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Weak Multinational Banking in Latin America. The London Bank of Mexico and South America, 1863-1903

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Introduction: Globalization and Foreign Banking in Latin America

The last third of the nineteenth century saw the rise and consolidation of an unprecedented stage of international economic integration and interdependence, now believed to amount to a very first globalization, that prolonged itself until the First World War. A relatively free and widening movement of capital, people and goods, fuelled by diminishing transport costs and substantial advance in information technology (submarine telegraphy), multiplied the reach and density of external connections between economies, through market mechanism as well as hierarchy (international firms). This was not an even and uniform process, neither from the geographic nor the sectoral angle. From the latter point of view, finance was an absolute protagonist, due to three related aspects: 1) the growth of trade, surpassing the growth in production, implied huge volumes of trade financing; 2) international finance channeled enormous amounts of funds in the shape of loans to governments and bond issuing; 3) international banking spread from European sources to numerous countries over various continents. Through the position of its external commerce, the leading role in foreign investment and intermediation, and the pound centrality in the gold standard regime, financial globalization was predominantly (but in no way uniquely) British driven.

Large differences between its economies notwithstanding, Latin America participated significantly in this process, resulting in a trend of integration within the Atlantic economy. This trend was not homogenous but distributed in quite a dissimilar way over countries and periods, and produced a sequence of booms and falls in emerging and "disemerging" markets. British overseas banks were the first foreign-owned banking enterprises to establish in Latin America and since the 1860s, represented an important financial connection for the main countries in the area. How much global were these economic actors? Were they foreign investors and promoters of British interests? Which was their contribution to the domestic financial system and their integration? The case of Argentina and Brazil have attracted a great deal of attention, due to the outstanding export performance of the two countries and the size of British investment in them. Much less is known about other countries, like Mexico and Peru, even if the presence of British banks was a pioneer one and of paramount importance for the development of the financial system. The London Bank of Mexico and South America, besides attempting to establishing roots in other areas (Colombia, Chile) operated during more than three decades in those two nations, and experienced a conspicuous set of adaptations and organizational changes which included creating domestic banks, abandonment of the banking business and turning into a financial company. Its trajectory sheds light on three interrelated strains of experience: a) foreign banking in Mexico and Peru during the last third of the nineteenth century: in both countries London Bank of Mexico was by far the biggest foreign bank and the only one with a continuous presence; b) the earlier growth of financial system in host countries, since during a significant span of time this British bank was the only or the main existing bank, and its exit from the two countries passed through the merger with, or the sale to domestic groups; c) the retreat of Latin American British direct and entrepreneurial investment into portfolio holdings.

Within this frame of reference, the purpose of this paper is to analyze the issue that we consider to be the salient one in this experience of British overseas banking, i.e., the organizational transformations that the bank experienced and the consequences for the business. Were they adjustments to the fluctuations of political economies in the host countries, or a response to institutional and liquidity changes in London? Did they conform to a strategy? In which way the financial instability affected the structure of capital of the bank and, in turn, displaced its activities and affected its business behavior? Which degree of control was the LBM-SA able to exert on the external connections? The analysis of these points structure the sections of this paper, introduced by a sketch of the evolution of London Bank of Mexico and South America evolution.

1. An outline of London Bank of Mexico and South America history

LBM-SA incorporation took place in the midst of a brief era of intense creation of British-overseas banks.[1] Within the British banking firms organized in the first Latin American wave, aimed at establishing bi-national operations (London headquarters and one particular country), London Bank of Mexico and South America (hence LBM-SA) was the only one intended to operating in several countries.[2] This feature marked a considerable difference, and one that marked the successive evolution and performance of the bank.

Initial operations started in Mexico, Peru and Colombia, where the LBM-SA represented the first bank and joined the privilege of issue; but after few years confined to the first two seats, since there was a retreat from Colombia and a Chilean attempt failed in the 1870's. LBM-SA set up operations abroad, whilst the head office in London operated as coordinating agency; due to the state of information technology, each national branch enjoyed a considerable degree of autonomy, that allowed the local manager to play a key role in determining the scale, scope and direction of local business. The head office intervened on major deals as well as on assistance with the discount of export/import bills,

[1] Between 1862 and 1866 25 such banks were established throughout the world: in Latin America during the two key years of 1862-1863 two such banks were set up in Brazil, one in Argentina, and one in Venezuela.
[2] Owing to its incorporation in 1864 as the result of merging of two British banking ventures: the plan of a group of investors to incorporate the Bank of Mexico Ltd., on one side; and the London and South America Bank launching, bound to set up branches on the West Coast of South America, on the other. Marichal and Riguzzi (2006).

which made up a large share of the bank's business.[3] Even if the structure of operations was determined by a variety of factors, both in Mexico and Peru, the bank had a minimal administrative staff at the start: general manager, accountant, cashier and collector.[4]

In all the selected countries various exogenous shocks hit LBM-SA, and the bank survived thanks to several adjustments and reorganizations. Particularly, the traumatic end of the Peruvian guano boom resulting in fiscal bankruptcy, which was followed by the War with Chile, decreased LBM-SA commitments and presence in that country. This pattern held until the late 1880s, when a chain of events changed the nature of the firm. In this year the Mexican branch turned into a domestic bank, the *Banco de Londres y México*, in which LBM-SA retained, initially, a controlling interest. In a similar fashion, during the 1890s, the Peruvian branch gave life to a Peruvian bank, *the Banco de Londres y Perú* and LBM-SA ceased to be a banker at all. In both cases it became a majority stockholder (with a considerable degree of control) in local banks, but this outcome was only temporary, and gave way, at last, to a minority shareholding position without effective control on the business. The displacement coupled with a disinvesting strategy in Mexico and Peru, while LBM SA began to diversify, beginning with Argentina, its portfolio investments in the Latin American banking sector. Hence it became a financial holding company rather than an overseas banking firm. By 1912, Anglo-South American, the leading British bank in the area, absorbed the London Bank of Mexico and South America. No other British banks operated in Mexico and Peru, until in 1919 Anglo-South established branches in the two countries.

