

# Public Policy and British Multinational Banks, 1914-1982

Geoffrey Jones  
*University of Reading*

## Introduction

Until the 1960s, when the advent of the Eurodollar market transformed the banking industry, British-owned banks were the predominant form of multinational bank. From the 1830s, British banks had established overseas branches, first in British colonial settlements in Australia and Canada, later in Asia, Latin America, Africa, and even California. By 1914 a group of around 30 banks owned and operated almost 1,400 branches outside Britain [24]. By contrast American multinational banking was minimal at that time, and was to remain so for the following half century [37].

Public policy had helped to shape the distinctive corporate structure of British-style multinational banking in the nineteenth century. The first banks had been regulated by the Treasury which, concerned in particular about the safety of private note issues, had opposed multi-regional banks and the mixture of domestic and overseas banking [14, chapter 2]. The British multinational (or overseas) banks developed as specialists on a single region or even country, and this was made explicit in such corporate names as the London and River Plate Bank, Standard Bank of South Africa, and the National Bank of India. Some banks specialised in the finance of single commodities - there was the "sugar bank," the "cotton bank," and even the "currant bank." They had no domestic UK banking business and usually only a single UK office, which served as the seat of the Board [24]. Britain's domestic - or clearing - banks abstained from foreign direct investment, as did her merchant banks, which conducted trade finance and foreign loan issues through family partnerships and correspondent links.

From the time of the First World War British multinational banks experienced competitive pressures. They had flourished when Britain was the world's leading capital exporter, when British foreign trade represented a significant share of world trade, when Sterling was used to finance two-thirds of world trade, and when the British Empire covered a large part of the globe. As these conditions changed over the twentieth century, so the British banks had to struggle to maintain their positions. Within this context, after 1914 the highly specialised structure of British multinational banking began to be perceived as a competitive disadvantage. This story was related to, and part

of, the decline of the "free-standing" type of British foreign direct investment analysed by Mira Wilkins [36]. There was a widespread conviction that a closer integration between domestic and overseas banking would bring advantages, but there was no consensus about what needed to be done, and corporate change was remarkably slow. Indeed, even in 1992 the last parts of the story were being played out. The British government and the Bank of England, which remained privately owned until 1946, exercised a noteworthy influence on these developments.

### **State-Sponsored Multinational Banking**

The interwar years witnessed the extraordinary spectacle of the British government and/or its central bank promoting, subsidising and owning a number of multinational banks. These initiatives were mostly begun in the hothouse atmosphere of the First World War and immediately afterwards, and this largely explains their unusual and unexpected character.

In 1917 the British government promoted a new bank designed, in some respects, to perform the functions hitherto performed separately by overseas and domestic banks. The motivation was a belief that German banks provided better trade finance facilities than their British equivalents. The Faringdon Committee, appointed in 1916, heard evidence about the apparent willingness of German banks to offer longer credit to exporters than British ones, the propensity of German banks to act entrepreneurially, in alliance with German industry, and about the benefits of the integration of German domestic and overseas banking and industrial interests which seemed very effective in winning overseas contracts and promoting exports. The highly specialised British financial system worked well enough in its individual parts, but more integration was required between them if Britain was to compete successfully with Germany after the War [29]. The upshot was the British Trade Corporation, which was given a Royal Charter, but - largely because of opposition in the City of London - denied special state aid (financial or otherwise), forbidden to call itself a bank, and mandated not to compete with existing banking institutions [19, pp 139-142].

The BTC proved a forlorn experiment. In 1922 half the capital had to be written off. The Corporation faced a number of problems. Its business strategy was to penetrate former spheres of German trading influence where the German, Austrian, Turkish and Russian empires had collapsed, but a British-based bank had few, if any, competitive advantages in such regions. This problem was compounded by the requirement only to operate in areas not already served by a British bank, which was equivalent to condemning the BTC to operate in places no one had ever considered financially viable. Its initial branches were located in such unlikely places (for a British bank) as Batoum, Belgrade, and Danzig. Strategies designed to assist British foreign policy led to heavy losses in Russia during the Civil War period, yet failed to secure any concrete British government favours. By the mid-1920s BTC was ruined, though when an American syndicate attempted to purchase a 25% stockholding this was blocked by the government. Finally, in 1926 a merger was arranged with the Anglo-Austrian Bank.

