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Baring Brothers: a London Merchant Bank in historical and comparative perspective

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The history of Baring Brothers epitomises that of a unique British financial institution: the London merchant banks. Admittedly, the history of merchant banks is shorter than 250 years. The year of Baring's foundation, 1763, not only predates that of all other houses – including Rothschild, Schroeder, Hambros, Kleinwort, Morgan Grenfell, Lazard, or Warburg; it also predates the birth of merchant banking as a predominantly financial rather than trading activity –which started at the turn of the nineteenth century. When the Baring partnerships were established in Exeter and London, it was as merchants, not yet as merchant bankers. The same is true of all the ancient houses, those established during the French Wars, before 1815, including Nathan Mayer Rothschild's arrival in Manchester in 1798, or Johann Heinrich Schroeder in London in 1800. These houses continued to call themselves 'merchants' well into the twentieth century.

On the other hand, the end of Baring Brothers, in 1995, corresponds to the demise of this component of the British banking system as, soon after, virtually all merchant banks were taken over by European and American universal banks.

So not only the history of Baring Brothers, but that of merchant banking as a whole, deals with institutions no longer existence –a situation which seemed hardly imaginable twenty years ago. This necessarily entails a change of perspective. It is often said, somewhat unfairly, that business history is only interested in success stories. Until recently, the London merchant banks were a success story *par excellence*, a symbol of the persistence of the City of London's world pre-eminence. The change that has taken place in the last twenty years does not mean that they have become objects of pure academic interest. On the contrary. Reflecting on the history of merchant banks, of which Barings were one of the pillars, is essential to understand the long-term evolution of the City of London, of British banking, and of world finance, whose transformation in the late twentieth century has played a far from insignificant role in the financial debacle of 2008. From this perspective, it seems to me to make perfect sense to consider the 250 years since the foundation of Baring Brothers.

What have been the characteristics of the London merchant banks in general and of Baring Brothers in particular during this period? Why were they able to play such a fundamental role in world finance? What made them both similar and different from international

private bankers elsewhere in the world, especially in the two other leading financial centres, Paris in the nineteenth century and New York in the twentieth century?

Merchant banks can be identified by looking at their type of activity, their form of ownership, and their position within the City of London. These three parameters remained fairly stable throughout the nineteenth century; they started to change, though only marginally, between 1914 and the mid-sixties; and they underwent more profound transformations in the last third of the twentieth century. I will consider in turn each of these three periods.

In the nineteenth century, merchant bankers were engaged in two main activities: financing world trade by means of accepting bills of exchange –what has been described as the 'bread and butter' of merchant banking; and for the more prestigious houses, providing capital worldwide by issuing foreign loans and equities. These activities were not new –in the sense of a financial innovation. Dutch bankers were already performing them in the eighteenth century, when Amsterdam was the financial centre of the world, with Hope and Co., a bank closely associated with Baring Brothers, clearly in the lead.

Things changed from the 1780s, when the Anglo-Dutch rivalry finally turned to Britain's advantage, and especially during the Napoleonic Wars, which brought about a complete reversal of roles. In 1802, the private banker Henry Thornton considered that London had become 'the trading metropolis of Europe and, indeed, of the whole world'; and by 1820, merchant bankers increasingly specialised in acceptance credits. At Baring Brothers, for example, the commission received to finance these acceptances represented 50 to 65 per cent of the bank's profits in 1830 and 75 per cent twenty years later.

At the same time, European states needing a loan had no other choice but to turn to London. City bankers had hardly any experience in the field and had to learn their trade. Baring Brothers, who established itself as the most powerful firm of the day, did so under the tutelage of Hope & Co., with the joint issue of a Portuguese loan in 1802 and, on a bigger scale, the financing in 1803 of the purchase of Louisiana by the United States from France –it was effected by means of American Treasury bonds, which Barings and Hope accepted in return for paying an equivalent sum in gold to France.