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[3] Joslin (1963), p. 88
[4] Cien años de banca (1964); Camprubí (1957)

2. **The organizational transformations of the bank**

The London Bank of Mexico and South America was born following the model described by Geoffrey Jones as "a set of single-unit banks joined in a federation to a centre" (the head office) that provided the general guide-lines and acted as a lender of last resort".[5] The most distinctive feature of LBM-SA development was the sequence of changes in its structure and pattern of operations, that ultimately led the British firm to lose its branches abroad and move beyond the specific bank's attributes. Table 1 present such changes.

Table 1. LBM SA in Latin America, 1864-1912: stages and pattern of operations

	Nature	Fields and activities	Main field
1864-1878	British "Latin American" Bank	Colombia, Mexico, Peru, Chile	Peru (until 1878)
1879-1888	Tri-national Bank	London (liquidity management) Mexico (bank of issue)-Peru (commercial bank)	Mexico
1889-1896	Dual Organization	Mexico: majority shareholder in local bank – Peru: commercial bank	Mexico
1897-1903	British Financial Investor with supervision	Minority shareholder in three banks of Argentina, Mexico and Peru	Balanced
1903-1911	Investment company	Shareholding in several Latin American Banks	Diversified
1912	Merger into Anglo-South American Bank		

The argument presented in this paper centers on the nexus between instability and weakness as the key to explaining the recurrent modifications in the boundaries and the structure of the firm. The countries that LBM-SA chose as operating fields featured a high degree of macroeconomic and political instability, which determined the development of the bank. The timing and succession of such shocks weakened the bank's institutional bases, in part because of the fragility given by LBM-SA free-banking regime and culture; in turn, this led to undergo successive arrangements that segmented its trajectory and

[5] Jones (1993), p. 43

deviated it from the original horizon. From the bank’s point of view, the whole process took the shape of clusters of exogenous shocks that hit the bank’s activities, and the adjusting responses. To explain the mechanism of this chain, an analysis of the connections between the “macro” aspects of instability and the “micro” foundations of the conduct at the firm level, is required. What this purpose in mind, the first step is table 2 display of the major intervening shocks, clustered in four stages.

Table 2. Exogenous shocks, 1865-1896

	Mexico	**Peru**	**Colombia**
1. 1865-67	Insurgency and fall of the Maximilian regime. Insolvency		Loss of tobacco crops; monetary crisis.
2. 1875-77		Fiscal bankruptcy; insolvency, convertibility, suspended, prolonged economic downturn	
1876	Civil war and new government		**Chile**
1879-83		War with Chile and economic collapse	Financial crisis and convertibility suspended
3. 1884-85	Attempt of expulsion		
1885-1886		Civil War	
4. 1896	Mexican investors’ take over of Banco de Londres		

How did these events affect LBM-SA operations and organization?

The First stage

The economic and political setting in each country in which the LBM-SA established were all marked in the early 1860s by favorable macroeconomic and political outlooks. Table 3 offers an overall picture of the primary "pull factors" that the three countries exhibited.

Table 3. Favorable conditions for LBM-SA in Colombia, Mexico and Peru

	Colombia	Mexico	Peru
Imports from Great Britain 1860-62 (£000)	801	601	1133
British firms operating	?	1 Railway; 2 mints; handful of small mines	1 Railway; 1 dock
External Loans	1863	1864	1863
Political stability	New Constitution	French backed Monarchy	New Constitution
Chief Resources	Tobacco	Silver (Eastern drain)	Guano
Banks in operation	NO	NO	1 small bank
Privilege of issue	YES	YES	YES
Banking regulation	NO	NO	NO
Currency	Silver and gold	Silver	Silver

In the three cases, it is observable the conjunction of expectations regarding political stability with the increase of trade, the flourishing of new export activities (guano, tobacco) or of their importance to the world commerce (silver), and access to external finance.[6] Besides the coincident favorable economic outlook in each country, the monetary and financial institutions of the three locations provided a common attractiveness, in that they

[6] In Peru it was the time of the guano export boom, which made the Peruvian state the richest of Latin America in fiscal terms and converted it in one of the largest world debtors. There was a thriving import growth and an intense cycle of investment in railroad construction and port modernization. See Bonilla (1986) and Gootenberg (1993). In Colombia, the substantial tobacco exports since the 1850s exceeded the traditional gold mining activities and, driven by very advantageous terms of trade, nourished the perspective of a growing prosperity; furthermore, positive outlooks accompanied the federalist Constitution of 1863. See Ocampo (1984), pp. 212-219. As regards Mexico, expectations rested on the establishment of the Empire of Maximilian of Habsburg, backed by Napoleon III and the French Army, and believed to be able to pacify the country and provide institutional stability. Moreover, the immediate boom in silver exports (Mexico was world leader in silver production), coped with the great demand provoked by the Eastern drainage. Alongside

allowed a complete set of free-banking operations. No barriers of entry, absence of competitors, no banking regulation and privilege of issuing notes, within system of metallic circulation, were thought to guarantee an open, low-risk field for overseas banking. This open field, free of governmental interference and hedged against inflation by the specie currency, would allow LBM-SA to direct its business to financially sound activities, according to British banking standards: the import/export trade, the discounting of bills, acceptances, and exchange transactions.

