In 1927, Japan was hit by a violent financial crisis, which particularly wounded its weak banking system and determined a run on bank all over the country. Among the approximately forty banks which closed during the financial panic, I will here consider the case of the Imabari Commercial Bank, a local bank which worked as kikan ginkō.
Banking Mismanagement as the Origin of the Financial Panic of 1927 in Japan: A Case Study

Marta Moretto

Abstract
In 1927, Japan was hit by a violent financial crisis, which particularly wounded its weak banking system and determined a run on bank all over the country. Among the approximately forty banks which closed during the financial panic, I will here consider the case of the Imabari Commercial Bank, a local bank which worked as kikan ginkō (institutional bank) for cotton industries in the Eastern part of Ehime Prefecture.

The crisis in the cotton industry in 1926, the strong use of loans without collateral and, above all other reasons, the practice of directorate interlocking determined the destiny of many banks during the financial panic of 1927, a destiny that the Imabari Commercial Bank could also not escape from.

Keywords
1927, Banking Crisis, Directorate Interlocking, Financial Panic, Imabari Commercial Bank, Japan, Mismanagement

1. Introduction

The Japanese financial crisis of 1927 was characterized primarily by a large-scale collapse of banks that led to greater financial control of the economy by the biggest banks taking over the assets of bankrupt firms.

The crisis developed in the latter stages of World War I (1914–18), when companies had to decide whether to reduce commitments in view of an expected slowdown after the war or to expand investments to take advantage of an anticipated postwar recovery. Many Japanese companies chose to expand their investments, sustaining development with credit.

1) Japan enjoyed an economic boom during and soon after World War I (1914–1918), when gross domestic product surged 17.5 per cent a year, monetary policy was extremely loose, and the country
When Japan’s stock market crashed in March 1920, the superstructure of this expansion collapsed. In this situation, debt-ridden companies lacked the competitive power to drive a recovery. Their prices had risen more rapidly during the war than those of their Western competitors, but had declined more slowly after World War I. The reason can be found in the underdeveloped state of Japan’s technology and the higher costs faced by Japanese companies seeking to manufacture comparable products.

Government countermeasures were undermined by the Kantō earthquake of 1923. The financial aftershock of the earthquake created an insurance crisis and expanded the debt held by banks that took out loans to invest in the stock market and enterprises during the post World War I boom. The government tried to improve the situation by issuing a special credit, the so-called “earthquake bills” (shinsai tegata).

A key institutional feature of Japanese finance in this era was represented by institutional banks (kikan ginkō); many banks had lent much to related firms, the fortunes of which were so precarious that cutting off credit would have meant bankruptcy for both companies and banks.

The most evident example of such a linkage, and the one that resulted in the biggest troubles, was the relationship between the Bank of Taiwan, a colonial bank of Japan with special benefits, and Suzuki Shōten, a trading company which was an outcome of the “season of nouveau-riche” growing rapidly during World War I through speculative businesses. In late March and early April 1927, the Finance Ministry warned the Bank of Taiwan to cut back on its loans to Suzuki. The situation came to a head and at last both Suzuki and the Bank of Taiwan closed, with the latter subsequently being reorganized.

As a result of this crisis and the consequent short bank moratorium, many banks and industrial firms they financed went bankrupt. Their assets would be later acquired by the large zaibatsu.


\[2\] The Suzuki Shōten had strong connections with Taiwan where it was given monopoly rights to the market of Taiwan-made camphor. But after WW1 and the burst of the bubble, Suzuki Shōten faced a bad debt problem and it asked its main bank, the Bank of Taiwan, to extend rescue loans. Despite its semi-official status, the Bank of Taiwan continued to lend to Suzuki by rolling over existing debt and providing new loans. Since by the end of 1926, the largest part of the unsettled earthquake bills were attributable to the Bank of Taiwan and Suzuki Shōten (48.4 percent), the government realized that to solve financial problems it was necessary to normalize the earthquake bills, that is to solve the Bank of Taiwan-Suzuki problem. Kenichi Ohno, The Economic Development of Japan — The Path Traveled by Japan as a Developing Country, Tōkyō: Yūhikaku Publishing Co. Ltd., 2005, p.121.

\[3\] Zaibatsu were family-owned financial and industrial groups, the biggest of which, known as Big Five, were Mitsui, Mitsubishi, Sumitomo, Yasuda and Daiichi. Consequently in a measure to overcome financial panic, shares of the five biggest zaibatsu banks increased the share of national deposits by zaibatsu groups from 24% in 1926 to 40% in 1930. The Mitsui Bank, A History of the First 100 Years, \[3\]
The financial crisis of 1927 can be placed within the larger patterns of Japan’s modern history. The era immediately preceding the 1927 crisis was a time in which Japan had been singularly inept at handling wealth produced by the wartime boom on the one hand, and deflation on the other hand, causing the decline in prices after the war.

