American Private Banks in International Banking and Industrial Finance, 1870-1914

Vincent P. Carosso,
William R. Kenan, Jr. Professor of History
New York University

This paper is a summary of a section of a longer joint essay, with Professor Richard E. Sylla, prepared for the Conference on International Banking and Industrial Finance (1870-1914), to be held at Bellagio, Italy (August 19-23, 1985), and headed by Professors Rondo Cameron of Emory University, Atlanta, and V. I. Bovykin of the Institute of History of the USSR, Moscow.

Between 1870 and 1914 private banks (unincorporated proprietorships and partnerships) occupied a strategic place in American domestic and foreign finance. Not much is known about these institutions (neither their number, capital, nor functions can be cited with certainty). Nor were all private banks alike. The differences among them were as great as those among the country's chartered banks. The available evidence suggests that only a relatively few of them, perhaps no more than a score or two altogether, dominated pre-World War I America's international banking business. The members of this small group, led by such well-known firms as J. P. Morgan & Co., Kuhn, Loeb & Co.,

BUSINESS AND ECONOMIC HISTORY, Second Series, Volume Fourteen, 1985.
Copyright (c) 1985 by the Board of Trustees of the University of Illinois.
Library of Congress Catalog No. 85-072859.

Speyer & Co., Brown Brothers, Kidder, Peabody & Co., and a few other New York, Boston, and Philadelphia houses, financed much of the nation's foreign trade and managed most of the era's long-term capital imports and exports.

That America's private banks should occupy so preeminent a place in the country's international financial transactions is understandable. They were the intermediaries with the longest tradition, most varied experience, and strongest overseas banking and business connections. Their most important foreign financial ties were with London. The connection generally took two forms: the organization of Anglo-American partnerships or the establishment of agency arrangements between the two countries' private bankers. By the beginning of the 1870s, upward of a half-dozen American banks had opened London offices. A few of them, such as Philadelphia's Drexel & Co., established themselves at Paris before they entered London. The same kind of interlocking partnership and agency arrangements also were employed by Europe's merchant banks seeking representation in the United States.

What was the nature of the business that occupied America's top private banking partnerships? The international operations of private banks, as noted, encompassed two broad areas. They financed the movement of goods from one country to another, and they dealt in government and corporate securities on the world's principal capital markets.

Private banks extended their trade clients all the standard banking facilities -- short- and long-term credits (both covered and uncovered), provided them with foreign exchange, arranged collections and payments, and often also held their deposits. The commercial credits business gave private banks a close knowledge of commodity markets and prices, information they used to buy and sell goods on their own or on joint-account with their agents and correspondents. The information, experience, and connections accumulated from their mercantile activities were the bases upon which private banks built their securities business. Corporations, starting with the railroads, turned to private banks for the funds they needed to build, improve, and expand their enterprises; and governments looked to them to finance their economic and political objectives, such as providing the money to modernize their economies, balance budgets, meet interest payments on earlier loans, pay for wars, and influence diplomatic policy. None of the major or lesser powers had the slightest compunction in pressing its bankers to serve the government's perceived needs.

Private banks satisfied the long-term capital needs of governments and corporations by issuing bonds, many of which they sold through international banking syndicates. The new issues business was a highly concentrated oligopoly. Its members were well-known to one another and, despite an occasional disagreement among themselves, adhered strictly to the accepted traditions of the business. The fact they did so added to their strength and influence.

The private banks' high place among the world's financial inter mediaries did not rest solely on the quality of their services. Apart from their unmatched ability to recruit large amounts of investment capital, the private banks' other great source of prestige and authority grew out of the nonfinancial services they provided their clients. Unlike the private banker's role in financing government's, which was essentially that of an intermediary employed to fulfill a specific service -- arrange a short-term advance, sell a loan, buy gold or exchange -- his relationship to the businesses he advanced monies ranged far more widely. Besides extending them all the same financial facilities provided governments, private bankers also served their business clients in a variety of significant entrepreneurial capacities.