This scenario saw substantial changes since 1866, owing to the chain effects of the Overend Gurney crisis in London, the monetary crisis in Colombia and the insurgency against the Maximilian regime in Mexico, that brought to its fall. These last two developments amounted to quite a significant reversal of expectations. How LBM-SA strategy coped with this new scenario? Table 4 indicates the responsive adaptations.

Table 4. Round 1 of external shocks and LBM-SA response

<table>
<tr><th></th><th>Problems</th><th>Local response</th><th>Global (firm) response</th></tr>
<tr><td>Colombia</td><td>Monetary crisis, inconvertibility and losses</td><td>Exit</td><td rowspan="2">1) Capital structure: shares cancelled and reduction of the uncalled liability
2) Shifting the assets weight to Peru
3) Expansion toward Chile</td></tr>
<tr><td>Mexico</td><td>Recovery from war, business stagnation and political hostility</td><td>Defensive attitude and disinvestment</td></tr>
</table>

All of these circumstances caused a set of interrelated changes within the banking enterprise, both at a local and more general level. In Colombia, the decline in international tobacco price and the worsening terms of trade caused specie drainage and recession. By 1866 the government had the mint to debase the silver coins, and put in circulation

of silver, the possibility of a sudden cotton expansion in response to American Civil War, fuelled the British interest for Mexico and for Peru.

unconvertible treasury notes, with redeeming power.[7] The downturn caught LBM-SA overextended and debtors' insolvencies hit hard its resources; by 1868 the London headquarters decided to liquidate the Colombian business, and realize assets, with an estimated loss of £28,000.

In Mexico, in the light of its much heavier involvement, LBM-SA faced a more problematic situation, with the following characteristics: 1) prolonged rupture of diplomatic relations between Mexico y Great Britain 2) the disappearance of the network of British merchant houses in Mexico, affected by bankruptcies and exit[8] 3) a drastic decline in foreign trade after the brief boom of 1863-1866 (by 1867-1869 the average drop was equivalent to 59%). 4) a trend towards autarchy of large sections of the Mexican economy, accompanied by debt insolvency and hostility towards foreign firms.[9] LBM-SA pulled back from many its former activities in the private sector, especially dropping most of its business in the rural sectors, having suffered the lack of credible mortgage legislation and the ending of an ephemeral cotton expansion. On the other hand, the bank avoided all transactions related to the government: did not participate in any new financing for the Juárez and Lerdo administrations nor in any of the negotiations on the Mexican external debt promoted by the Council of Foreign Bondholders. This left the bank's funds safe from the forced loans that the government required from merchant houses after 1867; at the same time, its banknotes were not accepted in government and tax offices. LBM-SA responded by not making public information on its activities. The Mexican branch concentrated most of its efforts in exchange and the silver trade, which constituted the leading item of the

[7] Torres (1994)
[8] With the effect of susbstantially weakening the regional presence and the information network of the bank.

export trade, provided for the payments of import and was also a means of constituting balances abroad for wealthy individuals.[10] This led the bank to function as a vehicle for capital remittances from Mexico, and to concentrate its activities to a restricted core of clients, mainly located in Mexico city. The bank's profitability lay essentially on the absence of competition, since no other banks appeared during the 1870s'.

In terms of its global Latin American strategy, the Bank of London tended to divert business from Mexico and directed most of its resources to Peru from the late 1860s, concentrating on the booming business in Lima and on the Pacific ports. While in Mexico LBM-SA had no branch outside the capital, the Peruvian expansion of the bank based on the twin branches of Lima and the port of Callao and was followed, between 1872 and 1874, by the Iquique one, in the booming nitrate area, and by an office in Valparaiso, Chile.[11]

As a result, the bulk of its assets came to be concentrated in Peru and 60% of its banknotes (£517,251) circulated in that nation.[12] It is worth of note that also in Peru the avoidance of credit links with the state was integral part of the bank's policy. LBM-SA did not participate in any of the transactions related to the export and sale in Europe of the two main items in Peruvian commerce, guano and nitrates. Both commodities were under government's proprietary control, and their earnings fed the extraordinary expansion of state expenses and investments.[13] As a result, most of the banks flourished in Peru in the 1870's were involved in financing the trade of the fertilizers or advancing funds to the

[9] Tischendorf 1961, pp. 8-9; Heath 1989; Annual Statement of the Trade of the U.K. 1869-1883. Initial actions of the Juárez regime were bound to harass the LBM-SA with fines and tax increase, measures that naturally created much friction with the government.
[10] See the LBM-SA activities in organizing and financing silver *conductas* (armed convoys for the remittance of silver coins and bullion to the ports for shipment).
[11] Report 1873, 1874
[12] The source are the LBM-SA reports in Banker's Magazine 1870-1873.

government.[14] Amongst them, appeared two short-lived British banks, the Anglo-Peruvian (1873) and the Mercantile Bank of Peru (1877), whose main area of activities was the guano and nitrate trades.[15] In addition, this country launched a debt financed development and became the largest Latin American debtor, whose external liabilities, in 1875, amounted to 53 millions of pound.