Anglo-Austrian Bank had been founded in the middle of the nineteenth century by British interests, but by 1875 shareholding and control had shifted to Austria [17]. When the First World War broke out the Bank of England was a large creditor of Anglo-Austrian's London Office. In order to try to recover the debts, and as an aspect of the ambitious plans of the Bank of England's Governor, Montagu Norman, for the post-war monetary reconstruction of central Europe, a debt to equity scheme was devised under which the Anglo-Austrian Bank was reconstructed as a British-registered institution, largely controlled by the Bank of England. This made the British central bank the owner of a multinational bank operating (in 1920) 33 branches in Austria, 29 in Czechoslovakia, 3 each in Hungary and Rumania, 2 in Italy, and 1 in Yugoslavia [32].

This was not a good idea. In the immediate post-War period Anglo-Austrian did play some positive role in central European reconstruction [15, p 201], but the commercial strategy was disastrous. The management of the newly anglicised Anglo-Austrian Bank desired that British banking principles could be followed, but they had acquired a classic example of the very alien Continental "mixed banking" tradition. Central European banking practices proved puzzling to the British staff, as did - apparently - the German language [18]. The Bank of England had to provide considerable financial assistance to keep its bank in business, and by 1926 the Austrian branches alone had lost £1 million [24]. The fusion with BTC to form the Anglo-International Bank united two semi-bankrupt institutions. The Bank of England had to purchase a £1 million of new equity so as to re-capitalise this institution, which made it the majority owner.

The career of the Anglo-International Bank was as ill-fated as its predecessors. The General Manager was Peter Bark, the last Minister of Finance in Tsarist Russia. He disposed of the multinational branch network. By 1929 only two Rumanian branches remained, and these were finally sold in 1932, but by then the bank had been overwhelmed by the central European financial crisis. The collapse of Credit Anstalt in May 1931 was a devastating blow, for much of Anglo-International's business derived from its old Austrian connection. By October 1932, 83% of Anglo-International's assets were "more or less frozen," but the Bank of England resolved to soldier on because a formal bankruptcy would "reflect adversely on British Banking prestige" [4]. Anglo-International lingered for the remainder of the 1930s, the price of its shares kept up by small Bank of England purchases of the stock. The bank was not, its Chairman reflected in 1939, "a good advertisement for British Finance" [9]. In 1943 the Bank of England calculated that it had lost some £1.6 million since 1927 through its support for Anglo-International [10]. A year later the "goodwill" of the business was given to a British commercial bank, who took over the few remaining liabilities to the public.

The Bank of England also became entangled with a bank run by White Russians, the London and Eastern Trade Bank. In 1925 the Bank of England agreed that a wartime debt could be converted into equity, and so became the owner of a quarter of its shares. The 1931 Crisis ruined the bank's business, and over time it transpired that the energies of the directors were focussed on

paying themselves fees from what was left of the assets, thus providing another blow to the "prestige" of the Bank of England [35].

It was the British government, rather than the Bank of England, which was to blame for another costly official intervention in multinational banking. The idea of establishing a British bank to operate in Italy originated with a British commercial bank. The outcome in 1916 was the creation of two institutions, the British Italian Corporation in Britain and an Italian counterpart. There were ambitious hopes that these banks could challenge the pre-War German strength in many Italian industries, such as electricity. The government offered financial support to the venture, providing an annual subsidy of £50,000 for ten years, plus tax relief.

The British Italian Corporation soon experienced problems. It became involved in shipping finance, and was caught in the post-War shipping slump with a substantial shareholding in a shipping company. The plans to penetrate the Italian electricity industry failed, as did hopes of establishing exclusive relations with major British companies active in Italy. The Corporation's dividend payments had rested entirely on the government subsidy, which ceased in 1922. Nevertheless for a time the Banca Italo-Britannica appeared to flourish. It developed a substantial branch network and became the fourth or fifth largest among the Italian commercial banks, but at the end of the decade it was hit by crisis. In January 1929 the Bank of England was advised that if the Banca Italo-Britannica did not find £2.6 million within a week, it and the British Italian Corporation would have to be liquidated. The Bank of England obliged the three British clearing banks which held part of the equity to put up the sum, and had to provide £250,000 itself [30, pp 260-262].

