 14, 1927, p. 587.
(2) E. T. Powell, Evolution of the Money Market, (1385-1915), p. 453.

Table 12 - Banking Offices in Towns of Various Sizes
(exclusive of the Bank of England)

| Town | Population(1) (nearest 100) | Joint stock commercial banks: Number of offices(2) | Joint stock commercial banks: Number of banks represented(2) | Persons per office (nearest 100) | All other banking offices(2)(3) |
|---|---|---|---|---|---|
| ENGLAND | | | | | |
| Devonshire | | | | | |
| Exmouth | 14,400 | 6 | 5 | 2,400 | - |
| Torrington | 8,300 | 4 | 4 | 2,100 | - |
| Kent | | | | | |
| Chatham | 43,500 | 6 | 5 | 7,300 | - |
| Lancashire | | | | | |
| Kirkham | 4,200 | 2 | 2 | 2,100 | - |
| Liverpool | 869,500 | 157 | 11 | 5,500 | 15 |
| Wardle | 4,600 | 1-Thurs. | 1 | - | - |
| Wigan | 6,500 | 10 | 7 | 700 | - |
| Lincolnshire | | | | | |
| Alford | 2,200 | 3 | 3 | 700 | - |
| Skegness | 7,300 | 4 | 4 | 1,800 | - |
| Norfolk | | | | | |
| Aylsham | 16,400 | 2 | 2 | 8,200 | - |
| Cromer | 4,300 | 2 | 2 | 2,200 | - |
| Northumberland | | | | | |
| Blyth | 31,500 | 5 | 5 | 6,300 | |
| Nottinghamshire | | | | | |
| Southwell | 28,300 | 2 | 2 | 14,200 | |
| Shropshire | | | | | |
| Dawley | 7,400 | 2 | 2 | 3,700 | - |
| Shrewsbury | 32,600 | 5 | 5 | 6,500 | - |
| Warwickshire | | | | | |
| Birmingham | 968,500 | 157 | 5 | 6,200 | 6 |
| Yorkshire | | | | | |
| Bradford | 289,200 | 56 | 7 | 5,200 | 12 |
| Eston | 32,500 | 2( Thurs. (Mon.&Fri. | 2 | - | - |
| Leeds | 478,500 | 59 | 6 | 8,100 | 25 |
| WALES | | | | | |
| Caernarvonshire | | | | | |
| Bangor | 10,900 | 4 | 4 | 2,700 | - |

(1) Estimated, 1929. The Registrar-General's Statistical Review of England and Wales for the Year 1929, Part II.
(2) Bankers' Almanac and Year Book, 1931-1932.
(3) Offices of banks not included in the list of joint stock banks by the London Economist. Some are offices of foreign banks operating in England.

". . . The monthly figures published by the clearing banks are not true daily averages but are averages of one selected day in each week of the month. It seems that, in order to present a better appearance, most of the banks concerned are at pains to manipulate their balances with the Bank of England on the selected day of the week so that they stand at a higher figure than usual. Moreover, each of the four biggest institutions pursuing these practices selects a differenct day of the week for the purpose, calling in loans from the market on its own selected day, but returning them next morning in time for the next big bank to call them for its making-up day."(1)

With respect to general conditions, Sir Josiah C. Stamp has said:(2)

". . Although there is the appearance of very free competition, all the same there is a current understanding beneath which business will not be done."

Mention has been made in previous paragraphs of how the rate for general customer advances has been standardized among the banks by giving it a definite relationship to the Bank of England rate although highly valued customers do get preferred treatment. In the same manner the rate of interest on deposits allowed by the joint stock banks has been standardized to a degree. This fixing of rates is analogous to the agreements among clearing house banks in this country, except that in England, of course, agreements are not limited to a localized area.

Deposits in joint stock banks may be classified as current accounts, which are withdrawable on demand, and those withdrawable upon notice, commonly seven days in London. Current accounts represent roughly one-half of all deposits and upon these no interest is customarily allowed in London and some provincial areas, while an interest rate is paid in other provincial areas. On deposits withdrawable on notice, the rate allowed in London is usually 2 per cent under the Bank of England rate quoted for

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(1) Report, Committee on Finance and Industry, p. 156.
(2) Minutes of Evidence, Committee on Finance and Industry, Vol. I, p. 272, par. 4139.