Stage 2

The strategy based on the West Coast expansion of the LBM S-A was cut short from the mid-1870s as a result of another and more traumatic round of external shocks. To begin with, the international crisis of 1873 and the liquidity contraction had a severe impact upon Peruvian economy: the guano exports began to decline in volume and price, hitting the fiscal revenue.[16] Balance of trade turned unfavorable, no more external financing was available, specie was drained out and the government suspended the convertibility and started issuing Treasury notes. During this stage, it is worth noting that LBM-SA represented a safe haven for the funds of merchants and wealthy Peruvians, and obtained an unusual flow of deposits.

But the commercial and fiscal crisis prolonged into a financial collapse: violent depreciation of the exchange rate followed, accompanied by the deterioration in the cost of servicing the debt. In 1876 Peru suspended payments, and the insolvency led to the paralysis of the great public works under way there and provoked a chain of

[13] Greenhill and Miller (1973).
[14] Camprubí (1957)
[15] Both had some French shareholding. Anglo-Peruvian wound-up in 1877, Mercantile in 1879. *The Economist*
[16] Marichal (1988), p. 120

bankruptcies.[17] The crisis played havoc with the banking system and by 1877 LBM-SA was the only surviving bank in Lima, thanks to having stayed away from lending to the public sector and to the London lender of last resort. But underwent a dramatic reduction in the scale of business, the liquidation of all the branches, and the abandonment of the note issue.[18]

Table 5. Round 2 of exogenous shocks and the adjustments in LBM-SA strategy, 1876-1879

Problem	Local response	Global adjustments
Peruvian collapse	Retrenchment, renounce to notes issuing and drastic reduction of commitments	1) Capital reduction from £ 0.5 to 0.25 million 2) Strong increase in liquidity ratio (from 28% to 50%) 3) Shifting of the asset weight to Mexico
Convertibility suspended in Chile	Exit from Chile	
British law on note issue	Failed attempt of lobbying for change	

LBM-SA Reports in Banker's Magazine

The heavy impact of the Peruvian crisis it is easily observable in the bank's balance-sheets, as shown in table 6.

Table 6. Changes in LBM-SA balance-sheets

	Notes in circulation	Loans and advances	London investment
1873-1877	-48%	-70%	148%

The imperative effort for strengthening the defensive lines of liquidity was not sufficient to contain the impact of the crisis, that profoundly affected the bank. The whole of the funds invested in London (that increased from £62.000 to £149.000) as well as the reserve funds (£40,000), were written off in order to maintain payments; provoking a violent drop in

[17] Bonilla (1986)

market value of stock and obliging to a 50% reduction of capital.[19] The depreciation of silver value further contributed to perturb commerce throughout Latin America in the areas in which the LBM-SA operated.[20] Finally, the military conflict between Chile and Peru in 1879 contributed to worsen the situation of the Peruvian branch, whose funds were subject to forced loans and appropriations, and which had to deal hazardously with Chilean military authorities.

While Peru went down this destructive road, the other field, Mexico seemed to offer no avail to LBM-SA, because of renewed political turmoil (internal war in 1876) and a massive note falsification that forced the bank to replace a large part of its issue (1878). At the same time, a change in home financial regulation affected the liabilities side: the Parliament Company Act of 1879 not only retained the unlimited liability for the note issue, but extended its coverage to those issued by British banks abroad.[21] This measure, overlooked at first, given the huge contraction of the note business, confronted later LBM-SA with an institutional bottleneck for the growth of its business.

By the end of the 1870s', the multinational banking model that the LBM-SA had attempted to establish in Latin America was clearly on the verge of disbandment.

Stage 3.

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[18] LBM-SA shut down the Callao branch, and sold its assets to domestic groups, that formed the *Banco del Callao*, bound to grow very succesfully during the 1880s'. And by the early 1880s' retired all its notes from circulation.
[19] Report for the year 1877.
[20] Reports 1877-1879
[21] In response to the Glasgow Bank's failure. Collins (1990)

The recovery for LBM-SA financial health came from Mexico, where the government of Porfirio Díaz, embraced a program of economic reform and modernization.[22] By 1879-1880, this political impulse intercepted the liquidity change in the US that eventually turned into a huge capital spillover into Mexico;[23] and this positive external shock presented the bank with an entirely new set of opportunities.[24] The railroad construction boom impelled, as well as the expansion of mining, by massive US investments, poured unprecedented flow of resources into the Mexican economy. The bank channeled a significant part of these funds, whose intermediation amounted to a sort of windfall profits.[25] The related strong upward trend of British exports to Mexico complemented the sequence; therefore the LBM-SA focused much of its transactions on this trade, at the same time as it became heavily involved in United States-Mexico exchange and investments.[26]

Thus, after approaching collapse the bank began to generate substantial earnings, mainly in Mexico, that allowed augmenting the average net profits by more than 50% in 1881-1883 with respect to 1878-1880, and tripling the reserve funds.[27] This phase of expansion, intense enough to rescue the LBM-SA from liquidation, was first interrupted between 1884 and 1886, owing to a serious fiscal and financial crisis in Mexico, caused by the stopping of US investment and the huge revenue deficit.[28] At a same time, a more paramount danger emerged, due to the efforts by the *Banco Nacional de México* (created in

