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Articles

Banco Herediano 1879-1884: Operational history of the first provincial bank in Costa Rica

Banco Herediano 1879-1884: historia de las operaciones del primer banco provincial en Costa Rica

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Abstract. The paper analyzes Banco Herediano's short operational life during the last quarter of the 19th century. It describes how the first provincial bank in Costa Rica took advantage of a period during which coffee prices boomed to develop an important regional credit activity. It presents a brief reference to the then existing economic and banking contexts to show how changes in these initially created conditions were favorable to establishing the bank. However, later, when changes in the world market led to a fall in coffee price, this situation ultimately resulted in the bank closing its business. Based on bank documents and national archival sources, we reconstructed the bank's structure and operations for 1879-1884. A summary of results includes details about financing operations, causes of changes in board membership, characteristics of 2 600 individual loans and 760 debtors, the type of guarantees utilized, and a brief comparison of performance in relation to contemporary banks in Costa Rica.

Keywords: banking history; provincial banking.

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Resumen. El artículo analiza la corta vida operativa del Banco Herediano durante el último cuarto del siglo XIX; describe la forma en la que el primer banco provincial de Costa Rica aprovechó la coyuntura favorable de los precios del café para desarrollar la actividad crediticia; también, presenta una breve descripción del contexto económico y bancario del momento, y muestra los cambios que promovieron las condiciones favorables para el establecimiento del banco. El artículo también analiza cómo los cambios en el mercado mundial del café provocaron la caída en el precio del grano en los mercados y, en consecuencia, el fin del negocio. Con base en documentos del propio banco y fuentes de los archivos nacionales, reconstruimos la estructura y las operaciones del Banco Herediano entre 1879 y 1884. Los resultados arrojan información sobre el financiamiento del banco, los cambios ocurridos en la composición del directorio, un análisis de los 2 600 préstamos individuales y 760 deudores, el tipo de garantías utilizadas, y una breve comparación con otros bancos de la época.

Palabras clave: historia bancaria; banca provincial.

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INTRODUCTION

According to Marichal (2008) and Marichal & Gambi (2017), in the 19th century Latin America banks provided models for a new business organization, as banks were organized as joint-stock firms acting as a stimulus to develop the slowly rising formal capital markets in the region, by helping to expand local credit markets and disseminating the use of modern financial instruments. In the region, bank development was not carried out at a uniform pace. Some economies had relatively more banks and improved banking services, while others had fewer banks and a lower level of banking services. In Argentina and Brazil, banks began operating in the 1820s, whereas other Latin American countries had no banks in operation as late as 1860 (Marichal, 2008; Zegarra, 2014). In most Latin American countries, banks appeared first, and commercial or banking regulations came afterward (Blasco & Noriega, 2019).

In this early period, banking developed in Latin American countries with a high economic growth rate as measured in terms of an increased level of foreign trade, population, and per capita income (Marichal, 2008; Zegarra, 2014; 2018). A greater level of economic activity was associated with an increasing demand for banking services and banks' profits. Thus, banks grew both through the demand and the supply side of credit. Zegarra (2014), using annual data for five Latin American countries for the period 1840-1920, found that an increase in exports had a significant effect on the growth of banking activities while, for the most part, changes in banking laws did not have a substantial effect in promoting banking in the region.

Costa Rica showed an early development of formal credit institutions in the 19th century and early 20th century (Zegarra, 2013, 2014, 2018). During the two decades following independence in 1821, the few export products (tobacco, gold, brazilwood) were financed with traditional sources

of commercial credit (Molina, 1987; 2002). These consisted of credit from both public and private lenders, supplemented by own capital available to merchants for internal market operations and limited external commercial credit used by importers and exporters. The small size of the economy offered few investment opportunities, and much of the accumulated capital went for the purchase of land or –to a lesser degree–commercial lending. It was not until the 1840s that trade fully developed with the entrance into the international coffee market (Hall, 1976). This dynamic external trade was financed with the limited capital existing in the country and through commercial credit instruments such as short-term loans and letters of exchange available from external creditors (Peters, 2004).

Research in Latin America suggests that the level of economic activity played a significant role in banking development. Peláez (1975), studying the Brazilian experience in banking in the early stages of economic growth and development (1800-1851), found that banks provided financing for coffee exports. Sweigart (1987) concluded that coffee economy-related factors worked to expand commercial banking in Rio de Janeiro. Hanley (2005) emphasizes how the expansion of coffee production stimulated the Sao Paulo capital market's development by creating a new and enormous demand for capital. Kisling (2020) analyzed the impact of the German bank's entry on the performance of export houses in Brazil during the period 1880-1913 and concluded that the *Brasilianische Bank* reduced previously existing credit constraints and that those companies it financed, exported significantly more than those that it did not.

In Colombia, Correa (2009) pointed out, that entrepreneurs took the initiative to establish a semi-official bank to promote the planting of coffee. The expanding coffee-based economy and the agrarian frontier's advance, in turn, encouraged the establishment of banks in different regions. While in Antioquia, banking activity financed productive conversion to coffee cultivation, on the Atlantic Coast, the banking industry's prosperity resulted from increased coffee exports channeled through its ports, which improved business volume and profits for local banks (Ramírez, 2018). In Bogotá, banks were instrumental in promoting large-scale coffee cultivation in the 1880s (Ramírez, 2018). Romero (1994) points out that in the capital, the primary beneficiaries of bank loans were the commercial sector, importers and coffee farmers, and the government.

In Costa Rica, according to Quesada (2012), the early development of banks is attributable to the coffee economy, which played an essential role in 19th century economic growth. Coffee growers and merchants were the founders of the first operational banking institutions (*Banco Anglo* and *Banco de la Unión*) and dominated these to such an extent that the latter became known as the *bank of coffee growers*. Establishing a new bank during the last three decades of the 19th-century was therefore not an easy task, as it implied competing in an environment where these two banking institutions had developed close business ties with the government and the private sector.