The increase in the banking offices in England has been much more rapid than the increase in population. In Table 7, page 23, of this report it was shown that the population per banking office declined from about 6,800 in 1901 to about 5,000 in 1921 and to about 3,900 in 1930. The population per banking office in the United States in 1930 was about 4,800. Thus England has more banking offices in proportion to the population than the United States, although the density of the population is much greater there than in this country, as indicated in Chapter I.

England has approximately one banking office for each six square miles, while in this country there is on the average one national or State banking office for about every one hundred and twenty square miles. Considering only the more densely populated States in the East (New York, New Jersey, and Pennsylvania), there is on the average a national or State banking office for close to every twenty-five square miles. The average deposits per banking office in England are roughly $955,000, compared with about $1,900,000 for State and national banks in the United States.

Some evidence that steps are being taken by the banks to protect themselves against excessive competition among branches is found in a recent address to the shareholders of Lloyds Bank by the chairman, Mr. J. Beaumont Pease, who said:(1)

> "Banks have sometimes been criticized for opening new offices in places where banking facilities were redundant. The multiplicity of branches has been to the advantage of the public, but, undoubtedly, there are places where the business is not sufficient to ensure satisfactory results to all the banks represented there, and, with this in mind, and by mutual arrangement with other banks, we have closed down a good many sub-offices, with a consequent saving in expense."

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(1) Annual Meeting of Shareholders, Lloyds Bank Limited, February 5, 1932, p. 5.

Further evidence of competition is supplied by the extensive advertising and other forms of publicity undertaken by the banks, as well as by innovation in the way of services such as the night safes and small home savings banks.

## Joint Undertakings

In spite of the competition which exists among the English commercial banks they are engaged in certain joint undertakings. When they increased their interest in overseas financing, numerous organizations were established to specialize in this activity, and many of these are owned by several of the English banks jointly. For example, a French bank, which was taken over, is owned equally by Lloyds Banks and the National Provincial Bank, and the British Overseas Bank was established by several banks and is now controlled by Williams Deacon's Bank, Union Bank of Scotland, and Prudential Assurance Company. Lloyds, Westminster, and Credito Italiano were the primary movers in the organization of the British Italian Banking Corporation, Ltd., but twenty-one other banks are interested. Within England itself an example of combined ownership is to be found in the Yorkshire Penny Bank which has as its stockholders the "Big Five" plus the District Bank and Williams Deacon's Bank. The joint interests of the banks in the new investment banking projects have been cited earlier.

## Working Agreements and Standardized Rates

Among the "Big Five" there are working agreements or tentative understandings with respect to the making of loans to bill brokers on short-term paper, and the days which the various banks enter and leave the market are fixed by mutual consent.

discount of prime bills, although in England, as in this country, large accounts get special rates. Prior to 1921, this rate of interest, known as the bank deposit rate, was $1\frac{1}{2}$ per cent under the Bank rate, and the lower level of recent years has been attributed by some to necessity growing out of the fact that other costs of doing a banking business have risen parallel with the amalgamation movement. Others see the widening of the spread between the Bank of England rate and the rate paid on time deposits by the joint stock banks as an indication of lessened competition and of gentlemen's agreements which are easy to effect when competing units are so few.

According to much of the current literature these cooperative undertakings, working agreements, standardized interest rates, and the like, merely indicate attempts to eliminate unhealthy cutthroat competition. Whether they may develop beyond this point remains to be seen. Even under the unit banking system of the United States numerous agreements exist regarding call loans, interest rates, and the like, and in various sections of the country there is a strong tendency towards standardized rates, even where there are no formal agreements.

# CHAPTER VI

## BANKING COSTS AND PROFITS

The earnings and expenses of banks are of interest not only to shareholders but to borrowers and depositors as well. A banking system which can do business at low unit cost can presumably sell its accommodation at lower rates to the borrower, pay the depositor more for his deposits, and leave the shareholder in possession of a good return on his investment. Low rates to borrowers, though regarded in some quarters as a stimulant to business activity, may have an adverse effect on the profits of banks. In the same way high interest returns to depositors, though desirable from the depositors' viewpoint, may, through the forces of competition, cause bankers to take too great risks in an effort to provide sufficient earnings to pay such interest. Since banks are run by private individuals for profit, a fair return to shareholders on their invested capital as well as for the risk involved is essential to the continuance of the system. It is generally assumed that a movement in business enterprise, such as the spectacular concentration of banking resources in England, has as one of its motivating forces the desire to protect profits in the face of competition.