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[22] LBM-SA sensed this opportunity since 1877, when its manager lobbied the Foreign Office for the renewal of diplomatic relations with Mexico. Tischendorf (1961)
[23] The United States returned to a de facto gold standard in 1879.
[24] In 1880 the manager of the Peruvian branch, Edmund l'Anson, was assigned to Mexico.
[25] A conservative estimate of the cumulative flow of investment between 1880 and 1883 would put them around 35-40 million dollars, equivalente to almost two years of Mexican imports.
[26] *Mexican Financier*, July 10, 1886
[27] The average net profits was £30.500, compared to £19,700 in the earlier period.
[28] Marichal (1996)

1881 and initially French-owned) to dislodge the British bank from Mexico. The resulting conflict reflected the clash between two different structures of banking interests: the relatively weak branch of a multinational bank, schooled in free-banking, which was the case of the LBM-SA, as opposed to the model of a government bank, committed to huge transactions with the public sector, that characterized the Banco Nacional (Banamex).[29] The directors of the Banamex, after financing the fiscal deficit, were able to use their considerable leverage over the government with the purpose of subtracting the basis of LBM-SA business. The instrument was the 1884 Code of Commerce, that required all banks to have proper incorporation in Mexico and established a de facto exclusiveness in the issue of banknotes, threatening to shut LBM-SA out from banking business. Due to the fact that the Pacific War had prostrated the Peruvian economy, by the mid-eighties the Mexican business was essential to the survival of LBM-SA as an overseas bank: thus, the menace was rather serious. Again, the bank's path had reached a crossroads.

Table 6. Round 3 of exogenous shocks.

Problem in Mexico	Local response	Global response
Attempt of marginalize LBM-SA through ad hoc legislation inspired by competitor	Appeal to the Supreme Court; building of elites alliances	Precommitment to move out of Mexico in case of defeat

At this critical juncture, the response was rather successful. How to explain it? At cost of keeping their Mexican business into a state of uncertainty for almost one year, the London headquarters decided to carry out a legal battle. Alleging the unconstitutionality of the Code's clause on note circulation, the British bank took the case to the Supreme Court and

29 Marichal (2001)

announced its commitment to leave Mexico, should they lose the appeal. This threat accomplished the function of setting the stakes high, causing serious concerns among Mexican decision makers on two fronts: 1) for jeopardizing the perspective of an agreement with the British bondholders, over the external debt; 2) for the fears than judicial proceedings could backfire and ignite a domestic political battle.[30]

This led the way to an arrangement for an out of court settlement, promoted by the government circles. Negotiations implied a double arena, both in Mexico and in Europe, and three actors; but the settlement went through a hierarchical structuring of bilateral exchange layers. The main one took place in the former country, between LBM-SA and government, while the other was a European one between banks (Banamex Paris board and London headquarters), as shown in table 7.

Table 7. Dual structure of Mexican banking negotiations, 1886

<table>
<tr><td>Primary layer of exchange</td><td colspan="2">London Bank ←→ Government</td></tr>
<tr><td colspan="2">Confirmed the rights of issue and banking.
Extended time to comply with the Mexican incorporation</td><td>Avoidance of political scandal and external worries over his policies without formal reneging of the Code.
LBM-SA accepts to operate with public sector.
Additional LBM-SA investment through regional branching.</td></tr>
<tr><td>Secundary layer of exchange</td><td colspan="2">London Bank ←→ Banco Nacional</td></tr>
<tr><td colspan="2">End of hostilities and recognition of legitimacy</td><td>Guaranteed the access of its shares to the official listing of London Stock Exchange</td></tr>
</table>

[30] By 1886, the Mexican government was contemplating the convenience to reach an agreement over the debt with the foreign creditors. At the same time, the "banking war" between London Bank and *Banco Nacional,* as well as the legal suit excited the public opinion, generating a considerable support for the LBM-SA.

This structure of exchanges rested on the pivotal role of a very small financial institution, whose purchase allowed LBM-SA bypassing the legal constraints of the Code.[31] The result of this accord was to force a restructuring in the organizational pattern of the LBM-SA. At gaining control of the *Banco de Empleados* charter, the British directors not only made an outlay of 8,5% of outstanding capital, but above all they inherited a new set of rights and following obligations (see table 8), that put a definite end to the regime of free-banking.

Table 8. New institutional regime for LBM-SA in Mexico, 1886

Rights	Requirements
the issue privilege is made legal	to maintain a 50% coefficient of metallic reserves on banknotes issued
possibility of establishing branches in the various Mexican states	disclosure of bank balances and accepting government inspection

All these elements required a level of assets-specificity that did not match the organizational structure of LBM-SA and its accounting procedures, which aggregated the operations of all the different branches. A tactical adjustment was to create a somewhat fictitious legal regime, whereby the Mexican branch became autonomous and presented its own balance, establishing a relation with the London home office close to that one of bilateral free-standing company. LBM-SA assigned its Mexican branch a capital of one million pesos (£161,000 at the current exchange rate) which represented almost two thirds