After this brief introduction to the historical events which led to the financial panic of 1927, I will now focus my attention on the case study of the Imabari Commercial Bank and the reasons at the base of its deadlock, namely the problem of mismanagement and directorate interlocking, which can be seen as the cause of closure of many financial institutions in those days.

2. The Imabari Commercial Bank

The Imabari Commercial Bank (Ehime Prefecture) can be considered a forerunner of the events which effected the Japanese financial system in 1927 and led to the collapse of the banking structure.

The bank (paid-up capital ¥2,500,000) was strongly related to wealthy businessmen in Ehime and it rapidly became an important financial source for the whole prefecture. The bank benefited from a tight relationship with the Bank of Japan branch in Hiroshima, which at that time was the closest branch serving the whole area of Shikoku and Chūgoku.

The Imabari Commercial Bank had been established with the purpose of creating a close link between the financial world and the textile and cotton industries, but during the economic slump after World War I (1914-18) which affected the whole country, the Imabari Commercial Bank as well suffered a period of instability.


\textsuperscript{5} The Bank of Imabari was established in May 1892 under the name of Imabari Finance Co. Ltd., but it changed its name into Bank of Imabari the next year, and again into Imabari Commercial Bank in 1900. It was established with a capital of ¥50,000. Thanks to the good business trend, its capital went up to ¥200,000 in October 1895, ¥1,000,000 in September 1900 and ¥2,500,000 (paid up) in March 1918. Imabari Cotton Industry Association, \textit{Imabari Mengō Hallatsushi}, Imabari: Imabari Cotton Industry Association, 1951, p.25.

\textsuperscript{6} The Bank of Japan branch in Matsuyama was established only in 1933, as the first branch of the Bank of Japan in Shikoku. Ehime Prefecture, \textit{Ehimekenshi — Shakai Keizai} 4, Matsuyama: Ehime Prefecture, 1988, p.337.

\textsuperscript{7} The bank aimed to extend its financial influence through Ehime Prefecture. It established its headquarters in Imabari, followed by the opening of 11 branches in the whole prefecture. The bank put its efforts mostly in financing companies related to cotton and textile industry, and that is easily understandable from the fact that the majority of clients were manufacturers whose activity profits (whether they were positive or negative) directly affected the bank’s trend. Ehime Prefecture, \textit{Ehimekenshi — Kindai Gokurakubetsu}, Matsuyama: Ehime Prefecture, 1988, p.519.
This was simply an external reason that affected the businesses of the Imabari Commercial Bank. If we look at it from an internal point of view, in fact the bank demonstrated itself to be weakened by its own way of carrying out business. The bank indeed lacked an effective and efficient management system: it did not safeguard its clients (in great part depositors) and offered loans – mostly long term ones and often not guaranteed by any collateral – to people and companies related to the board members.

A general tendency to deterioration was noticed in 1926, when a new crisis in the textile industry occurred as a consequence of a slump in cotton thread, and the bank faced the problem of the non-repayment of a great part of loans it granted to companies and individuals in Imabari.

The Imabari Commercial Bank realized the necessity to work on an eventual reorganization, but on January 14, 1927 as a consequence of various canards, the bank was subjected to a sudden and unexpected run on the bank by depositors. Defenseless when faced with such an incident, the Imabari Commercial Bank could only stop payments, so that on January 24, 1927 the bank decided to suspend temporarily its activity in order to allow an internal reorganization.

