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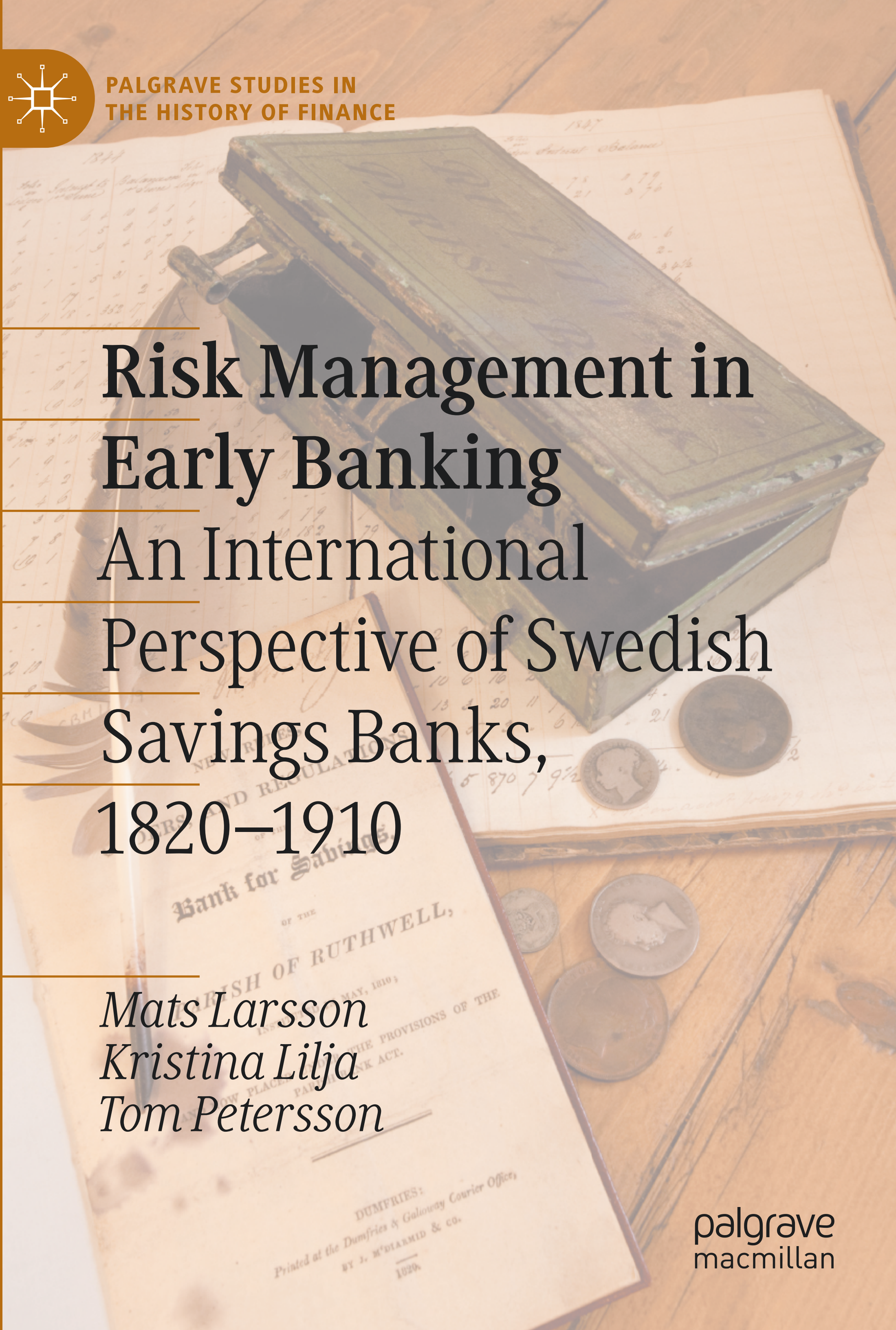

# Risk Management in Early Banking

## An International Perspective of Swedish Savings Banks, 1820–1910

*Mats Larsson*
*Kristina Lilja*
*Tom Petersson*

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# Preface and Acknowledgements

