# INTRODUCTION

It is a well established generalization that the supply of inland bills of exchange in the London discount market experienced a sharp fall after the seventies of the nineteenth century and that thereafter the main business of the market became the discount of foreign bills. It is said from this that the chief function of the market changed from the finance of domestic trade to that of international trade. Both of these propositions need qualification, as will appear later.

W. T. C. King, in his *History of the London Discount Market*, tried to explain the causes of the decline of domestic bills in the following words. He wrote,

> By far the most important of these new influences was the bank amalgamation movement, bringing with it a great expansion of branch banking, and enabling many banks to perform within its own organization the 'equalizing' function for which the bill market had previously been indispensable....After 1878...the era of really large-scale banking began. In consequence, the number of branch banks, which had risen by some 35 per cent. to 2,413 in the nine years to 1881, increased by a further 40 per cent. to 3,383 in the ensuing decade. This development, by enabling the bigger banks to finance from the deposits of their 'agricultural' branches the demands at their 'industrial' branches, removed one of the principal reasons for the use of the bills as the standard instrument of accommodation. From many points of view, it became a matter of indifference to the banks whether they financed their customers by discounting their bills or by granting loans or advances, and to the customers the flexibility of the overdraft system had definite attractions. Thus the spread of branch banks was accompanied in many trades by a gradual displacement of the internal bill by the 'open credit' system as the standard means of finance.[1]

[1] W. T. C. King, *History of the London Discount Market*, London, 1936, p. 273.

It must be conceded that King refers to other causes of the decline of internal bills. He writes (p. 274), 'Meanwhile, other influences were working in the same direction. The improvement in communications, accelerating the speed with which goods moved to market and into final consumption, was shortening the customary credit terms; the growth of the industrial combine, making it increasingly difficult for the head office of a business to watch the many bills of its retailer customers, and to ensure due payment at maturity, was producing a marked preference for cash payments, or at least for credit by ledger accounts; and a new and vigorous business competition was popularizing a system of cash rebates which made payment by bills definitely unprofitable. At the same time, the growth of the banking habit, and the availability of banking facilities in every important town, put an end to the use of bills as local currency.' As will appear later, there are some points here, in which I concur in explaining the decline of inland bills, but on the whole such impressionistic expositions are hardly sufficient for precise analysis. Moreover, there are obvious difficulties with some of these explanations. Industrial combines would experience the same difficulty and trouble in ensuring due payment at maturity either of bills or of ledger accounts of their retailer customers. On the other hand, bills are more convenient for industrial combines, because they can discount the bills when need be, whereas ledger accounts are not a liquid form of assets. If there were such developments, therefore, the reason must be sought, not in the numerousness of the retailer customers, but in the circumstance that industrial combines had more ample resources so that they had no need to discount the bills in their hands and it was immaterial for them whether they held their assets in the form of bills or ledger accounts. Secondly, rebate on cash payments has

R. G. Hawtrey, in his *A Century of Bank Rate*, endorsed the above opinion of King in almost identical words,[1] and thereafter King's argument has come to be almost unanimously accepted by monetary historians. As recently as 1968, W. M. Scammell writes as follows,

> The main reason for this decline [of inland bills] lay in the changes taking place at that time in the structure of the banking system. The old unitary banking system of the first part of the nineteenth century was giving way to a concentrated banking system working through a branch network. This made easy the transference of liquid funds from district to district and enabled the old 'equalising function', performed by the country banks and their practice of rediscounting, to be superseded. The overdraft and bank loan became common as means of financing short-term trade credit and their use grew as a result of their flexibility and convenience.[2]

