

**Professor Richard Roberts**  
**University of London**

Professor Richard Roberts is Director of the Centre for Contemporary British History, a research institute at the University of London. His publications on the history of investment banking include studies of the London merchant bank Schrodgers and the international consortium bank Orion. He has also written extensively on international financial centres, especially London and New York. His latest book is *The City: A Guide to London's Global Financial Centre* (The Economist, 2008). He is currently completing a book about the breakdown of the Bretton Woods fixed exchange rate system. He is also, with David Kynaston, writing a history of HSBC to mark the bank's 150<sup>th</sup> anniversary.

***International Banks and Financial Houses***  
***The rise and fall of the London merchant banks' international business model***

Richard Roberts

**Abstract**

This paper examines the development of the business models of the London merchant banks they evolved over the 19<sup>th</sup> and 20<sup>th</sup> centuries. It focuses particularly on the international business model from the early 19<sup>th</sup> century to the 1920s.

**International Business Model**

As firms whose origins lay in international trade, the merchant banks focused initially on international finance in two forms:

*Accepting:* Trade finance facilities were provided to merchants through the endorsement of bills of exchange. Endorsed bills were known as acceptances.

*Issuing:* The merchant banks specialized in the management of issues of 'high class' bonds - investment grade securities, in today's terminology. Their clients were principally foreign governments and overseas utility companies, especially railways. The key to issuing work was not execution - it was getting the mandates from borrowers.

From the mid-19<sup>th</sup> century to 1914, the London discount market that dealt in acceptances was the largest money market in the world. Foreign banks established

branches in London principally with the aim of participating in the discount market, both for treasury management purposes and for the development of their trade finance business. By 1913, 30 foreign banks from 12 countries had branches in London. The merchant banks faced growing competition both from foreign banks and from English joint-stock banks. Chapman estimates that the merchant banks accounted for around 70% of acceptance business in the London discount market in 1913, but 40-50% might be a more realistic guess.

London was the leading market for international bond issuance up to 1914, with Paris and Berlin as rivals from the 1880s. Latin America, especially Argentina, became the focus of a scramble between English, French and German bankers for loan mandates in the 1880s. The resulting chaos in the Argentine debt market led to the Barings Crisis of 1890. The Bank of England organized a rescue fund that prevented Barings from failure and saved the City from major systemic collateral damage. The foremost casualty was the merchant banks' reputational comparative advantage.

The merchant banks also saw increasing competition in issuing from domestic joint-stock banks and even stockbrokers. A solution might have been for the merchant banks to move into the higher-yield securities segment of the capital market, but they did so only sparingly.

### **The Merchant Banks and the Bank of England**

The merchant banks had close ties with the Bank of England, supplying many of its directors. By tradition, the Bank undertook to discount the acceptances of a director's firm without limit, conferring a competitive advantage. Another tradition was that the Bank would support the firm of a director if it got into trouble. At the time of the Baring Crisis the senior partner was a director and his firm was thus eligible for Bank support. The Baring Crisis is usually, and correctly, regarded as a milestone in the development of the Lender of Last Resort function of central banks. However, the Bank's conduct can also be interpreted, at least in part, as acting as Rescuer of Last Resort to a director's firm. The outcome for Barings, which had provoked a major systemic crisis, was remarkable. Not only was the incumbent management left running the firm, but by 1895 the family had reassumed full ownership. It was one of the most extraordinary episodes in the history of regulatory capture.

**Domestic Business Model**

Upon the outbreak of war in August 1914 the merchant banks essentially shut up shop for the duration. With the return of peace they found it difficult to resurrect the international business model. Although there was some recovery in acceptance business, the international loan market was now in New York. The merchant banks turned their attention to the domestic market and started seriously to court British corporations, which became the foundations of a new domestic business model.

The world depression led to the collapse of accepting and international bond issuance. The merchant banks' international business model was now completely bust. The firms' survival in the 1930s and 1940s and their revival from the 1950s was based on a new domestic business model with three principal elements: Corporate Finance; Asset Management; and Credit. This formed the business model of the merchant banks from the 1930s to the 1980s.

**Integrated Business Model**

The 'Big Bang' deregulation of the UK securities market in the mid-1980s led to the adoption by most of the leading merchant banks of the so-called 'integrated' business model. This meant the combination of their established largely advisory activities with securities market business, along the lines of the Wall Street investment banks. It was to be a short-lived new paradigm. By 2004, virtually the whole sector had been bought by either a Continental bank or an American bank or shut down.