It should be remembered that the accepting and issuing businesses were at the very core of London's position as the financial centre of the world in the nineteenth century, especially during the period 1870 to 1914. The bulk of world trade was financed through the medium of bills of exchange drawn on London; and over 40 per cent of the total exported capital of the world in 1913 had been raised on London's capital market. Significantly, merchant banks were able to keep their hold on these two central activities, with some 70 per cent of an accepting market which nearly trebled between 1870 and 1914; and 37 per cent of the issues placed on the London market, far ahead of the overseas banks, with 15 per cent, and the clearing banks, with 10 per cent.

For most of the nineteenth century, Baring Brothers was the City's leading accepting house and second only to Rothschilds in foreign issues, though they retained their advantage in American railway bonds. The Baring Crisis of November 1890 marked a turning point in its history. It was caused by the bank's over-commitments in Argentina, and by the autumn 1890, it was no longer able to meet its commitments. Being illiquid rather than insolvent, Baring Brothers was bailed out by the banking community of London under the aegis of the Bank of England, in an operation which would serve as a model for future rescues. Barings recovered fairly quickly and from the beginning of the twentieth century, it was again a force to be reckoned with in the world of international finance.

The market dominance of the merchant banks on the accepting and issuing businesses was all the more remarkable for the fact that they remained family-owned partnerships. This obviously imposed constraints on size –as joint stock banks were able to raise more capital, but could also vastly increase their resources by collecting deposits. Nevertheless, it was not before the last decade of the nineteenth century that joint stock banks started to forge ahead in terms of size. In 1890, Baring Brothers together with N.M. Rothschild, still ranked amongst Europe's seven largest banks, including joint stock banks, measured by total assets.

As owners of their banks and involved in highly profitable financial operations, merchant bankers made a great deal of money and were amongst the wealthiest business people in the City of London and indeed the country. They enjoyed a dominant position within the City, because of their wealth, because of the cachet of international finance, because of their directorships, and sometimes chairmanships, of London's major financial institutions, not least the Bank of England, and because of their social prestige –they belonged to the country's upper classes, with peerages bestowed to the most prominent amongst them (the Baring family had four between 1835 and 1892) and alliances, through a succession of marriages, with the landed aristocracy. They truly formed a 'financial aristocracy'.

This was a unique position in the world of finance. In Paris, London's great rival for financial supremacy in the 1850s and 1860s, during the Second Empire, and still a 'brilliant second' until 1914, the *haute banque* was in many respects comparable to the London merchant banks –a group of old established private banks, mostly Protestant and Jewish, primarily involved in international finance, above all the issue of foreign loans, and including such names as Rothschild, Hottinguer, Mallet, Vernes, Mirabaud and a few others. They were wealthy, moved in exclusive social circles, and were to be found amongst the régents of the Banque de France, as well as on the boards of the country's leading banks, insurance and railways companies. And yet after 1870, the *haute banque* had to cede control of the big international financial operations to the joint stock banks. For a typical Argentinian loan issued in London and Paris in early twentieth century, Baring Brothers had as a partner the Banque de Paris et des Pays-Bas rather that a private bank.

Wall Street investment bankers probably came closest to London merchant bankers, with whom they were connected, in terms of economic power. J.P. Morgan, Kidder Peabody

(who had close links with Barings), Lee Higginson, Kuhn Loeb, Speyer, Seligman, and a few others were also private banks; and they played a key role in the American economy, by financing the railways in the 1870s and 1880s, large manufacturing companies in the 1890s, and the great merger movement at the turn of the twentieth century. But they were a different type of bank. They were not involved in any accepting business –American foreign trade was mainly financed by means of bills drawn on London– and they were domestic actors, with lasting relationships with their industrial clients. The international dimension of their activities came from the fact that a significant proportion of the capital they raised actually came from Europe, primarily Britain. From this perspective, they remained somewhat in the position of 'junior partners' vis-à-vis their London counterparts before 1914.

Did the First World War change the old order? Gaspar Farrer, a partner in Baring Brothers, lamented that 'it is mortifying in the extreme to find how instantaneously the credit edifice that we have built for generations could tumble to pieces in a night'. The First World War did have, indirectly at least, very serious long-term effects –including the Great Depression, and the Second World War. In the short to medium-term, however, not everything changed for merchant bankers in general and for Barings in particular.