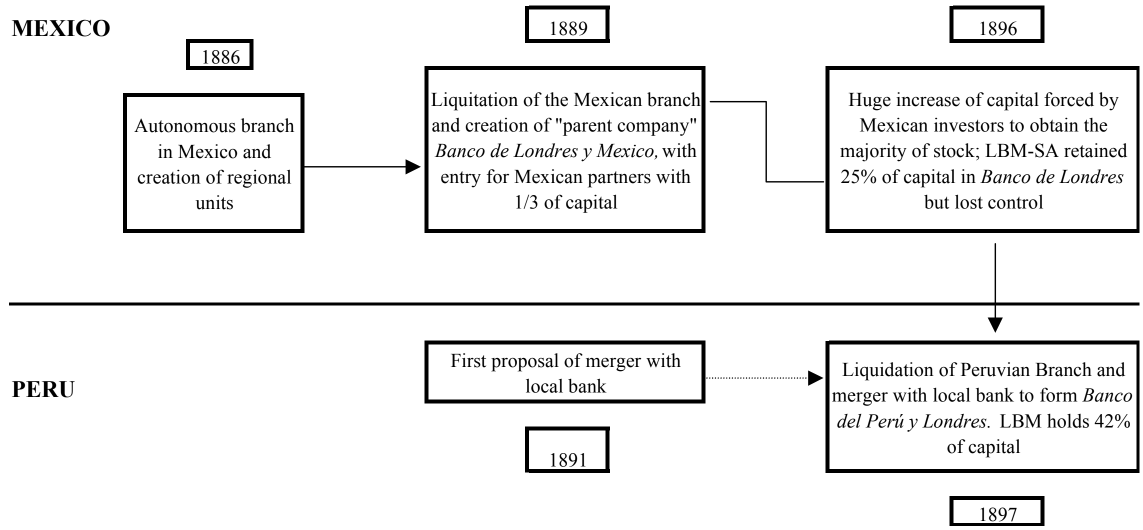
[31] Influential members of the Mexican elite intermediated the purchase by LBM-SA of the idle *Banco de Empleados*, which was strategic on account of its legal privilege to carry on banking activities and note issue. *Mexican Financier*, October 4, 1886.

(64%) of its total capital, and a note circulation equivalent to that which the London Bank had for all its Latin American branches as of 1877.[32]

The outcome turned to be a scarcely stable one, and the reason was that it embarked LBM-SA onto an unknown and different path, a one marked by financial deepening in Mexico and a split within the fields of activities. The argument presented here is that, in this frame, rising profits and diminishing organizational strength could associate. It may be argued that what allowed this discontinuous evolution was not the bank's credit policy, but rather a chain of institutional events set in motion by a competitor's predatory attempt. The path referred to, drove in fact onto an unexpected but growing process of "nationalization" of LBM-SA, that extinguished the British corporate identity. The following figure illustrates the mechanisms of this process, which took place first in Mexico and then in Peru, within the span of a decade.

[32] By 1887, the Bank repeated its shareholders that, beyond the equal importance of their two Latin American fields, Mexico was "no doubt (…) the more profitable".

Figure 1. From British bank to local "parent company" in México and Peru, 1886-1897



Between 1886 and 1896 London Bank presence in both countries changed substantially, beginning with the legal separation of British enterprise and Mexican and Peruvian branches, and ending with the lose of control. What does explain such a surprising shift in the model of operations of the LBM-SA? Since the process originated in Mexico, it is necessary to understand first the rationale behind it and its mechanism, and then how, why and when it reproduced in Peru. Is it really paradoxical that when Mexican bank began its period of maximum expansion, the LBM-SA shifted from direct investor to controlling interest to mere shareholder? What shaped this course of action was a combination of factors, which included the weight of the British banking regulation, the legal fragility of the bank in Mexico, the pressure of domestic investors and the role of the Mexican government. Our argument here is that LBM-SA was fully aware of and responding to some of them, but failed to envisage the implications of others, owing to the multinationally scattered character of the firm, and to its free-banking trajectory and organizational culture. So, whereas the incidence of legal and institutional aspects was dealt with, much less attention and response was given to the features of the political environment. What follows intends to prove it.

Since 1886, LBM-SA operated in new and more profound dimensions, while a substantial period of growth in the Mexican economy (1887-1890) led to a renewed boom of the activities of the bank, including the erection of a network of seven regional branches, and a wide range of relationships with local groups. Consequently, the volume of business and profits increased, positioning the bank close to the centerstage of private finance, behind the giant *Banco Nacional*.[33] In this setting, influential Mexican investors with excellent political connections targeted the bank. They were interested in the *Banco de Londres* profits, but also in the possibility of gaining access to a key source of future credit. This group was able to take advantage of government pressure to "mexicanize" the *Banco de Londres* by offering to take one third of capital (at 100% premium on nominal value of the share) and obtaining Mexican domicile for the bank, while allowing the LBM-SA to retain two thirds of the stock.[34] From the British point of view the arrangement was a successful one, for the following reasons:

1) it resolved outstanding problems with regard to both British and Mexican legislation, including the legal incorporation of the firm and the unlimited responsibility for the banknotes;[35]
2) it resulted in a positive financial result, cashing in a premium (£75,000) equivalent to 30% of the capital of the LBM-SA;

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[33] By 1888, LBM-SA market share in Mexico as regards to cash, notes in circulation and deposits represented 22%-23%. Since Banco Nacional was the the only other bank of issue, it accounted for the rest.
[34] Joslin (1963); circular in the *South American Journal*
[35] In response to the growth of business, the note issue in Mexico expanded quickly (3.5 times between December 1886 and June 1889). Owing to British regulation about unlimited liability, this marked an increase in the risk position of LBM-SA, perceived as such by the market.