Costa Rican coffee exports began in 1832 and gradually gained importance once they found a direct market in London by 1839. Demand for coffee exports grew in the following decades: from an average of 3 300 tons per year in the 1840s to 4 000 tons in the 1850s, 5 700 tons in the 1860s, to 9 700 tons in the 1870s, and finally to some 10 500 tons annually in the 1880s. As internal coffee prices tripled between the decades of 1840 and 1870, coffee earnings from exports became, by far, the country's primary source of foreign exchange during the period.

With an increasing degree of monetization of the economy, those farmers or merchants that were receiving income from coffee exports that they could not consume or invest directly sought ways to ensure the safekeeping of their money. This, and the need to transfer their earnings from

export sales in London and other markets to Costa Rica and convert the foreign coin into currency in use in the country, made it necessary to establish new financing mechanisms, which led to banks' being established as an instrument to deal with these diverse needs.

The paper addressed the following question: How significant was Banco Herediano's role in developing a credit culture in the limited regional-provincial market it operated in? By analyzing the bank's accounting books and Archivo Nacional de Costa Rica's documents, it was possible to reconstruct the bank's operations to a substantial degree and offer an initial response to this question. The large amount of data bank books provided on bank loans, repayments, guarantees, liabilities, and current accounts, were used to set up detailed tables which were then analyzed to reconstruct BH's loan operations; while annual balance sheet data, were used to compare overall performance results with those of other banks then active.

After the introduction, the article is divided into four sections. The first provides a short history of the banks established in Costa Rica between 1850 and 1880. The next focuses on Banco Herediano (here forth BH), its origins, objectives, principal shareholders, and the basis for its financing, including capital, liabilities, and current accounts. A third section, is an analysis of BH banking operations, considering loans, debtors, location, guarantees, loan repayment periods, and the comparative results vis-a-vis other banks. A final section states the conclusions based on available information.

ESTABLISHMENT OF THE FIRST BANKS IN COSTA RICA, 1850-1880

The first attempts at establishing a bank in Costa Rica dated from 1849 when a French investor presented a proposal for establishing a bank to the José M. Castro Madriz administration (1846-1849). The idea did not prosper at that time (Chacón, 2019 Villalobos, 1981; Gil, 1982), but Castro maintained an interest in setting up a bank and, during a trip to Europe, contacted bankers, and when he returned to the country in 1851, brought a new bank proposal developed by French investors. He presented a draft contract to Congress, but it did not receive support from Juan Rafael Mora's administration (1849-1859), and nothing came out of this early attempt at setting up a bank.

However, the idea of establishing a bank remained and the new Commercial Code approved in 1853 contained legislation allowing the setting up of modern-type commercial companies, including banks (Villalobos, 1981). A new proposal from Crisanto Medina, an Argentine entrepreneur, to establish a bank in 1857 during the war with filibusters which had taken over Nicaragua, when the Costa Rican government was having great difficulty financing the war, resulted in Mora this time strongly supporting the initiative, even providing part of its capital with government funds. That same year the Banco Nacional Costarricense was established, as the first authorized bank in Costa Rica (Gil, 1982; Villalobos, 1981).

As could be expected, those economic groups and individuals, which hitherto had run the financing system, based on private moneylenders and short-term foreign advances on future coffee crops, considered this bank a threat. The opposition went beyond the moneylenders and had to do with a broader political issue tied to rivalries between economic groups trying to control the economy, pitting Mora and his associates against powerful family clans such as Aguilar, Montealegre, Tinoco, and Yglesias. The strong resistance of these interested parties and Banco Nacional's own inadequate capitalization led to a very brief operating period for the bank (from June 1858 to March 1859).

Local entrepreneurs recognized the importance of having a financial institution such as a bank but agreed to establish it only if it was under private investors' control, without any direct government participation. Some years later, in June 1863, a group that included members of the Montealegre and Aguilar-Allpress families, together with Allan Wallis, a British merchant, created the Banco Anglo Costarricense (Corrales, 2000; Villalobos 1981; Gregorio 1981). This was the first banking institution that operated in a sustained manner; having successfully functioned for 131 years. It was established as an issuing bank (but did not have a monopoly). Its commercial operations were oriented to handling current accounts with deposits from clients, and providing loans with guarantees based on "vales" or promissory notes. In addition, it carried out active business discounting documents and letters of exchange from foreign markets (Chacón, 2019; Gil, 1982; Villalobos, 1981). According to Quesada (2012), Banco Anglo provided coffee growers with access to credit from the British market to pre-finance the coffee harvest.

To further growth by promoting economic activities, especially in agriculture, various efforts were made in the second half of the twentieth century to establish other banks. However, most of these were unable to obtain the required operational capital, and only the Banco de la Unión, in addition to Banco Anglo, managed to enter the credit market and operate on a long-term basis during this period (see table 1).

TABLE 1. BANKS ATTEMPTS IN COSTA RICA (1850-1890)

| <i>Bank</i> | <i>Years</i> |
|--|-----------------------|
| Banco Nacional de Costa Rica | 1858-1859 |
| Banco Anglo | 1863-1994 |
| Banco Nacional de Costa Rica | 1867-1877 |
| Banco Hipotecario Rural | 1873-1875 |
| Banco Nacional de Costa Rica | 1877-1887 |
| Banco de la Unión; Banco de Costa Rica | 1877-1890; 1890-today |
| Banco Herediano | 1879-1884 |

Source: Chacón (2019).

Founded by a group of landowners and businessmen, Banco de la Unión opened its doors in 1877. The Bank's starting capital was provided by eight well-known entrepreneurs. In 1884, it signed a contract with the government known as the Soto-Ortuño agreement, giving it the sole right to issue currency until 1887, and renewable until 1900. In November 1890, the Bank's Board of Directors agreed to change the Bank's name, to Bank of Costa Rica. The Bank began to compete successfully with Banco Anglo (Chacón, 2019; Villalobos, 1981; Gil, 1982). Quesada (2012) puts emphasis on the bank being founded at the height of the Costa Rican coffee boom when coffee growers and merchants had managed to accumulate significant capital which they then used to finance the new banking institution.

