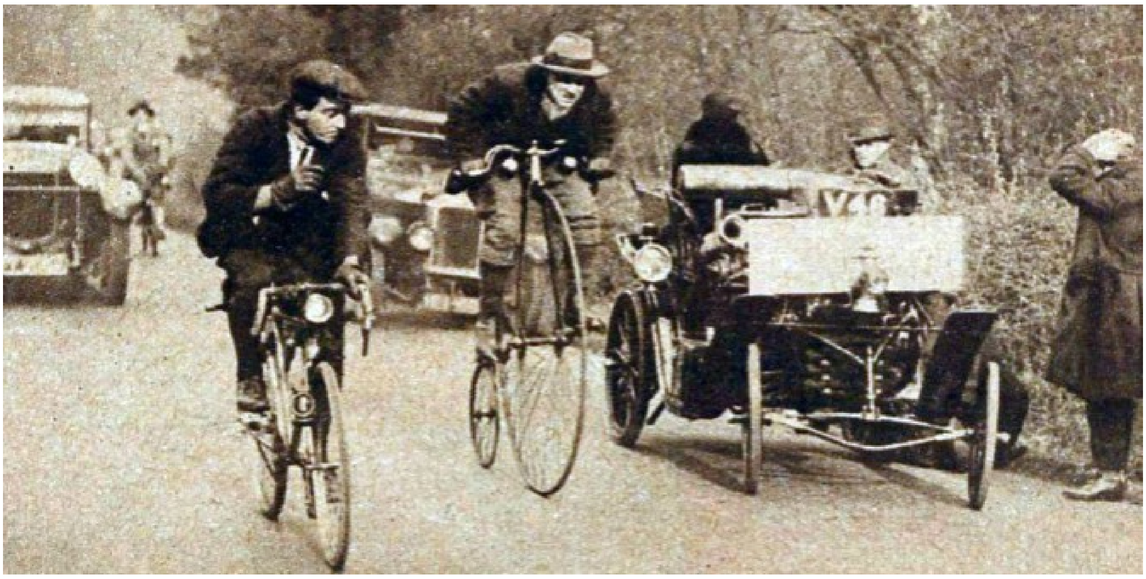
Lessons from the 1890s to realign innovation and finance in post-Brexit Britain



There is increasing consensus among political and economic commentators that the UK economy is in significant need of rebalancing. The gulf between the finance-based London economy and former manufacturing regions was thrown into sharp relief by the Brexit vote, reinforcing the momentum for the so-called “Northern Powerhouse” and “Midlands Engine” initiatives and, to underpin a new focus on regional policy hubs, the suggested devolution of some financial functions of the Bank of England to cities like Birmingham.

Our recently published research on the cycle and pneumatic tyre industry reveals some of the historical origins of imbalance in the British economy and offers perspectives on the current policy focus aimed at its correction.

In the late 1880s and early 1890s, this new manufacturing industry, centred on Birmingham and other cities of the English Midlands, including Coventry and Nottingham, came to prominence on a wave of innovation: First for pneumatic tyres and cycles, and later for automobiles and interchangeable, but patentable, cycle components.

A rush for stock market listings followed, based more on the earnings potential of these new patents than the value of established manufacturing facilities, which were often little more than small workshops. As such, cycle firms were risky challenges for investors and offered fertile ground for unscrupulous and, on occasion, fraudulent company promoters.

A boom followed, culminating in the spring of 1896 with the large Dunlop float. “Bicycle mania” featured high profile fraud cases, most famously involving the company promoter Ernest Terah Hooley, which attracted national newspaper headlines. Hooley’s methods featured “guinea pig” directors, several of whom were famous aristocrats, and so called for taking fees in guineas for providing nothing in return, famously parodied by Gilbert and Sullivan in *The Gondoliers*.

These “lords on the board” were thus implicated in an apparently serious misallocation of financial resources, in a boom that collapsed as quickly as it developed. As the major financial centre, London could now add a further reason for avoiding industrial finance in the manufacturing regions in favour of its emerging preferences for overseas investments.

Although the shunning of investment opportunities in the regions was clearly an important consequence, our research reveals that promotions using aristocratic directors were a conscious strategy to overcome already existing barriers to accessing London finance. Elite directors offered access to a social network, which in turn offered the access to the financial resources needed to underpin the development of this important new industrial sector.

Our analysis of 73 cycle and tyre firms showed that aristocratic representation on the board was the overwhelmingly important determinant of firms having London listings; more important than patents controlled, product type, financial instruments used, or location of head office.

In parallel with the "trust movement", which created dominant firms in some industries in the United States and in Britain in the 1890s, the objective of these promotions was to establish patent-based monopolies centred on groups of firms connected by elite interlocks at board level. A leading example was the British Motor Syndicate (BMS), a group of connected companies promoted by Henry Lawson that also drew together an impressive network from all corners of the British establishment.

Aristocratic and other elite directors did more than simply collect fees. They enlisted supporters, as in the BMS, ranging from road lobby, like the promoters of the famous London to Brighton rally of 1896, the "emancipation run" which ended the "red flag" based 4 m.p.h. speed limit on motor vehicles, to cycle touring organisations and product endorsing celebrities like the famous cricketer, Prince Ranjitsinhji.

Less glamorous firms, preferring to list only on regional stock markets, most commonly in Birmingham or Nottingham, were typically devoid of aristocratic or elite directors. A leading case was the Raleigh cycle company, which, following preferences of local investors, shunned the London market in favour of financial independence under the leadership of Frank Bowden, with shares quoted only in Birmingham.

Reliance on local pools of capital worked well for new firms as long as cities like Birmingham enjoyed some prominence. The Chamberlain family, including most notably in the 1890s, Joseph Chamberlain, dominated politics in Birmingham and nationally, and were also significant investors in the cycle industry.

Regional stock exchanges could easily cater for the financial needs of modest sized industrial firms. However, their relatively thin pools of capital became an important constraint as the scale requirement of firms increased – a problem exacerbated by their overdependence on regional sectors vulnerable to structural decline after 1920.

These constraints continue to operate today. The challenge to policy makers seeking to rebalance the British economy is to create clusters of innovation in the regions with access to suitable growth finance.

The bicycle industry was sustained by such local alignments for several decades, whereas the boom and bust of 1896 was very much a London phenomenon. The key questions for today therefore are: Should economic rebalancing involve the encouragement of regional middle tier financial institutions, or should London and the financial elite once again attempt to engage with networks of industry and innovation?

The answers from the bicycle boom are that the former solution offers low transaction cost, bespoke partnerships, whereas the latter provides access to deeper financial resources, albeit at higher cost. Regional policy, in the gap left by Brexit, faces a challenge posed by this dilemma, but also an opportunity to strike the right balance.

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Notes:

- *This blog post is based on the authors' paper Accessing capital markets: Aristocrats and new share issues in the British bicycle boom of the 1890s. Business History, VOL. 60, No. 2, 231–256.*
- *The post gives the views of its authors, not the position of LSE Business Review or the London School of Economics.*
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