The above hypothesis of King and others is by no means a result of a detailed study of the phenomenon, but is of the nature of a sketchy impression. There are certain difficulties with the argument. For one thing, the appearance of large-scale banks with balanced nation-wide branch networks is a comparatively recent phenomenon. They are largely products of the amalgamation movement among banks and this movement accelerated particularly in the nineties. Before the nineties there was only one such bank in England and Wales, namely the National Provincial Bank of England. If we take for instance the year 1885, we find only eight banks with more than 50 offices (i.e. including head offices, branches, sub-branches, agencies and sub-agencies, but excluding London agencies of country banks). They are London and County Banking Co. (162 offices), National Provincial Bank of England (155 offices), Capital and Counties Bank (98 offices), London and Provincial Bank (88 offices), Wilts and Dorset Banking Co. (78 offices), Manchester and Liverpool District Banking Co. (69 offices), North and South Wales Bank (66 offices), and London and South-Western Bank (54 offices). Of these, London and County, Capital and Counties, London and South-Western, and London and Provincial had head offices in London and their branches were mainly scattered in the London suburbs and the southern counties of England (which were, of course, largely agricultural or residential districts). Wilts and Dorset, North and South Wales, and Manchester and Liverpool District were

traditionally been given at attractive rates probably since the eighteenth century, although the rate seems to have fluctuated with the business cycle. (See L. S. Pressnell, 'The Rate of Interest in the Eighteenth Century' in *Studies in the Industrial Revolution* (ed. by Pressnell), London, 1960, pp. 199–200.) If cash payments became the order of the day, therefore, there must have been forces at work which enabled firms to pay in cash more than formerly.

[1] R. G. Hawtrey, *A Century of Bank Rate*, 2nd ed., London, 1962, p. 55.

[2] W. M. Scammell, *The London Discount Market*, London, 1968, p. 29. Faithfully reflecting King, Scammell points to other causes of the decline of inland bills. 'Apart from this, changes in the structure of business itself—a shortening of periods of trade credit, a preference by firms for cash settlement and a growing measure of competition—made the bill of exchange less attractive as a medium of payment than formerly.' (*Ibid.*, p. 29.)

local banks (North and South Wales Bank may be said to have possessed a balanced branch network, for its head office was in Liverpool and the branches were located mainly in North Wales). Thus, with the exception of the National Provincial Bank, there were at this time no banks capable of performing such functions as the transference of liquid funds from 'agricultural' areas to industrial counties.

On the other hand, the estimated amount of bills drawn began to decline from the financial year 1873, when it was £1,781 m. The decrease continued till the financial year 1894, when it was £1,121 m. (Years hereafter are financial years and 1873 means the year commencing April 1873 and ending March 1874.) If we take the amount of inland bills drawn, it was £721 m. in 1870 and was £490 m. in 1894. (The method of estimation of the volume of bills drawn will be discussed in Chapter 2.)

Moreover, the volume of inland bills coming to the London discount market must have experienced a much more drastic reduction than the figures of the amounts of bills drawn would seem to suggest. For the latter quantity will depend upon the following three factors: (1) the amount of bills drawn, (2) the average usance of bills, (3) the proportion of bills retained till maturity by the drawers themselves or by the local banks which had discounted the bills. We have evidence that the values of both (2) and (3) underwent considerable changes during the period in question. It is not inconceivable even that the supply of internal bills in the London discount market was diminishing before 1873, although the amount of inland bills drawn in each year was strongly on the increase during the period 1855–73. On this point there is evidence by William Fowler, a noted banker, who stated that rediscounting of bills by country banks 'rapidly reduced after 1857'.[1]

There is thus a gap of at least twenty years between the decline of the amount of inland bills in the London money market and the emergence of mammoth banks with branch offices all over the country. It is difficult to see how one can explain a phenomenon of the seventies by an occurrence of the nineties.

In the following pages I wish to criticize King's hypothesis. I wish to do that mainly by attaching statistical values to the argument and I hope in the process to be able to produce an alternative explanation of the decline of inland bills.