THE FOUNDING OF THE BANCO HEREDIANO

In Costa Rica, the establishment of banks in this period was carried out under the rules of the Commercial Code of 1853, which was, in turn, an adaptation of the Spanish Commercial Code of 1829. Articles 221-305 (modified by Law 6 of 1909) of the Commercial Code specify how commercial companies were constituted, among which banks were included. Some bad experiences with the constitution of banks, such as the Banco Rural de Crédito Hipotecario, resulted in the approval of Law 24 in 1875, where it was specified that companies could take three forms: financial, commercial, and industrial, indicating the type of functions that they could perform. By the time Banco Herediano was established (in 1879), financial companies were constituted according to Law 24 but did still not have legislation expressly stating how they should conduct their activities. This situation changed in 1900 with the approval of Banking Law No. 16, which specified for the first time a set of standards that banks should comply with in their operations.

Heredia province in 1883 had a total population of 25 800 (14% of the national total) and contained a high percentage (31%) of the area under coffee cultivation nationwide. The province had 140 coffee mills (mostly small-scale ones), 30 commercial firms, and seven large stores in the city and its immediate vicinity. Its main city was located near the capital (San José) and on the main road to the Pacific and the Atlantic. For these reasons, Heredia was an important regional market within the Central Valley and an attractive place for establishing a business. Agricultural and commercial activities in the province according to local capitalists, justified setting up a bank to attract and channel the province's coffee industry excess earnings.

In the context of this semi-rural economy based on coffee production, the BH was established when in 1879, a group of local coffee farmers and merchants came together to set up a commercial bank company. In total, fifteen men launched the new enterprise, all having substantial economic means, and included large coffee farmers, merchants, two lawyers, two doctors, and a priest (see table 2).

Family ties linked some of the associates; others had longstanding business dealings together, and others were political allies. Aside from the Trejos brothers, who had participated in some of the first attempts at organizing banks, none of the other members had any practical experience managing this new type of financial enterprise.

BANK CAPITALIZATION

The BH statutes established that the enterprise's operational period would be for five years –the legal minimum– and that the shareholders could extend this term in the future. However, this did not occur, as will be discussed below. The bank set an initial nominal share capital of 250 000 pesos, with 25 shares of 10 000 pesos each. This initial share capital was nominal and not the contributed capital, which at the first meeting of the board of shareholders amounted to only 18 000 pesos. To obtain the agreed social capital, the founding members considered requesting a loan from a foreign bank. This proposal failed, but it did not stop Banco Herediano from starting up operations on June 1, 1879.

Jose Gregorio Trejos Gutiérrez as president, Manuel José Zamora Gonzalez as vice president, Joaquín Gutiérrez as secretary, and José Ana Pacheco Alfaro as undersecretary composed the first BH board. They designated Joaquín María Flores Umaña (one of the founding members) as the bank manager, who would take on its legal representation and administer the bank's resources

TABLE 2. LIST OF ORIGINAL PARTNERS IN THE BANCO HEREDIANO (1879)

| <i>Coffee growers</i> | <i>Age</i> | <i>Main economic activity</i> |
|--------------------------------|------------|-------------------------------|
| Manuel José Zamora | 60 | Farmer |
| José Gregorio Trejos Gutiérrez | 40 | Lawyer |
| Jacinto Trejos Gutiérrez | 40 | Lawyer |
| Saturnino Trejos Gutiérrez | 40 | Topographer |
| Juan José Flores Umaña | 30 | Doctor |
| Rafael Flores Umaña | 30 | Doctor |
| Joaquín María Flores Umaña | 40 | Farmer |
| Joaquín Gutiérrez | 40 | Politician |
| Mercedes Bustos Garita | 40 | Farmer |
| Pascual Solórzano Sancho | 40 | Farmer |
| Esteban Echeverri Ruíz | 40 | Priest |
| Mariano Chaverri Ocampo | 40 | Farmer |
| José Jiménez Vindas | 40 | Farmer |
| José Ana Pacheco Alfaro | 40 | Merchant |
| Juan de Dios Pacheco Alfaro | 40 | Merchant |

Source: Banco Herediano, Banking establishment contract, Lara and Chamorro, 000510-T1-F.59, April 30th, 1879.

receiving $\frac{1}{4}$ of 1% of funds loaned out, in payment for these responsibilities. Administration of the BH turned out to be a complicated matter. From the start of operations, several financial problems arose, as well as issues of a legal nature with some of the shareholders and later with the repayment of loans from another bank.

Given the first shareholders' low initial capital contribution, the bank tried to bring in new investors, who would have to accept the same obligations as the original shareholders. According to Villalobos (1981), the bank's board decided to admit new members through their purchasing of shares that had been revalued to 100 pesos each, and at the same time, buying government bonds as part of the bank's capital. In 1881, two years after its establishment, the bank had a total of fifteen shareholders (see table 2). Some of the original members, such as Manuel Zamora and the three Trejos Gutiérrez brothers, had left the enterprise. In contrast, new ones took their place: Pedro Carvajal Murillo, Ramon Ramirez, Gaspar Rojas, Paula Paniagua, Manuel Zamora, and Santiago Salas. As a result of these changes, Carvajal and Rojas became the BH's main shareholders, instead of Manuel Zamora González (see table 3).