Due to the tight link between the bank and textile industries in the area, a sense of panic diffused through the prefecture and injured general trust towards banks. The Imabari Commercial Bank was not the only financial institution to be stormed by depositors. On the same days in fact, other banks in the area, mostly small and already weak, were exposed to bank runs. In similar conditions the prefectoral government joined efforts with the Bank of Japan branch in Hiroshima to save the situation and at the end of January 1927 calm was partially restored.

\[\text{particularly the textile sector. In this depressive period, also business of the Imabari Commercial Bank showed little progress, which became losses in the following years as a consequence of a contraction in profits by the cotton industry after the fall in the cotton thread price. Hitoshi Ochi, \textit{Imabari Orimono Kūgō Kyōdō Kumiai 90 Nenshi}, Imabari: Imabari Textile Industry Association, 1987, p.91.}\]

8) Difficulties in loans and discount, accumulation of a large sum of unpaid money by cotton traders and instability of the financial system were the reasons that led director Kōta Okada to fail in the speculation on cotton thread in the Osaka market in August 1926. Okada supposedly borrowed almost ¥800,000 (although it was later estimated to be ¥1,300,000) directly from the Imabari Commercial Bank enormously hitting the bank. \textit{Ehimekenshi – Shakai Keizai} 4, p.141.


10) Kainan Shinbun, January 25, 1927.


12) The Imabari Commercial Bank asked for help to the 52nd Bank, the Ono Bank and other financial institutions. Thanks to their help and the contribution by some companies, the bank could temporarily calm the situation. \textit{Ehimekenshi – Shakai Keizai} 4, p.141.
Every effort had been made to save the Imabari Commercial Bank: members of the board offered their private properties as a guarantee of a fast repayment of deposits, while eminent people in Imabari asked for help to authorities of Ministry of Finance and the Bank of Japan in Tōkyō. However, in spite of the negative effects accumulated by that time, at the end the right formula for the bank’s reorganization was found.

At the beginning of May 1927, the government enacted a law for special financing as an emergency measure to combat the serious financial panic which had diffused through all Japan. The law was applied by the Bank of Japan to all financial institutions which temporarily closed during the critical wave in March and April 1927, financing reserve funds for repayment of deposits as guarantees through properties, etc.

Also the Imabari Commercial Bank could take advantage of this law, which became the panacea for its complete reorganization. The Bank of Japan considered in fact the request of the Imabari Commercial Bank and sustained its reorganization after conducting an investigation on the balance sheets of the bank. In July, the reorganization plan of the bank was ready on the basis of the special financing offered to banks that closed in the days of the financial crisis and one month later, during the extraordinary general meeting of shareholders on August 15, 1927, the Imabari Commercial Bank announced that it would be the first bank to benefit from the special financing law.

Reserve funds had been already settled and on August 18, 1927, seven months after its closure, the bank could, with no obstacles, restart its activity and the repayment of deposits to depositors.

On September 6, 1927 board members of the Imabari Commercial Bank went through an election. Except for president Kamesaburō Yagi and director Michiyasu Yano, the directorate changed in lotto in an attempt to give new life to the bank.

### 2.1 Mismanagement Problems

The old directorate of the Imabari Commercial Bank was not only tightly related to entrepreneurs in the Iyo region, but almost all board members were also owner or board members of non-financial companies.

In this sense, the Imabari Commercial Bank was not an isolated case. In those days, in fact, 86.6% of ordinary banks showed an interlocking of directorate with non-financial firms. The

13) Considering data published by Ministry of Finance, 1,420 ordinary banks existed in Japan in 1926. Okazaki and Yokoyama analyzed the influence that directorate interlocking had on banks during the interwar period and results were very interesting: they analyzed the existing 1,420 banks and noticed that 1,030 banks showed an interlocking of directorate with non-financial firms with an interlocking average of 7.8 interlocking positions per bank. From the results of this analysis, any director occupied an important position in other firms somehow related to the bank. Okazaki Tetsuji, Yokoyama Kazuki.
directors of the Imabari Commercial Bank were often also major shareholders of other firms, in other words they were also owners. As Okazaki and Yokoyama stated in their analysis of directorate interlocking in the interwar period, the institutional bank hypothesis can be applied when banks’ directors are at the same time major shareholders both of the banks and the companies they are connected to. Assuming that poor financial conditions can compromise a bank’s evaluation in the financial market, a similar precarious financial situation led many banks to closure during the banking crisis of 1927. Banks with interlocking did have lower profits than banks with no interlocking of their directorate with other non-banking firms and because of the former’s weak structure, they were more exposed to risk, since interlocking was demonstrated to increase the probability of runs on the banks and consequently bank closures.