### Costs and the Concentration Movement

It is an unfortunate fact that the publication of earnings and expense figures among English banks is and has been so meager as to make difficult any adequate test of the effects on banking costs of concentration of head offices and the accompanying increase in branch offices. There are those who believe reductions have occurred, but considerable evidence points in the contrary direction.

In his book dealing with the amalgamation movement Sykes came to the conclusion that:(1)

> "Expenses have . . . increased.(2) Very definitely amalgamation is largely responsible for this. In the case of expenses it is apparent that the expected economies so often stressed in chairmen's speeches have not materialized, and consequently what was a strong argument in favour is actually a strong argument against the policy. Most bankers still seem to consider that more economies than diseconomies have resulted, and consequently do not seem to be alive to the results of their actions."

Another author has said:(3)

> "The returns reflect the fact that, for all their efficiency, the 'Big Five' have not reduced their working costs by amalgamation or by the development of branch banking, but have actually increased them. This is well recognized by the banks themselves . . . "

An example of this is found in the statement of the chairman of Lloyds Bank, quoted earlier, where he quite frankly referred to "places where banking facilities were redundant."(4) The cries of "Hear, hear," greeting every sentence at this point indicate that the chairman was expressing the sentiments of the shareholders as well as the officers of the bank.

In the years prior to 1916 it was the practice among some of the joint stock banks to make public an important part of their annual expenses. These statements did not include write-offs or losses or interest on deposits but did include salaries and wages and other miscellaneous expenses. These expenses expressed as a ratio of total working resources for the years 1911-

(1) Joseph Sykes, The Amalgamation Movement in English Banking, 1825-1924, p. 158.

(2) In a footnote Mr. Sykes says: "The results of the large railway regroupings has been similarly productive of increased expenditure."

(3) Patrick Fitzgerald, Industrial Combinations in England, p. 184.

(4) J. Beaumont Pease, Annual Meeting of Shareholders, Lloyds Bank Limited, February 5, 1932, p. 5.

1915 were published by Sykes as follows:[1]

Table 13 - Expenses of Joint Stock Banks per $100 of Working Resources, 1911-1915

| Year | Number of banks | Expenses (per $100 of total working resources[2]) |
|---|---|---|
| 1911 | 20 | $1.08 |
| 1912 | 9 | 1.03 |
| 1913 | 7 | 1.06 |
| 1914 | 8 | 1.02 |
| 1915 | 5 | 1.04 |

(2) Working resources include paid-up capital, reserves, deposits, and acceptances.

Subsequent to 1915 Barclays Bank alone published an annual expense figure through 1928 discontinuing it with that year. In the case of Barclays, annual expenses per $100 of resources were for 1924, $1.62; 1925, $1.55; 1926, $1.61; 1927, $1.64; and for 1928, $1.57.

Contrasting the figures for a group of banks on one hand and Barclays Bank on the other, expenses per $100 of business appear to have risen substantially in the course of twenty years, but conclusions can be drawn only with caution since one series of figures represents several banks and the other only one. On the other hand, it is commonly believed that the banking costs of all the "Big Five" are roughly comparable, and the contrast corroborates the commonly held view that parallel with the development of branch banking and concentration costs have increased. Sykes took note of this as indicated above and the Balfour Report recognized the tendency, but at the same time pointed out that rising costs have been common to various

(1) Joseph Sykes, The Amalgamation Movement in English Banking, 1825-1924, p. 130.

business activities over the past few decades and not unique in banking. And again in banking itself the causal factor with respect to rising costs may be less the result of cumbersomeness growing out of concentration than the result of an increase in the breadth of banking services to the community. For example, in the United States under a wholly different banking structure expenses have been increasing. Among national banks the cost of handling a unit of business has about doubled from the first to the third decade of this century. Statistics are not available which would segregate over a long period the higher costs attributable to interest on deposits, but it is quite probable that other components, such as salaries and wages and costs of premises, have been rising in the United States, as it is believed they have risen in England.