TABLE 3. SHARES SUBSCRIPTION AND CAPITAL CONTRIBUTIONS TO THE BANK

| <i>Shareholder</i> | <i>Number of shares July, 1879</i> | <i>Nominal value of shares in 1879</i> | <i>Nominal value of shares subscribed in 1880</i> | <i>Member status between 1879-1884</i> | <i>Guarantees provided to back the purchase of shares (pesos)</i> |
|-----------------------------------|--|--|---|--|--|
| 1. Manuel José Zamora González | 4 000 | 40 000 | 90 600 | Withdrew in June, 1882 | Mortgaged to BH in 1880-1881, 25 properties valued at 84 750; 24 of these valued at 62 375 in August, 1883 |
| 2. José Gregorio Trejos Gutiérrez | 3 000 | 30 000 | - | Withdrew August, 1880 | Withdrew, unable to cover a debt to H. Mayer of Hamburg |
| 3. Jacinto Trejos Gutiérrez | 2 000 | 20 000 | - | Withdrew August, 1880 | Withdrew, unable to cover a debt to H. Mayer of Hamburg |
| 4. Saturnino Trejos Gutiérrez | 3 000 | 30 000 | - | Withdrew | |
| 5. Esteban Echeverri Ruíz | - | - | 18 500 | Withdrew March, 1882 | Mortgaged five properties, worth 19 000, and ended up turning these over to the bh. |
| 6. Pascual Solórzano Sancho | 2 000 | 20 000 | 10 300 | - | Mortgaged three properties, worth 10 150 |
| 7. Mercedes Bustos Aguilar | 1 000 | 10 000 | 14 400 | - | Mortgaged two properties, worth 4 410 |
| 8. Joaquín Gutiérrez Córdoba | 1 000 | 10 000 | 10 000 | - | Mortgaged two properties, worth 10 000 |
| 9. Juan de Dios | 1 000 | 20 000 | 20 500 | - | Mortgaged four properties, worth 20 500 |
| 10. José Ana Pacheco | 1 000 | 10 000 | 10 000 | - | Mortgaged one hacienda in La-gunilla, worth 10 000 |
| 11. Rafael Flores Umaña | 1 000 | 10 000 | 12 000 | - | Mortgaged one coffee hacienda in La Pitahaya, worth 12 000 |

TABLE 3. SHARES SUBSCRIPTION AND CAPITAL CONTRIBUTIONS TO THE BANK

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|-----------------------------------|--------------------------------|---------------------------------------|--|---------------------------------------|---|
| 13. Joaquín María Flores Umaña | 1 000 | 10 000 | 12 000 | - | Mortgaged five properties, worth 12 000 |
| 14. José Jiménez Vin- das | 1 000 | 10 000 | 20 000 | - | Mortgaged three properties, worth 20 000 |
| 15. Mariano Chaverri Ocampo | 3 000 | 30 000 | 10 000 | - | Mortgaged properties, worth 7 500 |
| <i>Original members</i> | 24 000 | 250 000 | 228 300 | - | - |
| <i>New members 1880 and after</i> | | | | | |
| 16. Santiago Salas Ro- dríguez | - | - | 24 000 | - | Mortgaged 65 hectares of pas- ture in Barva, worth 24 000 |
| 17. Manuel Zamora Ocampo | - | - | 10 300 | Entered February, 1880 | - |
| 18. Gaspar Rojas | - | - | n. d. | - | - |
| 19. Pedro Carvajal Murillo | - | - | n. d. | - | - |
| 20. Paula Paniagua | - | - | n. d. | - | - |
| 21. Ramón Ramírez | - | - | n. d. | - | - |
| <i>Total</i> | - | - | 262 600 | - | - |

Sources: Archivo Nacional de Costa Rica, Lara and Chamorro, 000511/T1-F26, December 8th, 1880; and Biblioteca Leolibri, Colección Sáenz Flores, Joaquín María Flores (private documents), vol. 1.

A fundamental problem of the BH was then a low capitalization level from the beginning. Even though new shareholders were brought in the early years, some of the original partners left, so insufficiency in capital continued. Not having been able to secure a foreign loan for the amount missing of the agreed-upon share capital (250 000 pesos), the shareholders were forced to cover the difference by obtaining loans in their names and offering personal guarantees for these (see table 3).

When a comparison is made between the shares bought and shares subscribed and capital contributions to the bank, it is possible to ascertain that BH shareholders had wealth but did not possess sufficient liquidity to cover their obligations regarding the agreed share capital. In January 1880, several partners mortgaged various properties to cover the capital shortfall and comply with the bank's statutes (see table 3).

The three main shareholders in July 1879 were the Trejos Gutiérrez brothers, Manuel José Zamora, and Mariano Chaverri, who paid in 8 000; 4 000, and 3 000 pesos respectively as their outlay to purchase the nominal shares (see table 3). The other partners each put in 1 000 pesos, totaling 25 000 pesos as the paid-in capital, equivalent to 10% of the agreed share capital. Another member, Esteban Echeverri, a priest, took over one share of the two initially purchased by Pascual Solórzano. During the first year of operations, six additional shareholders joined, starting with Gaspar Rojas in February 1880, who bought fifteen of the now revalued 100 pesos shares.

Under the new revalued share arrangement, Manuel Jose Zamora bought 906 nominal shares for an outlay of 90 600 pesos; Santiago Salas bought 240 shares for 24 000 pesos; José Jiménez acquired 200 shares; the three Flores Umaña brothers jointly obtained 340 shares; and the Pacheco Alfaro brothers a further 205 shares. Other partners retained fewer shares: Echeverri, the priest, only took 185 shares; Mercedes Bustos paid in for 144 shares; Pascual Solórzano with 103; Manuel Zamora 103; Joaquín Gutiérrez 100 and Mariano Chaverri 100. Thus, the original group of partners altogether were obliged for 2 626 shares, equivalent in nominal terms to 262 600 pesos (see table 3). In terms of the bank's contract, this total had to be provided into its capital account before April 30, 1884.

However, between mid-1879 and 1882, coffee suffered an abrupt fall in price on the London market, seriously affecting coffee producers' income. This led to some of the partners not fulfilling their obligations concerning the bank's capitalization. When, in 1881 alone, coffee prices fell by 15%, the shareholders, were forced to seek an alternative source of funds to cover the increasing demand for bank loans by local clients.