A subsequent Bank of England investigation revealed some of the full horror of the incompetence and corruption at the Banca Italo-Britannica. The worst problems were at Rome, where large sums of money had been borrowed on short term from foreign banks in sterling and dollars, and had been utilised either for the purchase of securities or lent without authority to various debtors. The transactions had been kept secret in separate books and the balance between the totals of the debits and credits carried into the authorised books of the bank under false names. The most senior staff had been involved in the bribery of politicians and prostitution [31]. "The Italian conception of Banking is different from the British," one British investigator observed [26]. In 1930 the Italian bank was sold to the Bank of America. The three British clearers lost £5.4 million, and the Bank of England wrote off its £250,000 contribution.

The various public policy initiatives in interwar British multinational banking, therefore, achieved little except financial losses. They were self-evidently not the product of a single coherent strategy to modernise or upgrade British multinational banking, beyond a feeling that the specialised structure of British banking needed modification. Policies were ad hoc, full of ambiguities and contradictions, largely misconceived and poorly implemented. The interwar years were bad time for new banking ventures in Germany, Italy, and Central Europe, especially as British bankers lacked both knowledge of these markets and any obvious customer base. The decline of international trade, and of the British share of world trade, provided an

inhospitable environment for new multinational trade banks. More active British government support might have enabled the banks to locate a market niche, but this was not forthcoming. Moreover the consensus that the new banks were not to compete with existing institutions amounted to a virtual death sentence.

There are parallels with the attempts of the Bank of England in the interwar years to encourage the rationalisation and modernisation of Britain's troubled staple industries [33], provide regional assistance [21], and promote hire purchase [16]. All these policies were radical departures from normal central bank responsibilities. They were equally lacking in cohesion and effectiveness.

### **Public Policy as an Obstacle to Structural Change**

Curiously, while the government sponsored banks designed in part to overcome the specialised structure of British overseas banking, the Bank of England attempted to thwart the private sector's attempt to achieve a similar goal. During and after the First World War some overseas and domestic British banks sought to modify their heritage. Overseas banks which had specialised in the finance of a few commodities produced by a few countries felt a need to diversify their risks. Their "free-standing" organisation left them with a weak domestic British client base. The domestic banking system had evolved into a concentrated and oligopolistic structure by the end of the War. Some of the large clearing banks now perceived advantages to be gained from shifting from reliance on correspondent relationships to finance foreign trade towards owning their own overseas branches, which would permit the internalisation of intangible assets such as knowledge and reputation. Two of the "Big Five" clearing banks, Barclays and Lloyds, were particularly active in purchasing shares in overseas banks, while they (and others) also established greenfield branches in Continental Europe [24, 22].

Initially, the acquisition of overseas banks by domestic banks ran into official opposition because it ran counter to official policy to prevent further concentration in the banking sector. By the early 1920s, however, the central concern became the potential threat to banking stability should one of the clearer's overseas ventures go badly awry. One Bank of England adviser warned "how easily trouble can arise among "excitable Latin races" [2]. Montagu Norman readily espoused such views. The whole concept of domestic banks engaged in multinational banking threatened the specialised nature of British financial institutions, which he held produced stability, the preservation of which was his primary concern. There was a considerable element of misapprehension in Norman's argument. The specialised system had reduced risk in the nineteenth century, but potentially had the opposite effect in the twentieth. British banks which had specialised on individual countries or regions producing a few commodities were greatly exposed to risk as raw material prices and politics became unpredictable after the First World War.

Norman maintained his views for the next twenty years. In 1925, when Barclays formed a new multinational subsidiary, Barclays (DCO), by merging

banks active in the West Indies, South Africa," and Egypt, Norman violently objected, though Barclays persisted with its scheme [3]. The Bank of England closed down the accounts, and discriminated against the acceptances, of all overseas banks controlled by clearers, and all through the 1930s the bills of such banks carried slightly higher rates of discount [30, pp 244-248]. Norman tried various schemes to rid the clearers of the multinational operations. In 1936 he proposed that the Bank of England itself should buy Barclays (DCO), which had become the UK's largest overseas bank [7]. He tried to block the opening of new foreign branches by it [8]. He was equally energetic - and unsuccessful - in trying to get Lloyds to divest itself of operations in India and elsewhere [5]. In 1943, in the middle of the Second World War, he proposed merging all the Lloyds and Barclays' overseas operations and floating them off as a separate concern [11].