Branches. - Among the factors of cost of English joint stock banks, the race for branch representation has been accorded considerable importance by authorities. England today, it will be recalled, has over 10,000 branches and each of the "Big Five" has under its direct control between 1,000 and 2,100 offices. Many of these branches were established and are maintained, not because the business available for the time being justified their existence, but because the parent bank wished to preempt a field which some day might be profitable or because the bank deemed it necessary to be represented at the spot since one or more of its rivals were there. The example of the Midland Bank making arrangements to open 17 new outlets within twenty-four hours after hearing of expansion plans on the part of Lloyds Bank is typical of what has happened in many other instances. Today hundreds of villages and towns which could not support one independent local bank are served by one, two, and three branches of the large London banks. The inevitable result of this type of competition is numbers of offices which do not pay their way. Although such branches are the means of affording banking facilities to many communities which otherwise would be without them, they no doubt have contributed to the general rising costs of bank operations. It would appear that it will be a long time before a number of the existing offices can be placed on a profitable basis.

This situation in general was summed up by the late chairman of the Westminster Bank:(1)

> "In the days of private banking there was a sort of courteous convention, by which each local bank, except in the larger towns, was allowed its own district within which the irruption of a rival was regarded as something like poaching. These times have passed away, and the village must indeed be a small one in which there are not at least 3 offices of the large banks in direct competition. I do not complain of this: it is very much to the benefit of the commercial community. The only persons who have any right to complain are the shareholders, whose profits are devoted in some measure at least to the opening of fresh branches which take a long time before they can pay their way, and in some cases, one may fear, are not likely ever to pay at all. Before the war, a new branch, if established in a growing region, should pay its way after some three or five years of existence. Now, owing to the rise in overhead expenses on the one hand and the severe cutting of profits on the other, that period is about doubled."

Despite these facts, the number of banking offices of the joint stock banks has continued to grow, the annual average increase for the past five years being about two hundred and forty. However, this is a smaller increase than the annual average from 1918 through 1922, which was almost four hundred and forty-five. It cannot be doubted that many of the branches contribute their full quota of profits to the organization and unsuccessful ones have their value from an advertising point of view.

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(1) Statist, May 10, 1924, quoted by Patrick Fitzgerald, op. cit., p. 181.

Salaries and Wages. - The wastes which are related to the operations of organizations so large and so widely dispersed emphasize the problem of costs among the joint stock banks. Smaller and less cumbersome organizations might arrive at the necessary decisions without the consumption of so much time, including that involved in the elaborate reports and correspondence between branch and head office. It has been estimated that over 70 per cent of the annual expenses, not including interest on deposits or provision for losses, of a great English bank is consumed in salaries and wages.(1) Although the national banking system in the United States may not average much higher than 50 per cent in recent years in this connection, this does not necessarily put the English bank in an unfavorable light. As banking is a business which must depend largely upon personal services, English development may have been in the direction of reducing the proportion of non-salary overhead which is associated with an irreducible personal service element. A better test of labor efficiency in banking rests upon the comparative economy with which different banking structures handle a unit of business.(2) Facts for testing the British system along these lines are extremely limited, but some material has been found which will be presented in a subsequent paragraph.

It is sometimes pointed out that the effectiveness of personnel is stultified by regimentation incidental to organizations as large as the great English banks, no encouragement being given to the expression of initiative and energy. Management takes some steps to offset this

(1) Joseph Sykes, The Present Position of English Joint Stock Banking, p. 128.
(2) I.e., costs per $100 of loans and investments.

tendency by providing personnel departments which concern themselves among other things with discovering and encouraging individuals of promise. Much of the promotion among employees in the great banks is worked out on the basis of the success of bank clerks in examinations in various fields of study given by a professional banking society. Several of the banks attempt to stimulate interest among employees through affording them the opportunity to purchase stock in the bank.