Chapter 1 deals with the development of branch banking. Chapters 2, 3 and 4 aim at estimating the supply of bills, both inland and foreign, in the London discount market. As has been shown, the supply of bills in Lombard Street depends upon (1) the amount of bills drawn, (2) the average usance of bills and (3) the proportion of bills retained till

[1] 'Inaugural Address by William Fowler', *Journal of the Institute of Bankers*, 1891, p. 618.

maturity by the drawers and the local banks. The relationship may be expressed in a simple algebraic form as follows:

$$S_{\mathrm{BL}} = \frac{U}{12}\left(1-\left(\frac{B_{\mathrm{rd}}}{B_{\mathrm{D}}}+\frac{B_{\mathrm{rb}}}{B_{\mathrm{D}}}\right)\right) B_{\mathrm{D}},$$

where $S_{\mathrm{BL}}$ stands for the supply of bills in the London discount market, $U$ for the number of months of the average usance of bills, $B_{\mathrm{D}}$ for the amount of bills drawn, $B_{\mathrm{rd}}$ for the volume of bills retained till maturity by drawers and $B_{\mathrm{rb}}$ for the quantity of bills retained by local banks.

Chapters 2, 3 and 4 deal respectively with each member of the right-hand side of the above equation; i.e. Chapter 2 is devoted to the estimation of the amount of bills drawn in each financial year during the period 1855–1913, and Chapter 3 deals with the change in the average usance of bills during the period, while Chapter 4 aims at estimating the amount of bills discounted by banks. I must stress that the results obtained in these chapters are more or less in the nature of tentative approximations and that they may be liable to great margins of error. The estimated amounts of bills are, however, more reliable, since the estimation is based upon the more or less solid ground of the statistics of revenues from the sale of stamps for bills of exchange. The average usance of bills is estimated from the balance-sheets of two banks, Parr's Bank and Liverpool Union Bank, which state the amount of bills discounted, rebate of discount on bills in hand and the rate of discount applied to the calculation of the rebate. Besides this, considerable evidence on this point was given before the royal commissions and the select committees of the period. In addition, *The Economist*, *The Statist* and *Bankers' Magazine* are helpful in this respect. The volume of bills retained till maturity by the drawers themselves cannot be known. Bills retained by local banks, too, cannot be known precisely, especially before 1870, for published balance-sheets of banks are notoriously defective. For example, in 1867 only eleven banks clearly showed the amounts of bills discounted. Even in 1880 only thirty-one banks showed the breakdown between advances and discounts. The results obtained, therefore, purport to show only broad tendencies.

Chapter 5 deals with the tendency to cash payment, which King points out and which contemporaries thought to be the chief cause of the decline of the use of bills.

Chapter 6 deals with the change in the general character of bills which was caused by the decrease of inland bills and the increase of foreign bills, and also with some consequences of the change. A word of caution is in order here. It is customary to say that at the same time as internal bills decreased foreign bills increased to take their place, and that the chief function of the London discount market became the finance of international trade. But the fact is that foreign bills decreased hand in hand with domestic bills (although to a smaller extent than inland bills) during the years 1873–94, and so there developed a shortage of both inland bills and foreign bills in the market. The great increase in the amount of foreign bills took place only after 1894.

A further qualification is necessary to the above dictum. The distinction between inland bills and foreign bills is largely a legal one and does not necessarily show the difference in the nature of transactions behind the two kinds of bills. It would be rather naive to suppose that the London discount market was financing purely domestic trade before the seventies when domestic bills were predominant in the market, whereas after that the market came to finance international trade because foreign bills came to dominate. Inland bills were very often drawn to finance the export trade of the United Kingdom and therefore in a sense a part (or rather a greater portion) of inland bills on London were instruments for financing the foreign trade of the country. On the other hand, not all the foreign bills were drawn for the finance of international trade. Some of them were finance bills drawn in order to effect the international movement of short-term capital.