2.2 The Imabari Commercial Bank’s Directorate

The Imabari Commercial Bank directorate was formed by 12 members belonging to the most important families and industrial groups of the area. The directorate possessed 8,700 of the 50,000 shares in the bank, although the percentage of shares possessed by the directorate actually increased to 1/4 of their total amount if the ones possessed by relatives of the directorate are also included.

The board members were in many cases related to the management of other companies, triggering the phenomenon of directorate interlocking which was a very popular practice within companies and banks in those days. The bank granted loans to its acquaintances in a reckless way, without considering the necessity of receiving collateral and consequently provoking big losses to the bank.

During the reorganization and the investigation by the Bank of Japan, it became extremely clear that the directorate of the Imabari Commercial Bank exaggerated the value of its properties and consequently its own guarantees, creating obstacles to the reorganization.

The board members of the bank were tightly related to many business activities in Ehime Prefecture. President Kamesaburō Yagi was involved in the salt production business in Hashihama, but at the same time he was president of the Yagi Honten Corporation, managed various maritime businesses and deep-sea fisheries in Sakhalin and Kamchatka, and was a former member of the Prefectural Assembly of Ehime. In addition, he was director of the

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14 Measuring the Extent and Implication of Director Interlocking in the Pre-war Japanese Banking Industry, CIRJE, Faculty of Economics, University of Tōkyō, CIRJE F-Series, CIRJE-F-138.
15 Okazaki and Yokoyama, p.17.
Hashihama Dock Company and the Seihyō Gas Company.

Managing Director Haruki Yagi became auditor of the bank in 1907, director the next year and managing director in 1918. He led the family business in the distilling industry and he was one of the founders of the Imabari Electricity Company in 1906. He belonged to the constitutionalism party and as a high taxpayer he was a Diet member in the House of Peers. He worked as chairman of Imabari City Council and was a former member of the Prefectural Assembly. He was also a board member of the Iyo Mutual Saving Bank, auditor of the Abe Company and the Iyo Railroad Company, and president of the Imabari Brewery Company.

Director Michiyasu Yano, the major stockholder of the bank, assumed his office at the Imabari Commercial Bank in July 1905. Like president Yagi, he was involved in the salt production business and other related activities, and he had been a member of the City Council.

Director Joichi Nagashima became board member of the Imabari Commercial Bank in January 1905, holding, through the years, various positions, such as auditor and managing director. He owned his own kimono company, but after the closure of the business, he decided to form a mutual trust company, trying to speculate on land, although according to rumors he did not obtain good results.

Director Kōta Okada joined the directorate of the Imabari Commercial Bank in January 1925. He managed his own Okada Woven Fabric Company, possessed more than 650 looms and created one of the best textile industries of the city. He worked at the Kōgyōsha, managed by Tamotsu Yanase (an auditor of the bank) and was moreover related to the Yōshu Textile Company and the Imabari Seihako Company.

Auditor Toshitsu Ochi became part of the bank directorate from the time of the bank establishment. He had farming and other business relationships and was a very popular person, coming from a wealthy and powerful family.

Auditor Tamotsu Yanase became part of the bank directorate in July 1920. He was president of the Kōgyōsha, one of the biggest textile companies at the time, which employed

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19) Ehimekenshi — Shokai Keizai 4, p.140.
21) Ehimekenshi — Shokai Keizai 4, p.140.
22) Imabari Cotton Industry Association, p.22.
800 people. He became one of the highest-ranked traders in the city and was also director of
the Imabari Seihako Company.

Auditor Eijurō Yagi took office at the bank in July 1926. He worked in liquors, soy sauce
and the brewing industry and, since he came from a wealthy family of the area, he had close
family relations with president Yagi and director Yano. He was moreover director of the
Imabari Brewery and the Imabari Seihako Companies, and auditor of the Imabari Gas Seihyō
Company.

2.3 Methods of Bank Mismanagement

As already seen, the Imabari Commercial Bank establishment was aimed to create a link
between banking activities and the rising textile and cotton industries in the Ehime area at
the end of the 19th Century. From that moment, the bank tied its fate to the ups and downs

of economic trends in the textile market.