Office Equipment. - The backwardness of the great English banks in adopting modern business methods has been pointed out by some students as a factor resulting in high costs. Such American commonplaces of labor saving as loose-leaf ledgers, machines for calculating and stamping, and the like have been reluctantly accepted by the banks. Mechanical equipment has been adopted slowly due to the possibility of disturbing customers in their banking relations and also due to the personnel problem involved. It is a tradition of English banking that once an employee has passed his probationary period, his position is assured for the rest of his life, although promotion will depend on ability. Bank managers are faced with the problem of surplus employees resulting from the introduction of labor saving machinery. Moreover, the unwritten law guaranteeing a place to a proven employee develops a feeling of loyalty among the employees, who rarely seek other connections. Thus on the staff of each bank there are many clerks who have been doing the same sort of computation for years and the speed which results challenges the timesaving of novices with machines. Within the past year or so a considerable change has taken place in the direction of installing some of the modern office devices in an effort to reduce operating costs.

Adopting new accounting methods and forms presents serious problems in a great branch banking system composed of large and small branches. Any change in a standard form, for example, must be made in all the offices, from the largest to the smallest, in order to insure the maintenance of complete coordination of reports. Therefore, the banks have to consider whether the saving throughout the system will be sufficient to warrant changes, and in many cases they have found that more efficient methods for large offices would be unremunerative in the small. Perhaps more local experimentation would have taken place earlier, were it not for the rigid allocation of responsibility which has developed in the branch systems. The manager of each branch, realizing that the head office would hold him responsible for the success or failure of any undertaking, has been unwilling in many instances to take the risk. For the same reason branch managers have at times been reluctant to accept suggestions on bookkeeping and other banking technique from technical experts at head office.

<u>Operating Advantages</u>. - There are, however, many characteristics of the concentrated system which tend toward economical operation. In this class are a variety of matters usually associated with large scale operation, such as high-grade management at the top and specialization among individuals, making for expertness. The review of important credit commitments by several persons results in a composite judgment, often lacking in smaller institutions. The important officials of large organizations who specialize in handling the open market loans and investments are in a position to avoid mistakes which might develop if their energies were dissipated over a variety of matters.

Concentration brings effectiveness in the pooling of cash reserves and keeps them at the lowest level consistent with safety. Interbank balances are simpler matters between the offices of the same bank than between independent banks. In the same way, clearing and collection of checks and other instruments are facilitated when a much larger proportion of transactions represent relationships of one branch with another within one banking organization.

## Profits and Dividends

The only complete income and expense statement of a recent year for any one of the English joint stock banks which has been found is not official but represents a series of shrewd guesses by the English student of banking, Joseph Sykes, who reconstructed items for Barclays Bank for the year 1926 as follows:(1)

Table 14 - Income and Expense Account of Barclays Bank for 1926

| | (in millions) | |
|---|---|---|
| Income on advances | $41.32 | |
| Income on bills discounted | 8.32 | |
| Income on money market and stock exchange loans | 5.16 | |
| Income on investments | 13.43 | |
| Income on service charges on accounts | 9.73 | |
| Miscellaneous | 2.43 | |
| Total | | $80.39 |
| Interest on deposits | $32.02 | |
| Salaries and other expenses | 27.30 | |
| Bad and doubtful items | 9.25 | |
| Total expenses and losses | | $68.57 |
| Net available for dividends | | $11.83 |
| Dividends | | $ 8.03 |

(1) Present Position of English Joint Stock Banking, Ch. III.

In the case of this one joint stock bank for the one year, interest and discount make up the major portion of gross income, as they do among banks in this country. It is of interest, however, that nearly one-eighth of gross income was furnished by service charges received from depositors to compensate for carrying their accounts. Interest paid out on deposits was almost as large as all other expenses and losses combined and nearly three times as large as the net amount available for dividends.

Although no broad conclusions can be drawn from limited comparisons, the following tabulation, showing income and expense items for the year 1926 expressed as dollars per $100 of loans and investments in the case of Barclays Bank and comparable figures typical of a group of small national banks and a group of large national banks, suggests the extent to which a great English bank represents the averaging out of high cost small offices and low cost large offices.

Table 15 - Income and Expenses per $100 of Loans and Investments of Barclays Bank and National Banks in the United States, 1926

| | Barclays Bank | Small national banks(1) | Large national banks(1) |
|---|---|---|---|
| Interest and discount | $5.09 | $6.64 | $4.95 |
| Other income | .91 | .70 | .99 |
| Total gross | $6.00 | 7.34 | 5.93 |
| Interest on deposits | 2.39 | 2.03 | 1.97 |
| Salaries and other expenses | 2.04 | 3.61 | 2.05 |
| Losses | .69 | 1.09 | .44 |
| Total expenses and losses | 5.12 | 6.73 | 4.47 |
| Net available for dividends | $ .88 | $ .61 | $1.46 |

(1) Small banks, those with loans and investments $250,000-$500,000; large banks, $50,000,000 and over.