# 1. BANK OFFICES IN ENGLAND AND WALES, 1855–1913

As we have already seen, King puts great emphasis on the increase in the number of bank offices and the development of branch banking in explaining the causes of the decline in the use of inland bills. But he does not give any precise statistics to prove his points save very rough figures of the total number of bank branches: namely, he points out that the number of branch banks increased by 35 % to 2,413 in the nine years to 1881, and that in the ensuing decade the number increased by a further 40 % to 3,383. These figures relate to England and Wales and are quoted by King from Sykes, *The Amalgamation Movement in English Banking*,[1] and Sykes, in turn, quotes these figures from *Banking Almanac*.

There can be two criticisms of King's argument on this point. First, since he puts great stress on the transference of funds from agricultural areas to industrial counties, which is done in the framework of one and the same bank, it is not enough merely to enumerate the total number of bank branches. The relevant statistics would have been the number of branches per bank.

The second criticism is that the number of bank offices in England and Wales was increasing at a fairly regular pace from the middle of the nineteenth century and that the seventies and the eighties were not the only decades during which their numbers increased significantly.

According to my own calculation the number of bank offices (which includes head offices) in England and Wales was 1,225 in 1861, and increased to 1,647 in 1871, or by 34 %. It was 2,256 in 1881, an increase of 37 % compared with 1871. In 1891 it was 3,213, an increase of just about 42 % over 1881. During the ten years 1891–1901 it increased by 47 % to 4,726. From 1901 to 1911 it grew by 30 % to 6,127.

It is difficult to believe that only the 35 % increase in the seventies and the 40 % increase in the eighties (percentage figures according to King) were material in reducing the volume of inland bills, and that the 34 % increase during the sixties and the 47 % increase during the nineties did not have an equally decisive influence in this matter.

I have made my own investigation of the number of bank offices in England and Wales for the period 1855–1913. As the issue at stake is the progress of branch banking, the number of bank offices in Scotland and Ireland is not investigated, because in those countries branch

[1] J. Sykes, *The Amalgamation Movement in English Banking, 1825–1924*, London, 1926, p. 113. His figures as well as those of *Banking Almanac* are inappropriate. See Appendix to Table 1.

banking was already highly developed by the middle of the nineteenth century.

The main material used was, of course, *Banking Almanac* (*Bankers' Almanac* after 1920). Each issue of *Banking Almanac* generally records the number of bank offices in October of the year immediately preceding. But we should be careful in using the *Almanac*, for it is by no means an absolutely reliable source for the following reasons:

(1) It does not distinguish between genuine home banks and other financial institutions, e.g. merchant bankers, bill-brokers, credit agents, foreign bankers and so on. This defect becomes most troublesome when we deal with banks in great financial centres, such as London, Liverpool and Manchester, where there is scope for specialization in financial activities.

Needless to say, there cannot be any hard and fast rule by which to judge what is a genuine home bank and what is not such a bank. This is possibly a matter to be decided by common sense. Of course, there was a legal way of defining a bank. Legally a bank could be defined as a firm which was entitled to claim payment in cash over the counter of a crossed cheque which it held on its own account or on its customers' account. To be able to do this a bank had to be registered with the Inland Revenue Office. But this registration unfortunately is not a very good guide in identifying a home bank. For one thing joint stock companies were exempt from this duty of registration in conducting banking. In most such cases, the titles of the companies provide a clue. Then, those banks duly registered include a large body of merchant bankers and foreign banks and others (e.g. Gillett Bros., bill-brokers, and Samuel, Montagu, merchant bankers, are both included among the registered banks).[1]

It may be thought that membership of the Bankers' Clearing House would be a good guide in this respect. But many banks which must have passed as genuine home banks were non-clearing banks in this period. Traditionally a group of private banks in the City controlled the London clearing, and joint-stock banks experienced considerable difficulty in obtaining membership. For example, London and Provincial Bank, which had 344 offices in 1913 and was the seventh largest bank in England and Wales, was not a member.[2]

Therefore, one has to rely to a great extent on the contemporary

[1] 7 and 8 Vict., cap. 32 (Section 21) stipulates the registration of banks. 45 and 46 Vict., cap. 72 (Section 11) exempts joint stock companies conducting banking from this duty. By the way, London clearing banks have decided not to avail themselves of this privilege of claiming the payment over the counter of crossed cheques and instead exchange the cheques at the clearing.