Active banking participation in the management of enterprises to which they had extended credit occurred most frequently at times of uncertainty or when the business was in financial trouble. Bankers generally undertook nonfinancial responsibilities out of necessity -- to protect their own reputations (their single greatest asset) and the interests of the investors to whom they had sold the securities. These were the reasons that motivated the Morgan firms to intervene in the affairs of the companies they financed.[1] Neither Junius Morgan, nor his son Pierpont, nor any of their partners wanted to be railroad or industrial entrepreneurs. So opposed were they to assuming management responsibilities that they repeatedly declined to finance companies that appeared might require them to accept such assignments. The Morgans preferred to serve the needs of well-established, capably managed companies with adequate credit and satisfactory earnings. The fact that they stood ready to accept management responsibilities, when it appeared to them necessary to do so, made the Morgan partners among the most influential business leaders of their day.

Bankers intervened as aggressively in the affairs of their financially pressed mercantile clients as they did in the operations of the railroad and industrial corporations they served. The Morgan firms, for example, monitored closely the disposition of the credits they extended their mercantile clients, determined the bases upon which the business was to be conducted, and, when necessary, assigned a partner to supervise the enforcement of the houses' standards. The nonfinancial functions bankers assumed in advising commercial credit clients they considered over-extended included all the duties commonly expected of a business executive.

Such too was the case when bankers ministered to their financially ailing and bankrupt corporate clients. The rehabilitation of the Cairo & Vincennes (C&V), a strategically located 157-mile railroad in Illinois, which the London and New York Morgan firms reorganized, illustrates the range of entrepreneurial functions bankers assumed to save a tottering client. Restoration of the property took eight years, from June 1873, two months after the company had missed a scheduled interest payment on a £700,000 bond offering issued by London's J. S. Morgan & Co., to July 1881 when the firm arranged to have the C & V leased to the Wabash, St. Louis and Pacific Railway.

[1]Much of the information for this paper is taken from the first volume of my forthcoming study, "The Morgans: Private International Bankers (1870-1914)."

During that eight-year period the London house, assisted by its New York agent, Drexel, Morgan & Co., was in total control of the property. The two firms advanced the money to keep the road in operation, negotiated with the line's builders not to press for payments on overdue bills, forced the resignation of the company's board and the election of another of their own choosing, and supervised all disbursements and collections. The London house made Pierpont Morgan its official representative and the effective boss of the company. He hired engineers and contractors to inspect and improve the property, bought new equipment, purchased connecting lines to make the C & V more attractive to potential lessees, and appointed managers to execute his orders. When these measures proved insufficient to secure the road's full recovery, the London firm sold the road under foreclosure. The reorganization that followed was designed to accomplish two purposes: reduce the road's charges and protect the interests of the first mortgage holders by exchanging their bonds for the new C & V's common shares. The road's former mortgagees became the reorganized company's owners. Pierpont Morgan, the C & V's real head for the past half-dozen years, was elected the new president, a post he held until the line was leased to the Wabash. Salvaging the C & V proved costly. The London firm's losses on the "miserable business," as Pierpont Morgan called it, totaled a hefty £472,500 [3].[2]

Other private bankers fulfilled the same entrepreneurial functions for their troubled rail clients. The financial, administrative, and managerial reforms bankers used to salvage the faltering roads of the 1870s and 1880s were subsequently employed to rehabilitate most of the lines that went into bankruptcy during the depression of the 1890s.

Private bankers played a similarly large entrepreneurial role in the industrial companies they financed. The structure and management of the General Electric Company was largely deter-

---

[2]I am indebted to the late Mr. Henry S. Morgan for securing me access to this collection of Morgan papers.

mined by Drexel, Morgan & Co., not by the Edison Company, which had initiated the merger talks. The consolidation plan that was adopted was mostly the work of Pierpont Morgan and his partner, Charles H. Coster. They, more than anyone else, were responsible for the shape of the new company, which proved to be entirely different from the one proposed by Henry Villard, the Edison Company's president. He and Thomas Edison had planned to have their company, with its larger assets and output, take over Thomas-Houston. Morgan and Coster, acting more like industrial entrepreneurs than bankers, achieved the exact opposite. The better managed Thomson-Houston Company absorbed Edison Company [1; 2].