However, this very strong link the Imabari Commercial Bank created with firms in the area eventually weakened its business. The bank, in fact, lacked a management system. This is why it was not able to protect its clients and offered long-term loans, often without any guarantee, to people and companies directly related to its board members. This bolstered the theory that the Imabari Commercial Bank a) was serving as an institutional bank to firms in the Ehime Prefecture, b) had strong directorate interlocking with companies in the area, and c) was managing its business in a lax way.

Whenever a crisis faced the textile sector, because of the close link the bank had with the cotton and textile industries, it was prone to the risk of non-repayment of an enormous amount of loans it granted to companies and individuals in Ehime Prefecture. In the same way, the bank found itself defenseless during critical events, such as the panic that occurred in January 1927, when the Imabari Commercial Bank was forced to temporarily stop payments to allow an internal reorganization.

The Imabari Commercial Bank’s negligence in treating its business can be summarized in such banking mismanagement “rules” also confirmed by other examples of banks’ failure all over the world.

First of all, in the balance sheets, there was no neat list in which debtors’ names could appear. In general, without the name of the debtors no real or just estimate can be formed of the security of the investment. In other words, the larger the number of debtors, the more sure is the debt, since probably no bank is ever brought down by the failure of hundreds of small debtors.

Secondly, considering small loans, with ordinary security the bank could have probably been safe, not from any loss, but from any serious injury to the solvency of the establishment. It would have been therefore unnecessary to examine the solvency of such debtors to recognize the solvency of the bank. However, the bank failed in giving clear details about overly long-term-debts. Permanent loans, in fact, are not legitimate banking, and whenever a sum has been on loan for years without repayment, the debt ought to be strictly investigated. But the important outstanding debts that such a clarification would affect were those irrecoverable amounts, which instead of being written off, were carried forward from year to year as good assets under titles which hid their real nature. In this way this clarification should prevent bad loans from being seen as good ones.

Thirdly, there is one type of advances which are in their nature opposed to the principles

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of strict banking, namely unsecured loans of whatever nature: but the Imabari Commercial Bank largely contravened the general rule of never making a loan without security.

Another reason at the base of not only the Imabari Commercial Bank’s, but also many other banks’ collapse can be “secret management.” It is not believable that a bank could have reached so disastrous a condition, if the knowledge of the real state of their finances had not been locked up for a long time and kept secret from everybody else. The secrecy resulted to be unnecessary. Generally speaking, the fact of keeping undisclosed the real numbers of a bank leads people to act under a motive very different from the one which ought to regulate their management, producing different results. Such secrecy is injurious to the company in times of prosperity and adversity alike.

2.4 Reasons of the Closure

Analyzing in detail the internal factors which led to the Imabari Commercial Bank’s deadlock, it is well evidenced in the incapability the directorate demonstrated in the management of the bank’s business, in particular in the laxity in granting loans and discounts. On the eve of closure and during its reorganization, there was a strong imbalance in deposits and loans: against ¥13,700,000 deposits, the bank had granted loans for a total amount of ¥17,600,000.

2.4.1 Assets and liabilities

Assets and liabilities of the Imabari Commercial Bank were unbalanced, because of the business conditions which particularly affected the activities of the bank; the relationship between an easily estimated asset and liabilities subject to bank run was a very important factor.

We can assume that hypothetically all deposits on fixed term were subject to a bank run, first of all affecting liabilities, while assets were easily estimated as well as the whole amount of call loans and national bonds, company debentures, deposits’ papers and loans with

28) Tamaki, p.182.
guarantees, loans half guaranteed by stock certificates, and a modest percentage of credit
loans. Comparing in fact the surplus in assets easily estimated and all the amount of deposits
on fixed term, the percentage is very low, but if a destabilization in deposits occurred, a
surplus in assets would decrease, causing an impasse and creating a run on the bank. In other
words, in the specific case of the Imabari Commercial Bank, assets were in unstable con-
ditions.

2.4.2 Deposits

Fixed deposits increased gradually until the first months of 1926, while the rest of deposits
decreased as a result of new regulations affecting savings banks, but the decrease in certain
current accounts has to be considered noteworthy. Moreover, generally current accounts
balances were also fluctuating and at last their decrease was covered only partially by the
increase in fixed deposits.