The establishment of savings banks was an essential part of the development of modern banking—especially in Sweden. In this book we focus on the role of Swedish saving banks in the nineteenth century and early twentieth century, in a European perspective. This analysis covers a period when banking developed as a well-functioning system for deposits and credits. The book focuses on this development from a theoretical perspective connected to risk management and the role of trust and legitimacy in credits and savings. We analyse the role of insider lending and the practical aspects of granting credit, such as the use of collaterals and the level of interest rates to compensate higher risks. Research on savings banks has for many years been an important research field at the Department of Economic History, Uppsala University and has resulted in six Ph.D. theses and several other publications.

We want to thank the financiers of this research: HERA (Humanities in the European Research Area) for financing the UPIER project (Uses of the past in International Economic Relations) and the Sparbankernas Forskningsstiftelse (Savings Banks Research Foundation) and Enrique Rodriguez. Our sincere thanks also go to our present and previous research colleagues: Professor Håkan Lindgren and the members of the Uppsala Savings Banks research project Lars Fälting, Hilda Hellgren, Mikael Karlsson and Anders Sjölander for fruitful discussions. We are also grateful to the anonymous readers from Palgrave Macmillan for insightful comments. In the end, as always, any remaining errors are our own.

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CHAPTER 1

# Introduction

**Abstract** Research problem and aim of the study is presented. Theoretical approach presenting the problems of legitimacy, trust and risk on financial markets. The role of personal trustworthiness, networks and regulations to create legitimacy is discussed. The structure of the study is presented.

**Keywords** Theory · Legitimacy · Trust · Trustworthiness · Regulations

## Problem and Aims of the Study

Creating legitimacy and trust between individuals and organizations is one of the most important challenges for the development of financial systems. Uncertainty exists to a large extent due to information asymmetries but can also be connected to the uncertainty about what might happen over time. Legitimacy serves to reduce such uncertainty as well as the transaction costs. Legitimacy in the financial system is closely related to the general acceptance of both the system as such and the organizations within the system. Trust on the other hand is more personal and originates from relationships between actors on the market, created for instance through personal networks or repeated transactions



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between actors. However, trust and legitimacy are often combined and is a necessary fundament for the long-term stability of a financial system.[1]

Risk is a critical factor to be considered for depositors as well as lenders when conducting transactions. Trust between persons can reduce risks. But this also includes a well-known contradiction. Financial institutions can mediate financial risks, which at the same time makes them vulnerable to decreased trust or legitimacy.[2] This may lead to for example bank runs, crises in liquidity and financial panic. Hence, financial systems that depend on specialized financial institutions are often susceptible to periods of illiquidity or financial stress when trust in these institutions drops.

The failure of organizations specializing in financial intermediation—for example savings banks and commercial banks—may spread to other actors on the market and ultimately threaten the entire financial system. It is for this reason that we often understand financial liquidity as a public good, providing a motive for on-going government intervention, such as lender of last resort facilities. The question of legitimacy becomes even more crucial when financial systems are undergoing rapid change or when new and innovative financial systems are being established, as in Sweden during the nineteenth century.[3]

Legitimacy of and trust in financial actors were of the greatest importance during the establishment of the "modern" Swedish financial market in the 1820s. Legitimacy was the basis for the recruitment of depositors and borrowers as well as fundamental for risk management and the establishment of a banks' business activities.[4] Legitimacy was probably more important for savers than for the borrowers, but for the latter group trustworthiness was also important. Thus, it was of primary interest that a borrower could be confident that the terms of the credit were not to be changed and that the lender would not utilize information in an improper way.[5] The problems connected with banking in the nineteenth century

[1] The problems of risk, legitimacy and trust in the financial system especially in Sweden, has also been discussed—among others—by Larsson and Ögren (2019) and Gebert-Persson (2006).

[2] Diamond and Rajan (2001) and Powell and DiMaggio (1991).

[3] Larsson and Ögren (2019).

[4] See for example Gasslander (1956) and Hildebrand (1971).

[5] Hellgren (2003) and Perlinge (2005).