[2] At first, joint-stock banks were denied the right to join the Clearing House. It was only in June 1854 that some of them, including London and Westminster Bank, obtained membership. (See T. E. Gregory, *The Westminster Bank through a Century*, London, 1936, pp. 173–4.)

common-sense labelling in determining what is to be regarded as a genuine home bank. In the case of London this information is fortunately supplied by such publications as *Post Office London Directory*, *Handbook of London Banks and Bankers*, by Hilton Price, and *London Banks and Kindred Companies and Firms*, edited by Thomas Skinner. Of these the last-mentioned is of the most use, for it endeavours to show the nature of each firm's business.[1]

But these directories relate only to London. In the case of Liverpool and Manchester there is no such source of information. Only in one instance have I been able to weed out a merchant banker from the list, i.e. E. L. Samuel & Co., which moved to London in 1869 to join in the firm of Samuel, Montagu & Co.

(2) The earlier issues of the Almanac fail to record many banks, which begin to appear in it for the first time long after their formation. Sometimes the Almanac does give the years of their foundation, but in these cases, too, doubt arises as to the exact numbers of offices of such banks during the years in which they do not appear in the Almanac. In such cases I gave the value of unity to these banks in regard to their number of offices during those unclear years. And in very many instances the Almanac does not show the years of formation of these banks.

(3) In the case of country private banks *Banking Almanac* very often records the same bank over and over again as existing at the several places where the offices of the bank exist; e.g. Cunliffes, Brooks & Co. is represented three times as existing in Blackburn, Manchester and Altrincham. Then, there are cases of apparently different banks with slightly different partnerships, but in actual fact belonging to the same entity. For instance, the Gurneys of Norwich are related to Gurneys of Great Yarmouth, Fakenham, King's Lynn, Ipswich and Wisbech. There are many instances of such loose federation and it is very often difficult to determine whether they should be treated as one bank or as separate units. This again is largely a matter for discretion. I treated these federated banks as separate units unless it is clearly stated in the Almanac that a bank is a subsidiary of another bank. In the above example of the Gurneys, the Fakenham bank is indicated as a branch of the Gurneys of Norwich, but the other banks do not carry such identification.

(4) In the case of joint-stock banks there are those occupying the intermediate sphere between genuine home banking and other fields of

[1] The publication of this directory started in 1865 under the name of *The London Banks, Credit, Discount and Finance Companies*; it was incorporated in *Bankers' Almanac* in 1919. After 1880 it began to accord to each firm the designation of its business. It says, 'It is incidental to such an effort that it should not meet with entire approbation, but the object in view is so obviously useful, especially to foreign users of the book...' (T. Skinner, *The London Banks and Kindred Companies and Firms*, London, 1880, pp. 3–4.)

financial activity. For example, the Birkbeck Bank was a company which combined deposit banking and the functions of a building society. There are others like Reliance Bank (the savings bank of the Salvation Army), Co-operative Wholesale Society, Harrod's Stores Bank, Farrow's Bank (industrial provident society) and so on. Notably there was one 'bank' called Whiteley & Co. Ltd, which employed most of its resources in freehold estate. All these are listed as 'banks' in *Banking Almanac*. Fortunately, most joint-stock banks published their balance-sheets, so that in most cases we can distinguish genuine home banks from others by looking at them. (Of course, we cannot distinguish between a home bank and a foreign or a colonial bank by balance-sheets, but here the titles of banks give us the clue.)

(5) Most probably there are errors in *Banking Almanac*.

It is, therefore, almost impossible to arrive at absolutely accurate statistics of bank offices in England and Wales, if we rely on *Banking Almanac* alone. For our present purposes, however, statistics based on it may suffice, for it is the only exhaustive survey of banks in this period and the results obtained from it are unlikely to be very far wide of the mark.