Norman never made his policy effective. He was not strongly supported by the Treasury [34]. Worse still, he also found himself encouraging the further expansion of the multinational interests of the clearers when the collapse of overseas banks threatened the financial system. When Cox's, an overseas bank with branches in India and Egypt, ran into trouble in 1923, Norman asked Lloyds to take it over "in the interest of the community" [1]. A more prolonged rescue operation was needed with the collapse, at a most inopportune moment in 1931, of the Anglo-South American Bank, which had branches all over Latin America. Lloyds was part-owner of the other London-based South American bank, Bolsa. Initially Lloyds refused a Bank of England request to come to the rescue, but eventually (in 1936) Anglo-South was merged into Bolsa, even though it involved - in Norman's words - the "condoning of Lloyds' 'sin' in South America" [6].

The Bank of England, therefore, failed to prevent the acquisition of multinational investments by some domestic banks. However, it certainly slowed down the trend. By the time of the Second World War, Britain still possessed a large number of independent overseas banks, and three of the Big Five clearers had few, if any, overseas branches. The Bank may have also hindered the creation of appropriate multinational corporate structures at Barclays and Lloyds. Barclays remained only a part-owner of DCO. Lloyds acquired, in whole or part, banks active in Latin America, Continental Europe, India and New Zealand, but they were for the most part left to function as partly-owned independent entities, which were poorly managed and loss-making [24]. As Chandler and others have shown, the creation of managerial hierarchies did not come easily to twentieth century British business, but in this instance the public policy context was visibly unhelpful.

In the 1950s and 1960s the relative economic and political decline of the United Kingdom caused growing pressures on the overseas banks. Their core market was shrinking, and they were exposed to economic nationalism in the developing world. As small, undercapitalised institutions, they were also exposed to hostile takeovers [24]. One solution was merger among themselves, to create larger banks, or multi-regional banks. The Bank of England supported such mergers, not least because it did not want the small overseas banks to be bought up by American banks, but it would do nothing

to initiate any corporate reorganisation, for it governed the City of London not by regulations but by "nods and winks" [23, p 126]. The Bank would not coerce, or make any suggestion that would involve it in taking responsibility for the consequences of a decision. As a result, the Bank refused to act as a "visible hand" to overcome negotiations deadlocked by vested interests and distinctive corporate cultures.

In a characteristically British fashion, the Bank of England attempted to influence the structure of British overseas banking not by regulation but by hints and informal discussions. It used its influence to place former officials on the Boards of banks, a tactic which it has used up to the present day. By the 1960s the two banks most active in corporate reorganisation schemes, Bolsa and Standard Bank, both had former Bank of England officials as their Chairmen [24]. The view that if the "right man" was put in charge appropriate policies would be pursued was sensible, but only to a point, because the Bank of England thereafter left them to their own devices. It was not a strategy which facilitated rapid results.

While the Bank of England would do little to coerce the individual overseas banks into merging, it was rather more active in blocking their integration with either British domestic or American banks. After 1945 the Bank of England's overt hostility to multinational activity by the clearing banks weakened, but the sentiment remained the same. When one overseas bank mentioned the idea of a possible merger with Lloyds or another clearer in 1955, this was firmly ruled out by the Bank of England on the grounds that "they and the rest of the Clearers have more than enough with which to occupy themselves at home" [12]. It was not until the early 1960s that a policy change can be detected, as the Bank of England became increasingly alarmed about American penetration of the British banking system, and determined to prevent Americans acquiring control over an overseas bank. Several overseas banks actively sought American bank shareholders in the late 1950s and 1960s, partly as a means to secure dollar funds, but the Bank of England sought to limit such American investment, although there was no actual law against foreign ownership of British banks. Mellon's investment in Bolsa and Chase's stake in Standard Bank in 1965 were both kept to 15% at the Bank of England's request. In 1968 Citibank was allowed to take a 40% stake in National and Grindlays, but the Governor "insisted" that "British control of the bank was effectively maintained" [13].

Public policy helped to ensure that the reorganisation of British multinational banking proceeded at a leisurely pace. In the 1960s the pressure on the existing corporate structure intensified. British banks as a group appeared to have a valuable franchise in the new era of global banking - with headquarters in London, the home of the Eurodollar market, and world-wide branch networks - but these assets stood in need of reorganisation. Numerous merger proposals were discussed over the 1960s. The upshot, at the every end of the decade, was the formation of ANZ, which merged the two remaining British banks in Australia, and Standard Chartered, which merged two of the leading British banks active in Africa and Asia, while the minority shareholders in the Lloyds and Barclays overseas banking groups were finally brought out, and wholly-owned international subsidiaries formed [24].