A major change following the War was the respective position of Britain and the United States in the world economy. Britain lost part of its foreign investments and found it increasingly difficult to regain its role as exporter of long-term capital because of the constraints weighing down its balance of payments. The United States, on the other hand, was the great victor and in a few years changed from a debtor country to a creditor country. Capital was in far greater supply in New York than in London, and during the second half of the twenties, foreign issues placed in New York exceeded by 50 per cent those placed in London. On the other hand, and despite competition from New York, the draft on London remained the preferred instrument for financing international trade.

New York investment bankers thus rose to prominence, and none more than JP Morgan, which undoubtedly reached its apogee in the 1920s –through the sheer volume of its operations, the strength of its international connections, and its unique position at the hub of the world of business and politics, particularly in the field of financial diplomacy. Still in family hands, J.P. Morgan was the largest private banking house in the United States, and probably in the world, with assets about four times those of the largest merchant banks. The latter, however, which included Barings, Schroeder and Hambros, were of about the same size as Kuhn Loeb, Wall Street second largest investment bank.

In London, merchant bankers continued to form the City aristocracy, in terms of wealth, status and power, despite the greater assertiveness of the salaried managers of the newly formed 'Big Five'. Merchant banks remained family owned banks, even if some of them, including Barings following its reconstruction in 1890, converted into limited liability companies. The group of leading house was the same as before the War, though

cooperation, especially between Barings, Rothschilds, and Schroeder, the so-called Trinity, prevailed in a tougher climate. Despite their modest size (the Midland Bank was fifteen times larger than Baring Brothers, in terms of total assets, in 1928) and in the face of fiercer competition from the clearing banks, these houses remained dominant in both the accepting and the issuing businesses, even though they suffered from the decline of foreign issues on the London market.

Ultimately, it was at the crossroads of finance and international politics that merchant bankers benefited from a decisive advantage –an advantage that they owed to their social status; to their network of relationships; to their presence on the court of directors of the Bank of England; to their closeness to the governor, Montagu Norman; and to their expertise in monetary questions, which dominated the economic problems inherited from the War.

London merchant banks survived the Great Depression and the Second World War, some better than others. However, the economic climate of the post-war years was not very congenial to their international financial operations. London was no longer the world's leading financial centre. Until the mid-1960s, New York's predominance remained undisputed. The dollar had become the main trading currency and the cornerstone of the new international monetary system established in 1944 at Bretton Woods; while the pound's international role outside the sterling area suffered from not being fully convertible on current account until 1958.

Nevertheless, merchant bankers were successful in rebuilding and expanding their business. For most of them, acceptance credits remained the principal activity well into the 1960s if not the 1970s. But they also offered new services in fields whose importance started to grow in the City from the late fifties and early sixties, above all corporate finance and the Euromarkets.

Merchant banks had already been involved in domestic issues in the interwar years –and even earlier, with Baring's famous flotation of Guinness in 1886. However, from the 1950s, it was no longer a matter of simply issuing securities on their behalf, but also of providing advice to companies, especially in connection with mergers and acquisition –an activity which became known as corporate finance and, more than any other, came to personify merchant banks.

The emergence of the Euromarkets, which quickly made London their natural home, marked the rebirth of the City as a leading international financial centre and enabled merchant banks to expand their international activities. In 1957, merchant bankers, in particular Kleinwort, Samuel Montagu and Warburg, were amongst the first to carry out transactions in Eurodollars –in other words in dollars held outside the United States and free of American regulation. And Siegmund Warburg was responsible for the first Eurobond issue in 1963.

However, the Euromarkets were far more competitive than corporate finance. While merchant bankers continued to dominate the market for mergers and takeovers, they had to abandon much of their early advantage in Eurodollars and Eurobonds to foreign banks, first American, then European and Japanese. Their share of the Eurocurrency market, which had peaked at nearly 20 per cent in 1962, had fallen to just over 5 per cent in 1973 and 3 per cent in 1976. The situation was similar in Eurobond issues, with only there firms – Warburg, Rothschild and Hambros– appearing in the list of the top twenty lead banks, or joint lead banks, of issue syndicates between 1963 and 1972.