The first of these capitalization resources came from time deposits by the partners themselves or from local merchants. However, even these proved to be insufficient to solve the liquidity problem, given their client's increasing loan demands. For this reason, the board of the bank, in mid-1881, decided to request a loan for 100 000 pesos from the Banco Anglo. This bank agreed to provide the credit but under stringent conditions, such as requiring the BH partners to offer crossed guarantees through promissory notes. Thus, the Banco Anglo granted a loan for 100 000 pesos, with the backing of ten promissory notes, each for 10 000 pesos. The joint debt was guaranteed by having four partners sign each promissory note, where they mortgaged properties to the Banco Anglo.

The loan was to be settled in July 1882, requiring that all ten promissory notes be paid at the same time. However, this proved impossible for some of the signees, and in 1883 the Banco Anglo was forced to start a long-drawn-out trial against the BH and its board members. By July 1883, the partners had been able to pay back just half the total debt, so they still owed 50 000

pesos to the Banco Anglo. After many attempts at collecting the debt, and having the BH partners declare themselves unable to pay in cash the rest of the outstanding loan, in July 1883 the Banco Anglo began to take over the properties that had been put up as collateral, which included coffee plantations, pasture land and houses. These partners ended up losing properties, as the Banco Anglo auctioned these off to get back its loan funds.

During 1881 and 1882, the BH operational earnings seemed sufficient to cancel the promissory notes on time. However, from early 1883, as BH profits fell drastically, the loan's balance could not be paid back. In 1882 and 1883, as will be seen later, the BH tried to reach an agreement on payments with its creditors and auctioned off properties it had received as collateral on its loans but with little success, as these did not find buyers.

The BH decided not to renew its operational permits for its business when it came due in 1884 because of the unfavorable national economic situation and its own individual members' inability to pay back the Banco Anglo loan. Thus, the initiatives that tried to solve insufficient capital led to the BH's closure and to several of its founding members declaring bankruptcy.

PASSIVE OPERATIONS

Banks will typically use different financing sources to accumulate resources with which to provide loans. These include its own capital and funds provided by clients, be these through current accounts and funds obtained from fixed period loans from private individuals or other banking institutions. For a bank that is just starting operations, its capacity to attract deposits in current accounts, depends on the confidence its clients have in the organization and the capitalists, that are promoting it. Since funds deposited in current accounts by clients of the bank, could be withdrawn on demand, the bank, therefore had to deal with cases where the normal turnover resulted in more withdrawal requests than deposits into current accounts, and this meant relying on capital and fixed term deposits to maintain liquidity.

Current accounts were established after the first three months of operations, starting in September 1879. The first persons to open these accounts were shareholders and as well as individuals not linked to the bank. It is possible from annual bank balances to obtain information on the relative importance of the different funding sources to the BH's finances. Table 4 summarizes the structure in percentage terms according to the different sources of financing from start of operations in July, 1879 to December, 1882.

Aside from the main passive banking activities mentioned, the BH carried out other operations of lesser importance, such as discounting letters of exchange and issuance of banknotes. Also, during its final year, it became involved in an unorthodox business for a bank, that of buying and selling coffee on the international market, as a means of generating badly needed income, but which only resulted in further losses, given the continuing fall in the price of coffee.

TABLE 4. BANCO HEREDIANO. SOURCES FOR FINANCING OPERATIONS 1879-1882

| | <i>Balance at July 1st, 1879</i> | <i>Balance at December 31st, 1879</i> | <i>Balance at December 31st, 1880</i> | <i>Balance at June 30th, 1881</i> | <i>Balance at December 31st, 1881</i> | <i>Balance at December 31st, 1882</i> |
|---|--|---|---|---|---|---|
| <i>Financing sources</i> | | | | | | |
| Total financing sources | 18 | 102 173 | 165 661.4 | 220 006.4 | 189 281.6 | 125 238.9 |
| Paid-in capital (percentage) | 100 | 15 | 15 | 17 | 21 | 19 |
| Obligations to pay (liabilities) (percentage) | - | 75 | 84 | 81 | 78 | 40 |
| Current accounts (percentage) | - | 10 | 1 | 2 | 1 | 41 |
| Percentage of total | 100 | 100 | 100 | 100 | 100 | 100 |

Source: Banco Herediano, Libro de Caja, num. 1, July, 1879-December, 1880.

In principle, a bank could only make loans up to the value of the share capital it possessed. However, this limitation could be changed if the bank increased its lending resources by issuing banknotes that were backed by the amount of gold or silver currency it held (Chacón, 2019, pp. 18-19). During the last third of the nineteenth century, the Banco Anglo Costarricense, the Banco Nacional de Costa Rica, the Banco de la Unión, and the Government issued banknotes (Chacón, 2019, pp. 45-72). BH issued banknotes in May 1881 for an amount of \$50 000, but due to the problems generated by the coffee crisis market, it withdrew them at the end of that same year (Carranza, 2012, pp. 151-152). The issue was made in denominations of \$5 to \$100 (see table 5).

TABLE 5. BANCO HEREDIANO ISSUED BANKNOTES

| <i>Banknotes denominations</i> | <i>Number of banknotes</i> | <i>Banknotes emissions value (pesos)</i> |
|--------------------------------|----------------------------|--|
| 5 pesos bills | 500 | 2 500 |
| 10 pesos bills | 250 | 2 500 |
| 25 pesos bills | 400 | 10 000 |
| 50 pesos bills | 300 | 15 000 |
| 100 pesos bills | 200 | 20 000 |
| Total | 1 650 | 50 000 |

Source: Banco Herediano, Libro Diario, num. 2, fl. 48, May, 1881.

The American Bank Note Company manufactured the banknotes issued by Banco Herediano. No information is available, however, as to the value of banknotes that went into public circulation (see illustration 1).