The Imabari Commercial Bank collected many fixed deposits in order to accumulate the
money necessary for long term loans. The amount increased constantly and at the end of 1926
it reached 70% of the total deposits. Also, payments of interest were high: the lowest interest
the bank paid was 7%, but it became more than 8% to big depositors and among them some
could receive 9%. We can assume however, that this method failed badly, since there was a
great increase in long term loans.

The run on the bank in January 1927 evidenced that the percentage of reserves for
repayment of deposits were kept at low levels. As a matter of fact, the bank had no money
in hand, because it was used for guarantees of exchange balance and loan guarantees. It
cannot be stated, therefore, that the bank was reserving money. In addition, call loans set off
call money and in practice reserves for repayment were low.

The most important items in reserves were current money and deposits and because most
of the deposits were on fixed term, generally reserves appeared healthy, but if we do not
consider fixed term’s ones, the percentage of reserves decreases drastically.

2.4.3 Absence of rules in lending

As already seen, the biggest troubles of the bank depended on the absence of rules in
lending. Until the first semester of 1926 there was a notable increase in the total amount of

29) It should be added also the fact that possessed valuable notes did not include local stocks and
company bonds, which were not working in the market. Ehimekenshi — Shokai Keizai 4, p.143.
31) Ehimekenshi — Shokai Keizai 4, p.144.
32) Originally, ordinary banks considered a positive means to use fixed deposits as capital, and banks
tried to accumulate as many fixed deposits as possible. This attitude was not wrong, but considering
that by their nature those deposits gave high interest, the term was comparatively long and not fixed
and at the very end, not conscious of their mistake in lending money, banks collected a large number
loans and discounts, mostly in loans on bills, but on the other hand discount bills decreased. This movement of money could not be expected to be positive. The extent of non guaranteed loans and discounts was particularly high, and on the eve of the bank closure, it occupied almost 50% of the total amount of loans and discounts. Guaranteed loans and discounts were often granted by real estate and buildings (28% of the total amount of collateral and 58% of guaranteed loans and discount.) Loans and discounts secured by stocks represented 12% and covered 10% of the total amount of collateral. On the other hand, collateral on superior securities was very low and collateral on national bonds was only 0.2%.

The rather frequent abuse in the excess in lending on real estate as collateral was also common in regional banks at that time and the Imabari Commercial Bank itself did not avoid such a widespread practice. Moreover, credit loans and loans with collateral, secured by real estate and goods, increased from the first years of the 1920’s, but, on the contrary, loans with stocks as collateral decreased, national bonds and company bonds did not substantially change and valuable securities showed a general decreasing trend.

In summary, the way of lending was in a total disorder as a consequence of the absence of rules for general managers and their assistants, who had the power of deciding and lending, and this lack of supervision was the cause of the chaotic situation. Even when loans and interests were not repaid after their natural deadline, the Imabari Commercial Bank continued to lend money and postpone the due date. The fact of not getting paid back at the end of the natural term worsened the bank’s conditions. Not only this - in some cases the bank lent over the value of guarantees received. In addition, there were almost no orders by auditors (who actually should have been present by law) in the trade between directorate and bank. Within discount bills there were many accommodation bills and in spite of the existence of a limit in financing, such a limit was often exceeded and also the bank lent money without any guarantee, simply trusting creditors.

The total amount of loans and discounts of the bank had always exceeded the total amount of deposits and had been maintained at the percentage of 120% to the latter. It was essential for the bank to find money to grant loans, since together with a continuous increase in loans and discount in the 1920’s, there was an increase, especially in long term loans, which were sporadically paid back. As a consequence, loans became longer termed and for this reason

33) Even if those loans and discounts were different in nature, it was not easy to understand in which way they were different: within discount bills, in fact, there were not real commercial bills, like stocks and real estates as collateral and also within unsecured loans and discount there were also accommodation bills. The Bank of Japan, p.173.
35) Ibidem, p.177.
36) The Imabari Commercial Bank postponed sometimes the due date of its repayment more than 20 times and once even 49 times! Ibidem, p.179.
there was not enough money in hand, so that the bank found itself in serious straits, unable to overcome a bigger danger.