3) the entry of the Mexican investor group assured the bank political security and guaranteed for future expansion of its business, which would generate dividends for the British firm;

4) there would be organizational and management continuity and the right to keep LBM-SA controlling interest in the future.[36]

All together, British investors viewed the Mexican arrangement in a favorable way, a fact underscored by the subsequent rise of 20% in the value of the shares on the London Stock Exchange.[37] The directors eagerly exploited the opportunity to increase the bank's capital, from £250.000 to £400.000, issuing shares at premium and replenishing the reserve fund.[38] The "demonstration effect" of the benefits of the Mexican arrangement convinced the London board, and already in 1891 they instructed the Peruvian branch to work out a merger with the local *Banco del Callao*, without result.[39]

However, the equilibrium established between the British bank interests and the degree of autonomy for the local bank was to reveal unstable. The break came in 1896 with a new increase of capital by the *Banco de Londres*, from 3 to 10 million pesos, paralleled by a change in statutes and a new Federal charter. The domestic investors designed this enormous increase (at current exchange rates, it meant twice the capital of the British Bank) to gain full autonomy from London. The driving force behind it was the strength of the demand for credit in the capital scarce country, reflected in a much higher remuneration for capital, as shown in table 9, and assured by a less risk-averse lending policy in Mexico.

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[36] The source is the LBM-SA Reports and Meetings in *Banker's Magazine*, 1890-1897

[37] Price increase between June and August (last week), as reported by *The Economist*.

[38] Then, in 1891 the Mexican firm doubled its capital in response to an extraordinary increase in the volume of business, with LBM-SA retaining two thirds of total stock. The London market, still under the full effects of the Baring crisis did not react favorably with regard to the increase of capital, and stock prices declined by 10% after the announcement.

Table 9. Net profits to capital ratio, LBM-SA and *Banco de Londres,* 1890-1895

	1890	1891	1892	1893	1894	1895
LBM-SA %	7.7	13	10.5	12.4	10.5	10.3
Banco de Londres %	36	46	26	20.5	20	18.5

Source: calculations based on LBM-SA reports

The displacement of LBM-SA interests took place within a "chicken game", introduced by an ultimatum from the syndicated Mexican stockholders. The alternative the London board faced was to accept the increase in capital of *Banco de Londres*, thus allowing the transfer of financial control into Mexico, or losing the support of the government, which would compromise the bank's position and future business.[40] The Mexican government backed up the threats about the consequences of not consenting the increase in capital and, by means of the coincidental elaboration of the Federal Banking Law, set powerful incentives that local investors were capable of exploiting as a pressure reinforcement.[41] Given this correlation of forces, the opportunity cost of maintaining British control was extremely high.[42] In this way, there took place the non-conventional process (by nineteenth century standards) by which groups of domestic investors in a Third World country were displacing foreign investors.

Even if this development in Mexico came from the inside of the LBM-SA business network, nonetheless can be regarded as an exogenous shock, unexpected and over which

[39] Quiroz (1989), p. 215.
[40] *Mexican Financier*, June 6, 1896 and June 20, 1896. Joslin (1963), p. 211.
[41] The 1897 law, was the first piece of regulation regarding banks. Concurrently, the increase of capital of *Banco de Londres* was to be rewarded with a fresh 50 years charter, against the existing 20 years one, granted in 1889.
[42] At the 1897 LBM-SA meeting, the Chairman told hte shareholders that the directors came to the conclusion that would have been "very unwise to oppose the increase of capital".

the London headquarters had no control. In this sense, it would represent the fourth round of shocks, that LBM-SA confronted in the following way:

Table 10 . Round 4 of shocks, 1896-1898

Problem	Local response	Global firm response
Take over of *Banco de Londres* by Mexican groups	Acquiescing in Mexico. Promoting merger of Peruvian branch with *Banco del Callao*	Abandon of direct banking operations. Entry as portfolio investor in Argentina's *Banco del Comercio*

The loss of control led to a decisive transformation in the organizational model of the LBM-SA, which implemented the lessons learnt in Mexico in the other seat of activity. In Peru, after the LBM-SA had emerged from the 1870s crash as the healthiest bank amongst the few survivors, its importance had been considerably weakening, due to several years of retreat and very conservative credit policy.[43] In the 15 year-span between 1880 and 1895, its share in the total banking capital declined from around 75% to 14%.[44] *Vis a vis* the much more pushing activities of local banks, the British bank' stance remained fixed around the defence of its assets against the depreciation of the paper currency and the distance from government's business;[45] and even when, in the 1880s, the Peruvian economy stabilized the

[43] Quiroz's map of elite groups and their credit links lists 22 such groups. Most of them entertained financial relationships with banks during the 1880s-1890s, but none with the LBM. See Quiroz (1998), pp. 76-79.
[44] 45% in 1885, 22% in 1890.
[45] Not even the task of assisting the government to reintroduce a metallic currency, after the desastrous experiments with paper currency, deviated the LBM-SA from its estrangement. The responsibility devolved upon the *Banco del Callao.* At the same time, when the agreement between the country and its foreign creditors (1887) led to a swap of assets and to the formation of the British firm Peruvian Corporation, there was no LBM-SA involvement. See Miller (1976) and (1983).

currency and experienced strains of recovery, the LBM-SA did not abandon its financial trench and was in no position to benefit.[46]

After the Mexican turn, the Peruvian branch was instructed to carry out a fusion with the *Banco del Callao*, a leading financial institution, in order to consolidate one dominant banking enterprise. The offshoot was the incorporation of the *Banco del Peru y Londres*, by far the largest bank in Peru, wherein LBM-SA maintained initially the role of chief portfolio investor.[47] Actually, this outcome was the result of the firm's strategy, after many years of purely defensive responses to traumatic displacements. The goal was twofold: first, to preempt a sudden displacement like the Mexican one, opting instead for managing the process of integration into the host economy; second, to end LBM-SA prolonged estrangement from the Peruvian business core and the consequent decline in market share. Additionally, the government provided a set of implicit incentives that signaled its favor towards the merger.[48]

What the two separation processes had in common, was the governance structure that allowed the portfolio relationship between the LBM-SA and the new local banks, whose focal point was the continuity of British management. In Mexico as well as in Peru the former local manager of the British bank stayed in charge after the separation or the loss of financial control, with the purpose of guaranteeing to the London board supervision and inside information on the business. Moreover, LBM-SA established a contractual relationship with *Banco de Londres* and *Banco de Perú*, by which acted as their agent, charged with handling the London end of their activities.