ILLUSTRATION 1. BANCO HEREDIANO'S BANKNOTES



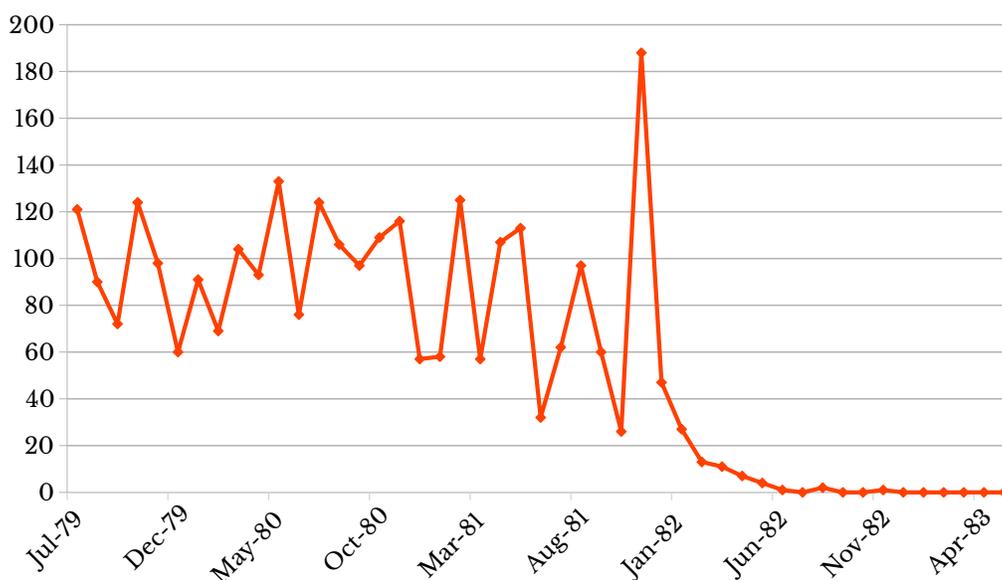
Source: Colección Banco Central de Costa Rica, Fotografía, Fundación de los Museos del Banco Central de Costa Rica.

Probably, only part of the bills authorized reached the public, as the BH banknotes are today very scarce and highly prized by collectors, indicating a low level of circulation. While having made the bank more visible to the public, this activity did not produce any significant profit.

LOAN OPERATIONS OF THE BANCO HEREDIANO

The BH began loan operations in July 1879. The demand for credit was very high from the very beginning of operations. That a large unmet demand for loans existed in Heredia, can be seen in 565 loans being approved in the second semester of 1879 alone, all with surety based on a personal guarantor. Once the initial pent-up demand was addressed, the number of loan operations averaged about 90 per month from January 1880 to December 1881 (see figure 1).

FIGURE 1. BANCO HEREDIANO. NUMBER OF LOANS APPROVED PER MONTH



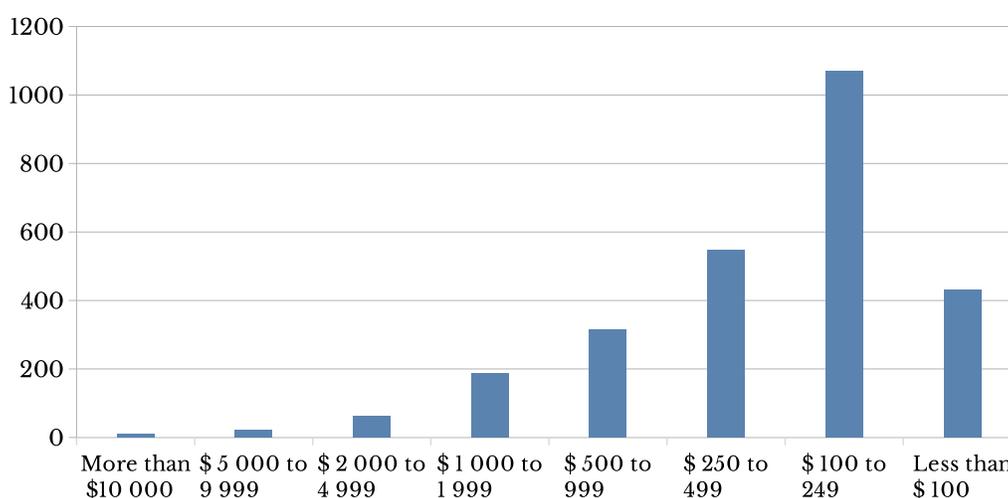
Source: Banco Herediano, Libros de Caja, 1879-1884.

During the three years in which the BH was fully operational, it approved 2663 loans to a total of 762 debtors that were identified in analyzing the bank's accounting books. The actual purpose of each of these loans is not indicated in the bank books, and for this reason, the specific economic use of only a small percentage of loans is known. Those refer mostly to loans to merchants located in Heredia at that time. Of 67 active merchants registered with the Heredia municipal government, it was found that 30 of these, nearly half, received loans from the BH.

Even though loans to these merchants represented only 5% of all bank operations, they received 130 000 pesos in loans, representing 10% of the credit allotted by BH, which totaled 1 242 500 pesos, that is, in proportion, merchants received loans valued at twice the number of credits approved. Four of these merchants were among the most important shop owners in Heredia: Manuel Zamora, Mercedes Bustos, Mariano Chaverri, and Paulino Ortíz, and all were shareholders in the bank. These four cornered 93% of total loans to merchants, the bank thus helping the strengthening of the city's large-scale business. The other 7% went to small ("trucheros") and very small ("tilicheros") shop owners. The requested loans ranged between 25 and 7 600 pesos.

In terms of the average size of loans, clients mostly opted for relatively small loans as 40% of these were approved for amounts between 100 and less than 250 pesos, followed by medium-sized loans in the range of 250 to 500 pesos, which represented another 21%. Larger loans, those above 500 pesos to less than 1 000 pesos, made up 30% of the total loans, and very large loans above 1 000 pesos, were only 250, or 9% of the total (see figure 2). Since 60% of loans were for amounts under 500 pesos, this could indicate that the bank was in effect covering an existing but unsatisfied demand for credit by small and medium farmers and merchants who previously only had access to loans from moneylenders or to coffee credits from mills or exporters against the following year's crop.