Business profits of the Imabari Commercial Bank, shown in the profit-and-loss statement, generally decreased, but there was an unbalance between various deposits and loans and interest income from various loans and discounts (an important item in the profit-and-loss account) on the one hand, and the repayment of interest on the other hand. The result of the unbalance was a decrease in business profits. Loans and discounts, together with their profits, increased, but at the same time this increase was accompanied by a proportional increase in loans. The interest payment of loans increased constantly while within deposits only fixed deposits dropped lately, and repayment of interest increased. There was an increase in the cost price of funds employed and at the end the profit margin gradually began to decrease. Eventually, the fundamental cause of the business crisis was the discrepancy in each important item in the bank statement.

The Imabari Commercial Bank demonstrated great imprudence also in the selection of collateral to grant loans. As a consequence, the character of loans worsened and the bank faced the great danger that its loans would not be repaid. Analyzing, for example, the situation on February 10, 1927, loans and discounts using the bank’s securities as collateral were ¥534,000, but this kind of lending was illegal! The number of stocks used as collateral was 13,000, that is to say 1/4 of the total 50,000 shares possessed by the bank. In any case, one stock’s value was ¥50 paid up and considering the total amount of loans and discounts by this means, the danger was that it was not too far from the total paid up average.

Within loans, the collateral of which were certificates of deposit, terms of financing were extended, but there was the risk of a discrepancy in the certificates of deposit used as collateral. The value of each kind of guarantee was kept too high and collateral was not estimated for its right value.

The bank’s business showed many bad examples of variance in danger. It concentrated the major part of its loans and discounts in a few big long term loans, making it difficult to correct the situation. Considering, for example, the situation on February 10, 1927, as reported in the Bank of Japan documents after the bank’s inspection, loans of over ¥50,000 corresponded to 45.2% of the total lending, while there were few loans exceeding ¥300,000. The total accounts of shareholders in the bank were ¥3,836,000, including capital, deposits and transferred money, while loans without guarantees were almost half this amount, putting in serious danger their repayment in case of crisis. Considering debtors over ¥50,000, the}

Fig. 3: Debt Related to Directorate and Directorate Interlocked Companies (unit: ¥)

<table>
<thead>
<tr>
<th>Bank executive</th>
<th>Personal debt</th>
<th>Guarantee liabilities</th>
<th>Total</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
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<td></td>
<td></td>
<td></td>
<td>On security</td>
<td>Without security</td>
</tr>
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<td>President Kamesaburō Yagi</td>
<td>* 446,200</td>
<td>378,496</td>
<td>824,696</td>
<td>102,000</td>
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<td>Managing director Haruki Yagi</td>
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<td>190,445</td>
<td>785,415</td>
<td>75,518</td>
</tr>
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<td>Director Kōta Okada</td>
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<td>153,744</td>
<td>1,320,547</td>
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<tr>
<td>Director Michiyasu Yano</td>
<td>100,800</td>
<td>323,152</td>
<td>423,952</td>
<td>119,675</td>
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<td></td>
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<tr>
<td>Director Jōichi Nagashima</td>
<td>211,435</td>
<td>40,965</td>
<td>252,400</td>
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<td>18,148</td>
<td>18,148</td>
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<tr>
<td>Auditor Tamotsu Yanase</td>
<td>* 523,553</td>
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<tr>
<td>Auditor Eijurō Yagi</td>
<td>89,436</td>
<td>196,756</td>
<td>286,192</td>
<td>137,827</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>3,133,197</td>
<td>1,301,706</td>
<td>4,434,903</td>
<td>868,494</td>
</tr>
</tbody>
</table>

(Source: The Bank of Japan, pp.181–2)

major part was represented by members of the board, while other debtors were people closely related to the former. The total amount of loans they received was more than ¥4,000,000, namely, half of the total amount lent.

Most of the debtors were involved in the cotton industry, both in clothes manufacturing and machinery. The amount of loans granted to them was 57% of the total large loans. The remaining part was distributed between various activities, mostly related to the directorate and cotton industry. Because the major part of lending was reserved for the latter, the crisis of the sector wounded the bank businesses, most of all because loans were in great part without guarantees. The result was the impossibility of repayment of 36% of the money lent,

40) Ibidem, p.145.
which became a liability, and most of the loans were long-termed.