The indication is that the gross return of small national banks in this country on their loans and investments is much higher than that of a great English bank, and thus represents higher charges to borrowers by the small bank. It is generally believed that the large bank in England, providing through branch offices services to small communities which in this country would be accommodated by a small bank, makes a more even charge for accommodation than does the unit banking system of the United States. Outlying borrowers stand therefore to gain in this respect from the concentrated English system. During 1926 Barclays Bank received $6.00 per $100 of loan and investment accommodation but returned $2.39 in interest on deposits. The difference, which may be regarded as the measure of the cost of banking services to the community, amounted to $3.61 for every $100 of loans and investments, which compares with $5.31 for small national banks and $3.96 for large national banks in the United States. Barclays Bank had a final margin of profit available to shareholders of $0.88 per $100 of loans and investments; small national banks, $0.61; large national banks, $1.46.

Conclusions based on the experience of one bank in one year are of limited value, as previously stated, and the average experience over a period of years would be a better basis for tests of this sort. In this connection it is worthy of note that the only cost item available over a period of years in the case of Barclays Bank--salaries and other expenses--averaged $2.00 for the three years 1926-1928. This indicates that the figure of $2.04 for the year 1926 is probably typical of average experience. The average figure for the three years for small national banks was $3.57; for large national banks $2.14.

In a direct comparison such as this between the operating costs of the banking systems of two countries cognizance should be taken of the difference in types of services rendered. In earlier chapters mention was made of the fact that English banks have confined themselves much more to the business of deposit and lending and do not supply some of the services given by American banks. English banks do not control the fiduciary business of that country to the extent that banks of deposit do here, nor do English banks engage in the business of merchandising securities for their own account. For these reasons the actual value of the services rendered by the banks to the two communities cannot be compared.

The following tabulation gives the annual profits and dividends for a large group of English joint stock banks for a five year period before the war and for the past five years. The ratios presented in the second part of the tabulation, which show the margin of profit per $100 of resources and the rate of profit per $100 of invested capital, are particularly interesting.

Table 16 - Profits and Dividends of English Joint Stock Banks(1)

| Year | Annual net profits (in thousands) | Annual dividends (in thousands) | Dividends as per cent of profits |
|---|---|---|---|
| 1908 | £ 7,743 | £ 6,904 | 89 |
| 1909 | 7,454 | 6,722 | 90 |
| 1910 | 8,241 | 6,761 | 82 |
| 1911 | 8,214 | 6,818 | 83 |
| 1912 | 9,124 | 6,884 | 75 |
| Five year average | | | 84 |
| 1926 | 13,843 | 10,099 | 73 |
| 1927 | 13,349 | 9,854 | 74 |
| 1928 | 13,784 | 10,274 | 75 |
| 1929 | 13,978 | 10,461 | 75 |
| 1930 | 11,941 | 9,913 | 83 |
| Five year average | | | 76 |

(1) Economist (London), Banking Numbers.

Table 17 - Net Additions to Profits per $100 of Resources and of Invested Capital

| Year | Annual profits per $100 of resources(1) | Annual profits per $100 of invested capital(1) | Invested capital per $100 of resources |
|---|---|---|---|
| 1908 | $ .96 | $8.98 | $10.69 |
| 1909 | .91 | 8.75 | 10.44 |
| 1910 | .96 | 9.71 | 9.84 |
| 1911 | .93 | 9.80 | 9.47 |
| 1912 | .99 | 10.68 | 9.23 |
| Five year average | $ .95 | $9.58 | $9.93 |
| 1926 | $ .66 | $9.51 | $6.92 |
| 1927 | .61 | 9.15 | 6.70 |
| 1928 | .59 | 9.30 | 6.34 |
| 1929 | .62 | 9.43 | 6.62 |
| 1930 | .53 | 7.93 | 6.67 |
| Five year average | $ .60 | $9.06 | $6.65 |

(1) Resources and invested capital are as of the end of the year. Annual profits are for a large group of joint stock banks which make reports; resources and invested capital are for all joint stock banks. The discrepancy due to the omission of several banks is not great.