FIGURE 2. NUMBER OF LOANS BY RANGE SIZE (IN PESOS)



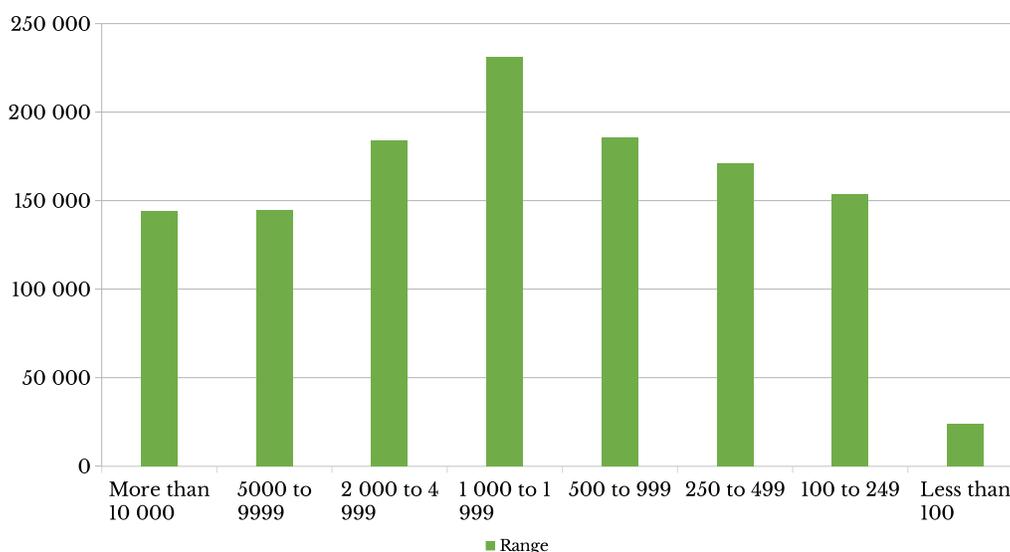
Banco Herediano, Libro de Caja, 1879-1884.

While in terms of the loan numbers, these were concentrated in those under 500 pesos, if the size of loans is used instead as the parameter to classify the loans, then large loans –those located in the range of 1 000 pesos or more (see figure 3)– concentrated approximately 57% of the BH's total loans by value.

Looking at the distribution by range-size of loans (see figure 3), this tends to follow a normal distribution curve. Other loan size ranges are distributed in a homogenous way around the range with the largest amount of loans (1 000 to 1 999). Therefore, even though large lenders received more than half the funds, medium and small lenders did manage to obtain a significant percentage of total funds.

The interest rates on loans and current accounts were similar to those used by other banks. Interest rate charged for short-term loans (90 days average) was 1½ % per month (BH, Libro Diario, number 1), with interest on the first month deducted in advance. On the other hand, rates for current accounts held by the BH were between 1% and 4% monthly for short periods (90 days). The large difference in rates is explained because certain shareholders were induced to provide

FIGURE 3. TOTAL AMOUNT LOANED BY RANGE SIZE



Source: Banco Herediano, Libros de Caja, 1879-1884.

additional short-term funds renewable for 90 days, and were paid a higher interest (4.1%), as these funds were vital in providing liquidity to allow the bank to keep lending, given its inadequate capitalization and low level of current accounts.

For the bank to approve a loan, it required the great majority of its clients to provide a fiduciary guarantee (surety). However, in those cases where the debtor was also a shareholder in the bank, a loan could be obtained by mortgaging that person's property. Sometimes though, this type of guarantee was abused because the bank administrator in some cases agreed to provide loans to shareholders without any guarantee, a situation which put the BH at great risks, such as when in 1881 and 1882, the drastic fall in coffee prices made it impossible to pay back many of those loans, due to the debtors' lack of liquidity. While from 1879 to 1881, the great majority of loans were secured with personal sureties, once the economic situation turned for the worse in 1882, a more significant proportion of loans required mortgage guarantees.

The surety system was adequate given the relatively short period for which most loans were taken out. This way, the guarantor could reasonably be assured that the debtor was in a position to pay back the loan on time, reducing his risk of exposure. BH account books confirm that most loans had a short to medium time limit, that is, 90 days or less. Table 6 offers the data obtained on loans, covering the first year and a half of operations.

It is not surprising that most loans were granted for 90 days, as this was the most common time period used in commercial operations at that time. However, it is possible to deduce that being short-term, these loans were directed mainly to financing commercial activities like the purchase of goods such as coffee, which could then be sold to exporters, within a short period of weeks. However, they were not useful for investing in the long-term development of agriculture, which required that the credit period be extended over one year or more.

TABLE 6. BANCO HEREDIANO. LOAN PERIOD FREQUENCY, 1879-1880

| <i>Range of loan period frequency (in days)</i> | <i>Number of loans approved</i> | <i>Percentage</i> |
|---|---------------------------------|-------------------|
| From 10 to 20 | 11 | 2 |
| From 21 to 30 | 31 | 5 |
| From 31 to 60 | 26 | 4 |
| From 61 to 90 | 496 | 83 |
| From 91 to 150 | 18 | 3 |
| From 151 to 300 | 16 | 3 |
| From more than 301 to 400 | 1 | - |
| Total | 599 | 100 |

Source: Banco Herediano, Libros de Caja, num. 1, July, 1879-December, 1880.

A negative aspect of BH operations was the use made by bank shareholders of their own institution's financial resources (see table 7). Of the 30 main clients listed in the table, 14 of them were also BH shareholders. This very unhealthy practice of taking advantage of their status within the bank to obtain personal benefits, eventually became a heavy burden for a good administration, given that the total debt from bank loans, in the case of some partners, exceeded what they had contributed to the bank's share capital. This was most notorious in Manuel J. Zamora, Pascual Solórzano, Mercedes Bustos, and the priest Echeverr . The relation of debt to capital input was nearly 150% in Zamora's case. When this partner went bankrupt in 1881 and was unable to pay the debt altogether, he had to cede the properties put up as collateral to the bank, which given the country's worsening economic situation, left the BH in an increasingly difficult position as property values fell.