The reorganisation left three large survivors of the overseas banking tradition with large branch networks and almost no UK business. There were ANZ, Standard Chartered, and the peculiar case of the Hongkong Bank, which was registered in Hong Kong but British managed. ANZ solved its problems by taking Australian nationality in 1976 [27, pp 296-299]. During the 1970s Standard Chartered and the Hongkong Bank followed the fashionable strategy of diversification and globalisation. They both purchased large American banks in 1979/80 [25, chapters 16 and 17]. They also sought a British presence, and it was this which led them to bid for the Royal Bank of Scotland, one of the "Big Three" Scottish clearing banks.

When the Royal Bank and Standard Chartered began negotiations, the Bank of England was informed and, unlike in earlier years, supported the proposed integration of domestic and overseas banking, believing that it might enhance the competitiveness of British international banking, as well as create a desirable "fifth force" in domestic banking. In March 1981 Standard Chartered announced a £334 million agreed bid for the Royal Bank of Scotland Group. Three weeks later the Hongkong Bank made a higher counter-bid.

The Hongkong Bank bid infuriated the Bank of England, which had agreed to the Standard Chartered proposal and, when Hongkong Bank's Chairman advised of his intentions, had asked him not to proceed. When the Hongkong Bank ignored his advice, the Governor of the Bank of England did everything possible to block its bid. The evidence of the Bank of England to the Monopolies and Mergers Commission - the British government's anti-trust regulatory agency - vigorously opposed the Hongkong Bank bid. It objected to the Hongkong Bank's "overseas" ownership and control; it suggested that Hong Kong's banking regulations were inadequate; and it even criticised Hongkong Bank's management of other acquired banks. However, the fundamental objection was that the Governor's authority in the City of London would be fatally weakened if his authority was flouted [20 pp. 122-126]. Although the Bank of England supported the Standard Chartered offer, the extreme ferocity of its opposition to the Hongkong Bank contributed significantly to an atmosphere in which the preservation of the Royal Bank's Scottish identity was seen to be a crucial matter. The affair became entangled with Scottish nationalism and in 1982 both bids were ruled out by the Commission, which stressed the need to retain an autonomous Scottish banking system with ultimate decisions taken in Scotland [28].

The subsequent decade proved difficult for both the overseas banks. Standard Chartered lost strategic direction, and, faced by accumulating bad debts, had to divest from the United States. It was saved from a hostile takeover by Lloyds by a group of Far Eastern and Australian business magnates, and for a time its very future seemed in doubt. Hongkong Bank sought another route to Britain by buying, in 1987, almost 15% of the equity of Midland Bank, another "Big Four" British domestic bank which had just lost £1 billion through an ill-fated acquisition of Crocker National of California. After a troubled courtship, the Hongkong Bank announced a full - and agreed - takeover bid for the Midland Bank in March 1992 which, if successful, promised to create the world's largest transcontinental bank, an



integration of a domestic and an overseas bank which had been discussed for so long 24].

## Conclusion

British public policy towards banking prioritized stability above all else. This had positive consequences, largely unmentioned in this article. The major interwar banking collapse of the Anglo-South American Bank was handled well, and did not lead to a general crisis of confidence. Post-1945, the Bank of England created the stable and reliable regulatory framework which made London the home of the Eurodollar market. But the pursuit of stability also had its costs. In domestic banking, official policy allowed and encouraged a collusive and uncompetitive oligopoly to prevail between the 1920s and the 1970s [3]. In multinational banking, the Bank of England functioned best at resisting corporate restructuring. In contrast, it was hesitant and ineffective in promoting changes it considered to be necessary. Public policy played a part in the relative decline in international importance of British-owned banks. In the 1960s British banks, with almost 4,000 overseas branches, had far more extensive multinational operations than those of any other nationality. By 1990 British banks accounted for only around 5% of the international assets of banks, behind not only Japan (35%) and the United States (12%), but also Germany (10%) and France (9%).

British-style "administrative guidance" emerges from this study as a rather toothless relative of its Japanese equivalent. In both countries public policy was often implemented by informal influence and personal contact, but there was a striking difference between the effectiveness of the two systems. In Britain, attempts to create new corporate entities were half-hearted, constrained by a refusal to challenge vested interests. Radical change was seen as a threat. Preferred policies were to nod and wink and to graft good chaps onto bank boards. In multinational banking, as in so much else, British public policy in the twentieth century played its part in helping British business to remain unchanged in a changing environment.

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