The average margin of profit per $100 of resources for the five years 1908-1912 was 95 cents; for the past five years, 60 cents. The lowering of the margin of profit is in part a reflection of the higher costs per unit of business which have been spoken of in earlier paragraphs. Despite the lowering of the margin of profit per unit of business, the rate of earnings on book invested capital has not decreased materially, the average for the earlier period being 9.6 per cent and for the later period 9.1 per cent. As the third column shows, the reason for the contrast in the decline in the rate of net earnings on resources and on invested capital grows out of the fact that there has been a large reduction in the ratio of book invested capital to total resources.

In connection with the apparent rate of earnings on invested capital, it should be borne in mind that because of hidden assets or secret reserves the actual invested capital of English banks is no doubt much higher than the books indicate. To whatever extent it is greater, the rate of earnings on invested capital is commensurably lower.

The tabulation brings out that on the average for the past five years English banks have paid out 76 per cent of profits in dividends; in the period 1908-1912, 84 per cent was so paid out. For some years, the rates of dividends declared by the "Big Five" remained unchanged and a feeling had developed that changes were very unlikely. The uncertain business conditions, however, coupled with heavy losses suggested the wisdom of conserving reserves at the expense of dividends, and during 1930 and 1931 most of the banks reduced their dividends.

## CHAPTER VII

## CONCLUSIONS

Safety Record. - Losses to depositors because of bank failures have been negligible in England since the rise of the great branch banking organizations in recent decades. There were less than ten failures among commercial joint stock banks from 1900 to 1925, and since that date there have been none. Since 1914 the ratio of deposits of suspended banks in England to the average yearly deposits of active banks has been less than one-fiftieth of the same ratio for the State and national banks of the United States.

The existing banking structure in England, where about 80 per cent of both commercial banking deposits and offices are concentrated in five large branch systems, is the outcome of a long period of competition between small local banks and joint stock branch banking companies. A century ago there were scores of local banks operating as small partnerships, many of which failed during the course of the nineteenth century. After the law of 1826 gave joint stock companies the right to operate in the commercial banking field, they began to develop branch office systems and their growth was rapid, especially after the Act of 1862 definitely permitted banks to operate as modern corporations with limited liability.

These large branch systems of England, in contrast to small local banks of earlier periods, serve a wide geographical area and are in contact with a variety of business interests. Therefore, they have a wide diversification in their portfolios. Management in England has endeavored to operate along traditional commercial banking lines, keeping funds liquid in the form of short-term loans and investments. Careful attention to the problems of internal audit and supervision of large and small banking offices alike has been essential to the stability of these large organizations.

Many of the branch banking offices in England that have proved unsuccessful have been liquidated but this liquidation has not caused losses to depositors. Assets of the discontinued offices have been transferred to other offices and losses sustained by the operation of these offices have been absorbed by the banks. About 4,000 offices were closed in England between 1876 and 1914, as compared with about 9,000 that were opened during the same period.(1) The number closed was almost half as large as the number opened. In 1915, 154 new branches were opened and 53 were closed,(2) but during 1916, when the war made the banking situation very difficult, more offices were closed than opened.(3) This indicates that adjustments to changing economic conditions and expansions into new fields have been made in England as in other countries, but these adjustments have not caused losses to depositors because forced liquidation of assets was avoided and operating losses have been absorbed by the banks.

Availability of Credit. - Government commissions in England charged with investigating the problem have concluded that all classes of borrowers at the commercial banks, including farmers, are well served by existing facilities there. It is recognized, however, that the large banking institutions extend their accommodations on a less personal basis than small local concerns. Since this has served to bring fewer undesirable assets

(1) Bankers' Almanac and Year Book.
(2) Ibid., 1917, pp. 26, 27.
(3) Ibid., 1918, p. 25.

into the banks, it has been generally regarded as more of a gain than a loss to the community.

Available figures indicate that a substantial proportion of the loans of the great branch banking organizations are in small units, and the small man in England who represents a reasonable commercial banking risk receives adequate consideration and accommodation. Although the widely diffused branch banking systems are channels for the mobilization and distribution of funds, the investigating commissions have concluded that this does not result in draining deposits from the outlying communities to the industrial and financial centers. Comparisons which have been made between the rates of interest charged for short-term accommodation in England and elsewhere, indicate that English borrowers are in a favorable position.