The directorate of the bank took undue advantage of its position granting loans using personal favoritism for relatives or close friends. The damages were caused not only by loans by the directorate, but also by the ones done by clerks. Because of the consequent reckless loans, bad loans increased to the extent of becoming an important cause for the failure of the Imabari Commercial Bank. Namely, loans related to personal ties of the directorate and clerks on February 10, 1927, corresponded to 30% of the total loans of the bank, 90% of which were related to personal connections of members of the board, such as to their companies or relatives. It is clear that loans and discounts, including the ones related to the clerks and their relatives, were arbitrarily decided by the directorate, without any approval by auditors, demonstrating a careless way of financing, and giving no clear explanation of most of the bank’s business.

Regarding loans of small amounts, these were often granted to people doing humble or poorly paid work, even if they did not possess property. It was certain this money could not be paid back. It was not unusual that personal trust was valued more than the rules of lending.

During the temporary closure of the bank, not only did the board members leave traces of promissory notes they actually did not emit, but also they promised to categorize the losses of the bank under the name of “losses and allotments.” In any case, the members of the board were not able to repay the losses, since they were using the money for different purposes. Part of the losses were used in businesses the directorate members individually managed.

Regarding the investigation of the Imabari Commercial Bank, the forecast of loans’ repayment was the possibility of an easy repayment of about 30% of the loans and discounts, while the remaining 70% were long term loans and within that the part impossible to collect was half of the Imabari Commercial Bank’s capital. The bank was optimistic about the forecast of repayment, but the truth was different, since loans which could have probably been repaid, but in the long term, made up the biggest part. Long term loans within the total amount of loans and discounts went in many directions. The higher the amount of loans, the lower the ratio of repayment. Big loans, loans to cotton industry and loans directly related to the directorate were huge, as well as the proportion of long term loans related to the

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41) Many long term loans were made by the bank to cotton industries in the years of economic depression and, because in 1927 they were not yet paid back, it is easily understandable that these loans were difficult to recover in such conditions. One third of the total amount of long term loan was related to cotton industries, while two thirds were general loans. The Bank of Japan, p.181.


43) Ibidem, p.182.

members of the board.

In conclusion, loans were recklessly given and even as the situation worsened, the bank continued to lend, being the first cause of its own troubles.

3. Concluding Remarks

The Imabari Commercial Bank was managed by influential people from Iyo, who mostly came from wealthy and pioneering industrial families. The directorate of the bank was predominantly formed by businessmen running leading companies in the cotton, textile, flannel and towel industries and they dedicated their lives to the promotion of the area, riding the wave of economic and industrial modernization.

On the other hand, people put much trust in bank savings. The establishment of banks in the first place, and consequently deposits, had been important changes in post-restoration Japan and local banks covered a fundamental position in sustaining the areas in which they were offering their services. As in, for instance, the Imabari Commercial Bank’s case, in January 1927 the number of bank accounts exceeded 70,000. In similar situations, it was obvious that a bank’s troubles would have affected not only bankers and businessmen, but also small depositors, who had put all their savings in local banks.

In any case, we should of course be aware of not justifying the bank’s conduct from a managerial point of view. Generally speaking, if managers or directors of a bank intend to deceive or conceal the details of their management, they will find some way of doing so, in spite of every check that may be imposed. Fortunately, it is not willful imposition that it is to be guarded against. In the majority of instances, those who misdirected the businesses did it through negligence or for some other reasons than their own profit. Frequently, they gradually became involved in some speculative undertaking, until the moment that, unable to set themselves free, they sank hopelessly deeper and deeper into ruin with those they attempted vainly to support.

It is easy to be wise after the event, but probably there could have been some general suggestions which would have helped banks in the past (and indeed, nowadays as well) avoid many risks. The keyword for it should be “audit.” Directors and auditors of a bank ought to pursue their examination of a bank’s affair fixing, for example, a certain amount of debt in order to identify large debtors to the bank; reporting loans over a certain amount and outstanding for over a defined period; specifying the not yet matured liabilities of the bank, such as bills rediscounted, acceptances, etc., as well as unsecured loans. It is implied in such an audit that materials to be examined should be honestly placed in front of the auditors, who are willing to spend some time in the investigation, demonstrating that they are people of
intelligence, experience and courage.

Nowadays, banks are, of course, more regulated and risk is much more diversified than in the past, averting the danger of runs on banks. But general rules of common sense and honesty are still the foundation necessary to avoid the recurrence of similar events.

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