[46] Years after year, the reports to the shareholders indicated that the policy in Peru needed to stay contained.
[47] The new bank's capital was 200,000 libras peruanas, aproximately equivalent to the £; LBM-SA retained at first 40% of the shares.

However, not even this step meant the reaching of an equilibrium: being a British overseas "bank" whose entire investment abroad was locked in two Mexican and Peruvian banks puzzled the shareholders and did not meet the favors of the stock market. Following the Mexican and Peruvian displacements, LBM-SA opened a third field of activity as a portfolio investor, this time in Argentina, thanks to the 1897 investment of £100,000 in the local *Banco del Comercio*.[49] This move, financed by the sale of shares in Mexico and the profits from Peruvian merger, responded to the strong recovery of Argentinean finance after the 1890 crisis, and at the same time locked in the new LBM-SA strategy away from banking and into portfolio investment. The immediate financial results obtained in Argentina confirmed this strategy and LBM-SA, while progressively loosening the information grip through management of the Mexican Bank and Peruvian Bank, began to sell portions of the stock and reducing its financial participation in the two countries where it had operated during three decades.[50]

This led the way to the last and decisive turn in the British bank evolution, in order to embrace the career of financial holding or investment trust, characterized by risk diversification and full administrative disengagement from the previous strongholds.[51] This movement is portrayed in table 11.

Table 11. LBM-SA portfolio investment in Latin American banks, 1897-1911

[48] The British bank held claims against the Government, amounting to £25,000, due to advances made in 1880. These claims, recognized both by the Courts and the Congress, were object of a protracted litigation since the mid-1880s, because of the failure to pay. The matter was then easily settled in 1899.

[49] The Bank was renamed *Banco del Comercio Hispano-Argentino*, after that the *Banco Hispano-Americano* de Madrid took an interest in it.

[50] By 1903, the British manager of *Banco de Londres* (H.C. Waters) left Mexico and returned to England, to be ascended on the LBM-SA board. This put an end to the privileged channel of information between London headquarters and the Mexican bank. In Perú, the British man (M. Wells) was eclipsed, within the dual system of management, by the far dominant influence of the Cuban-born José Payán, outstanding character as financier, promoter, and financial advisor to the Government.

[51] Average Rates of return of foreign financial trusts, during the 1890s, roughly doubled the ones of British overseas banks. Davis and Huttenback (1986), pp. 84-85.

	1897	1900	1904	1908	1911
	Mexico	Mexico	Argentina	Argentina	Argentina
	Peru	Argentina	Peru	Peru	Chile
		Peru	Mexico	Cuba	Peru
			Chile	Mexico	Cuba
				Bolivia	Mexico
				Salvador	Bolivia
					Salvador
Investment book value £	314.500	375.000	291.000	356.500	341.600
% assets	31.3%	33.9	27.9	17.4	14.1

Note: the countries are ordered in descending importance with regard to the LBM-SA investment

By 1911, LBM-SA investment spread over seven Latin American banks, whereas it represented less than 15% of the total assets. This change gave the shareholders stable and higher yields, but led the business to nowhere: the London Bank of Mexico and South America was no bank at all, and its London investment surpassed significantly the overseas investment. The following year, in spite of disgruntled shareholders, LBM-SA was absorbed by Anglo-South American Bank

Conclusions

The focus of this paper has been to explain the several and profound organizational transformations that the London Bank of Mexico and South America experienced along its half a century participation in Latin American banking. The initial location of its activities impressed the bank's development with a marked path-dependence character. On the whole, the instability (financial, political and legal) in the host countries caused wide fluctuations in their political economies that defined the game field, and forced the British bank to an unexpected set of adjustments. The free-banking imprint on the structure and business of LBM-SA turned to be an important channel of transmission of this instability, since rested on the expectation that banking activity could be performed without taking into account the state. But the state, in Mexico as well as in Peru or Colombia, was an important and rising part of the financial system, and a crucial actor in producing (or at least reinforcing) and managing the instability. For the major Latin American countries, the limited financial globalization did not mean, by any means, a displacement of the state.

In this setting, and compared with the distance from government's goals and practices, the strength of the external connection and the British status of LBM-SA were not factors conducive to raising its capability of coping with local political economies. The British bank, in this case, absorbed much more pressure from inside than it was able to release, as carrier of foreign interests and links. Its recurrent adaptations, based on contraction, displacement and capital mobility within the firm, were essential to its survival but did not respond to a corporate strategy, because of their unforeseen character and the low degree of control that LBM-SA was able to exert on the outcomes.

It took three decades before the firm's strategy could make a difference and be the driving force in achieving a new equilibrium. This happened around 1896-1897, but at the same time that it signaled the recovery of strategic decision making by LBM-SA, it implicated the exit from the banking sector and the conversion into a financial holding. Gold standard, foreign investments and financial globalization notwithstanding, by the final years of the nineteenth century in Mexico and Peru the specific competitive advantages of being a foreign (British) bank had vanished.

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