On the other hand, a body of opinion for years has been critical of the attitude of the banks, holding that they should make longer term commitments to industry and agriculture. Bank management has resisted these suggestions on the ground that it is not sound banking to lock up for long periods deposits payable on demand or short notice. Responsible investigating commissions have concurred in this view. They report, however, that England needs more adequate investment banking machinery to handle capital financing.

Effective Competition. - After the emergence of the "Big Five" more than a decade ago public policy set its face against further uncontrolled concentration of banking resources. It was felt at that time that continued reduction in the number of banking units might lead to joint agreements among the remaining banks resulting in a "money trust." The

Government has been an advisor and adjudicator in connection with all subsequent moves toward concentration.

Government commissions have concluded, however, that "up to the present there has been little or no attempt on the part of the amalgamated banks to exercise any monopoly powers, or to suppress competition by districting or other working agreements."(1) Indeed, many believe that concentration so far has been accompanied by increased competition, which has found expression among other ways in the spread of banking facilities through new offices.

The large banks have branches and sub-branches spread over practically all of England and Wales in competition with each other. Usually a town which needs banking facilities has two or more banking offices (branches or sub-branches) representing two or more of the joint stock banks. It has often happened that a bank has opened a new office in a locality because a competitor was operating there and not because enough business existed to justify the outlet. In some cases these redundant offices have been put on a paying basis after a period of several years. On the other hand, such overbanked situations have affected earnings substantially and have frequently led to the closing of unprofitable banking offices. Nevertheless, the number of banking offices has increased during nineteen out of the last twenty years.

The increase in the banking offices in England has been much more rapid than the increase in population. The population per banking office declined from about 6,800 in 1901 to about 5,000 in 1921 and to about 3,900

(1) Committee on Industry and Trade, Final Report, 1929, pp. 52, 53.

in 1930, compared with 4,800 in the United States. Liverpool had a commercial banking office for every 5,500 persons; Birmingham had one for every 6,200 persons. As of a comparable date New York City had a commercial banking office for every 10,500 persons and San Francisco, one for 5,800 persons.

There was one banking office in England for each six square miles, while in this country there was one national or State banking office for about one hundred and twenty square miles. In the densely populated States of New York, New Jersey, and Pennsylvania, there was a banking office for each twenty-five square miles.

These figures illustrate the relative accessibility of banking offices in England. The responsible heads of English banks have on occasion commented on the problem of excess offices. In 1924 one of them spoke of "fresh branches which take a long time before they can pay their way, and in some cases, one may fear, are not likely ever to pay at all."(1) Some evidence that steps are being taken by the banks to protect themselves against excessive competition among branches is found in an address to the shareholders of Lloyds Bank early in 1932 by the chairman, Mr. J. Beaumont Pease, who said:(2)

> "Banks have sometimes been criticized for opening new offices in places where banking facilities were redundant. The multiplicity of branches has been to the advantage of the public, but, undoubtedly, there are places where the business is not sufficient to ensure satisfactory results to all the banks represented there, and, with this in mind, and by mutual arrangement with other banks, we have closed down a good many sub-offices, with a consequent saving in expense."

(1) Chairman of the Westminster Bank, Statist, May 10, 1924, quoted by Patrick Fitzgerald, Industrial Combination in England, p. 181.

(2) Address to shareholders quoted in American Banker, February 24, 1932, p. 4.

Costs to the Community. - Data available with respect to the earnings and expenses of the joint stock branch banks of England are so meager that it is difficult to draw conclusions in respect to the relative cost of banking services to the public. Although the English banks make smaller charges for their services than do small unit banks in this country, their advantage over large banks here is not clear. It is clear, however, that the costs of the great British branch systems are the result of averaging low cost large offices with high cost small ones. The competition for new branch outlets has been reflected in the costs and profits of English banks.

Although there has been a reduction in the margin of profit per unit of business among English banks during the past two decades, a commensurate reduction in the rate of profit on book invested capital has not occurred, owing to a large increase in operations per unit of capital. If hidden reserves are taken into consideration in computing invested capital, however, the real rate of profit is considerably smaller than the apparent rate which averaged about 9 per cent during the five years 1926-1930.

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