It must be said that in these years, Baring Brothers was no longer in the front ranks of the City merchant banks, though it remained highly prestigious, like the other old-established family-owned houses. However, changes were taking place at this level too, with a wave of conversion into public companies. The movement had started earlier, but most houses had remained in family hands. What changed in the 1960s was the opening, in a variety of ways, of both ownership and control to outside interests –not only outside the family, but also outside the traditional networks of relationships. This, ultimately, meant the end of the private bank character of these venerable institutions.

The conversion into a limited company and, especially, into a public company, had a number of advantages. It could offer tax advantages to partners; it removed the risk of large capital withdrawals following the death of a partner; it enabled the firm to offer better incentives to valued executives who could be lured by competitors; and it provided the firm with wider resources as they engaged in new activities, especially trading and principal investment, requiring ample capital, and had to incur the costs of new technology. Together with 'Big Bang' in 1986, which permitted banks to buy member firms of the Stock Exchange, this change of legal status gave merchant banks to possibility to catch up with Wall Street investment banks, which had undergone a similar development, turning into public companies in the 1960s and acquiring securities firms following the abolition of fixed commissions on the New York Stock Exchange in 1975.

As is well known, this didn't happen. Still fairly modest in size, merchant banks faced increasingly keen competition from American investment banks and big European universal banks, which bolstered their presence in London from the beginning of the nineties. The former were attracted by the prospects that Europe's economic and monetary union seemed to offer, while the latter wished to strengthen and diversify their international activities in various types of markets. After the first mergers at the end of the eighties, it was Baring Brothers' bankruptcy in February 1995 that sparked off a widespread buyout trend which led, in a few years, to the disappearance of the oldest and most prestigious segment of the British financial industry.

With the benefit of hindsight and a long term perspective, it is probably the longevity of the merchant banks rather than their abrupt disappearance which requires proper explanation.

This is of course a vast topic, which I have no time to develop, but let me briefly stress three points.

First, merchant banks' prominence before 1914 was due to the unique role of the City of London at a time when Britain was the world's dominant economy; and to the extreme specialisation of the English banking system. But even then, competition was stronger in the issuing business than in the accepting business, which had always been their core speciality, and which was the first to decline.

Second, for most of their history, merchant banks were private banks, in the sense of family-owned partnerships. And private banks have always flourished in fairly narrow segments within the world of banking and finance, in rather specialized activities, free from competition from joint stock banks. Merchant banks did eventually convert into public companies, though not always completely, and they never attained a sufficiently large size.

And third, the level of competition prevailing within the City's international sector was far less strong during the first globalisation (between the 1870s and 1931, with the interruption of the First World War), than it has been since the beginning of the second, from the 1980s onwards.

Have American investment banks been in a radically different position? In the end, they haven't done that much better. Most have succumbed to universal banks after the repeal the Glass Steagall Act in 1999 and the ravages of the subprime crisis in 2007-2008. Only two, Goldman Sachs and Morgan Stanley, have survived as independent entities –and have in fact converted into bank holding companies. In the post 2008 context, the question of 'why not a British one' has probably been less pressing than ten years earlier.

As I suggested at the beginning of my talk, the history of Baring Brothers epitomizes the history of London merchant banks –in terms of type activity, form of ownership, stages of development, strengths and weaknesses. But the history of Baring Brothers has also been exceptional –because of its early leadership in the field, its mythical rivalry with the Rothschilds, the unrivalled social assets of the family. And it has been more spectacular and more dramatic, with two crises bearing its name, which in their way have been historical landmarks. In 1890, Baring Brothers was definitely too big to fail and had the Bank of England let it collapse, most of the other big houses would have fallen with it. By 1995, it was no longer too big to fail, but by one of these ironies of history, most of the other houses exited with it.