Industrial mergers, like railroad reorganizations, involved bankers in numerous entrepreneurial decisions of far-reaching importance. Morgan and Coster were both bankers and businessmen. It is probably no exaggeration to say that the Morgan partners, perhaps as many as half of them at any time, were as heavily engaged in shaping some of their clients' business decisions as they were in satisfying their financial needs. Banking intervention in corporate policymaking usually resulted in more conservative, prudent, investor-conscious managements, tighter accounting controls, and improved administrative practices.

Bankers also accelerated the spread of advanced scientific and technological skills and equipment. The Morgan firms' long association with the Argentina Great Western is a case in point. The Morgan firms' relations with the company involved them in a complex mix of financial, entrepreneurial, and technological decisions. Besides managing the road's foreign bond offerings, arranging its short-term sterling advances, maintaining a market in its shares, and acting as its fiscal agent, the London house, which headed the account, also helped select the company's engineers, contractors, suppliers, and lawyers. The firm participated in the Great Western's subsidy negotiations with the government, which guaranteed the road's bonds, helped arrange most large equipment purchases, and advised the company's officers on construction and maintenance contracts. The London firm's large holding of the road's stock, mostly acquired in payment for issuing the company's bonds, gave J. S. Morgan & Co. "practical control" of the property. The firm exercised its authority during the Argentine depression of the late 1880s and early 1890s, when the road's depressed earnings, made worse by bad management, forced J. S. Morgan & Co. to take over the company's operations. The firm, aided by Morgan's Buenos Aires agent, hired engineers to inspect the property, selected supervisors to check repairs, appointed maintenance personnel, chose auditors to impose strict accounting controls and enforce a stiff retrenchment program, and dictated the choice of a new general manager. It took J. S. Morgan & Co. six years to restore the Great Western to financial stability, reform its management, and update its roadway and equipment [3].

Experiences of that kind made established private bankers reluctant to finance new industries and untested companies, especially those doing business in countries where the partners had few strong connections. The Morgan firms generally avoided new promotions. Those in which they did participate usually were undertaken as members of a small group composed of other banking houses and the promotion's sponsors. Arrangements of this type had several advantages. They limited the bankers' exposure, while allowing them to earn interest, fees, and commissions on the financial services they extended the group. London's Morgan & Co., for example, was both a promoter of and banker for the Caucasus Copper Company, an English corporation set up to explore and develop mining properties. Much the same relationship existed between J. P. Morgan & Co. and the Alaska Syndicate, the well-publicized group set up in June 1906 to explore the territory's copper, coal, and other resources. Neither firm assumed any management responsibilities in its promotion. All each house did was to serve its group's banking needs, mostly advancing credits.

Promotions like the Morgan firms' participations in Alaska and the Caucasus accounted for an insignificant share of their total business. Neither firm earned much from its promotions. Nor does it appear that most other leading international private banks were any more involved in the ventures they promoted, though much more research into the business of these houses is needed to assess the nature and extent of their contribution to the development of new, high-risk enterprises. If the record of the Morgan houses is any indication, the role of America's top private banks in financing new enterprises was minimal. The Morgans' principal business, like that of the other foreign and domestic banking houses with which they competed and cooperated, was financing trade, arranging government loans, and satisfying the capital requirements of established corporations. Their activities as government and corporate bankers, the reorganizers and consolidators of large businesses, gave private bankers immense influence. More than any other group of financial intermediaries, the private banker was chiefly responsible for the rise of giant enterprises, the consolidation of i'industries, and the organization of the earliest multinationals.

REFERENCES

1. Dietrich G. Buss, *Henry Villard, A Study of Transatlantic Investments and Interests, 1870-1895* (New York, 1978), pp. 218-20.

2. Alfred D.Chandler, Jr., *The Visible Hand: The Managerial Revolution in American Business* (Cambridge, MA: Harvard University Press, 1977), pp. 427-28.

3. J. S. Morgan & Co., *Papers*, Morgan, Grenfell & Co., London.