The results of my investigation are shown in Table 1. From it we can see that the number of offices per bank was 3·1 in 1861, 4·5 in 1871, 6·7 in 1881, 12·3 in 1891, 30·7 in 1901 and 77·6 in 1911. If we take joint-stock banks only, the figures are: 6·9 in 1861, 9·2 in 1871, 12·9 in 1881, 23·1 in 1891, 56·2 in 1901 and 126·9 in 1911. It is evident from this that the great leap forward in the number of offices per bank commenced from the nineties.

Table 2 gives the names of banks with more than 100 offices and from it we can see that until 1886 there were only two such banks, i.e. National Provincial Bank and London & County Bank. It was in 1889 that Lloyds Bank came to possess more than 100 offices, while the Midland reached that point in 1893. Barclays was formed in 1896 out of fifteen private banks, while the Westminster Bank became a nation-wide bank only after 1909, when it amalgamated with London & County Bank. Thus, it becomes evident from a glance at the table that the formation of big banks with national networks of branches is a feature of the nineties, although the National Provincial Bank had been a national bank ever since its foundation in 1833.

Another point which contradicts King's hypothesis is that banks in Lancashire and Yorkshire kept comparatively aloof from the bank amalgamation movement. Since it was from Lancashire and the West Riding of Yorkshire that the greater part of inland bills were sent to London in the middle of the nineteenth century, the linking of Lancashire and West Riding banks with those in 'agricultural' areas would have been necessary for the use of inland bills as a means of the transference of money to have been effectively discontinued. Nothing of the sort happened save in one case, that of the amalgamation of Parr's Bank, originally of Warrington in Lancashire, with Stuckey's Banking Company of Somersetshire. This fusion is an ideal case for King's hypothesis, but unfortunately this occurred in 1909, much later than the decline in the use of inland bills.

Further, it should be recalled that agriculture was particularly hard hit in the Great Depression of the last quarter of the nineteenth century, when agricultural depopulation was in progress. In the circumstances, we would scarcely expect banks in agricultural areas to be as prosperous as they were in the middle of the century. Former agricultural areas in the South of England were, however, apparently becoming more prosperous, judging from the proliferation of bank offices in these districts after the seventies and from the great increase in deposits of banks situated in these districts. Apparently this is a consequence of the increase in income from abroad and, in the case of London suburbs, of the growth of salaried classes. It might, therefore, be misleading to use the term 'agricultural' in the cases of banks like Stuckeys, London & County, Wilts and Dorset, Capital & Counties and so on. The counties in which these banks were situated may more aptly be termed residential or rentier districts.

In this connection, it must be added that it is not supposed that the increase in the number of bank offices had nothing to do with the decline in the use of inland bills. As banks in industrial cities came to be able to absorb more savings deposits by setting up branches in the suburbs, their position became more liquid. With more liquidity these banks became better able to hold till maturity the discounted bills which they had previously sent to London for re-discount. It would, then, become immaterial to them if they accommodated industry by the discount of bills or by overdraft. If the banks' customers became able to use the facilities of overdraft more liberally than formerly, they would cease to pay by bills (i.e. by permitting their creditors to draw upon them), and use cheques in payment, thereby gaining the rebate on cash payment.

This is substantially the same argument as King's, but the difference is that we need not consider that the linking of 'industrial' banks with 'agricultural' banks is the necessary pre-condition for the decline of inland bills.[1] Quite apart from such a movement, the position of banks in industrial counties was changing radically during the period in question, as will be seen in Chapter 5.

[1] This may be a slight overstatement. According to Sayers, Gillett Bros., bill-brokers, had a small amount of country bills in their portfolio even in 1905 and, as country banks were absorbed one by one by London banks, the flow of bills from the country to the London firm tapered off. See R. S. Sayers, *Gilletts in the London Money Market 1867–1967*, Oxford, 1968, p. 48.