The bank thus showed considerable deficiencies in its management of risk in loan operations with its shareholders. This was due to a failure in establishing limits to the amount of credit the partners could negotiate, which resulted in some of them obtaining large loans based on the prevailing high prices of coffee, with the expectation that high profits would cover their loans. However, upon the collapse of coffee prices in 1881-1882, they could no longer continue to do this and defaulted.

Significant debtors that were not shareholders in the BH also fell behind on their loan payments in 1882. These included Jesus Maria Solera Arias, with a debt of 3 167 pesos; Pedro Carvajal Murillo, with 3 129 pesos; Jose Maria Aguilar Gonzalez, 1 563 pesos and Santiago Rodr guez Vargas, 550 pesos. These debtors reached a repayment agreement with the bank administrator, and in their case, the loan period was extended by two years with an increase in the rate of interest to 2% monthly. They were also required to mortgage coffee plantations, pastures, and houses, to secure the outstanding loans.

As the economic situation continued to deteriorate, the loan operations faced additional problems. The bank had to seize and auction more properties to repay debts. In the case of Nicolas Alvarado, this debtor lost four properties that the bank auctioned. According to the bank's account books, Alvarado requested various small loans that did not exceed 1 200 pesos. A medium size debtor like Alvarado, probably came out a loser by becoming involved with the bank.

TABLE 7. BANCO HEREDIANO, MAIN DEBTORS

| <i>Debtor</i> | <i>Amount of loan</i> | <i>Shareholder in bh</i> |
|-----------------------------|-----------------------|--------------------------|
| Manuel J. Zamora | 126 872 | Yes |
| Pascual Solórzano | 44 488 | Yes |
| Mercedes Bustos | 40 822 | Yes |
| Joaquín Gutiérrez | 40 497 | Yes |
| Prbro. Estevan Echeverri | 36 094 | Yes |
| Manuel López | 32 820 | No, but owned a bank |
| Manuel Zamora | 30 758 | Yes |
| Rafael J. Flores | 28 834 | Yes |
| Mariano Chaverri | 23 050 | Yes |
| Pacheco Hnos. | 22 930 | Yes |
| Juan J. Flores | 22 198 | Yes |
| Solera, Jesús M. and Manuel | 21 966 | No |
| José Jiménez V. | 15 598 | Yes |
| Pedro Carbajal | 14 243 | Yes |
| José M. Morales | 13 075 | No |
| Pedro Ulloa M. | 12 665 | No |
| Santiago Salas | 9 902 | Yes |
| J. M. Flores | 8 676 | Yes |
| Dámaso Villalobos | 8 287 | No |
| Manuel Zúñiga | 8 142 | No |
| Rafael Dobles | 7 700 | No |
| Pedro M. Flores | 7 552 | No |
| Manuel Arias | 7 320 | No |
| José de la Rosa Elizondo | 6 206 | No |
| Segundo Villalobos | 5 250 | No |
| Antonio Elizondo | 4 250 | No |
| Ramón Rodríguez | 4 171 | No |
| Policarpo Trejos | 4 034 | No |
| Florencio Córdoba | 4 029 | No |
| Manuel Balenciano | 3 800 | No |

Source: Banco Herediano, Libro de Caja, 1879-1884.

Certain debtors with sureties could not payback their loans, and the BH had to fall back on the guarantors to obtain repayment. This was the case of Antonio Elizondo, who was guarantor for Jose de la Rosa Elizondo (possibly a relative), who did not cancel a 378 pesos debt with the bank. The first Elizondo lacked liquidity to pay and was forced to give up a two manzanas plot. As stated before, the bank used personal surety as its primary form of the loan guarantee. In this case the debtor, Jose de la Rosa Elizondo, was one of the bank's leading clients and debtors (see table 4). Bank books indicate he received fourteen loans for a total amount of 6 206 pesos, so in his case the amount defaulted was moderate, and the BH received payment.

The great majority of Bank clients were found within a five to ten kilometers radius from the BH headquarters in Heredia. The limited size of the operational area and the population being in a few towns around the city, where its clients (and their guarantors) were well known, facilitated management of loan operations.

COMPARATIVE PERFORMANCE OF THE BANCO HEREDIANO

In its short operational life, the Banco Herediano managed to accomplish an essential economic function by substantially increasing the supply of credit in the province of Heredia. For the shareholders of the bank, however, the fact that a stable financial condition was not achieved, forced them to constantly carry out emergency actions to keep the company financially afloat. The BH's financial statements are presented in table 8 from July 1879 to December 1882 and are useful in analyzing its financial performance. Data is not available for later periods but given that the last of 2 700 loans were approved in November 1882, the balance for the last period probably reasonably reflects the bank's normal operations at that moment.

Analyzing table 8 first from the credit category, the subscribed capital item shows an increase through December 1881, but thereafter it decreased, indicating the effects of intractable problems mentioned above. In the accounts' payable category, these rise rapidly until June 1881; a similar increase on the debit side takes place with accounts receivable over this period, but then both categories start to fall, probably reflecting a reduction in loan demand. By December 1882 however, accounts receivable still stood at a high 106 000 pesos, while accounts payable stood at only 50 000 pesos, which would indicate problems with loan repayment by clients. On the debit side, it is important to note the large increase in the categories of legal costs and properties in custody, reflecting how the loan operations were running into trouble by June, 1881 and the ever more frequent resort by the bank to foreclosures. As mentioned above, this situation increased costs to the bank by forcing it to spend resources it did not have to maintain the properties and later to auction them to obtain payment. The data clearly point out the bank's deteriorating situation, even though the inevitable end would not come until 1884.

In terms of comparability with other existing banks, the Banco Herediano, in some respects, showed credit indicators similar to those of the Banco Anglo and the Banco de la Unión but it differed in others (see table 9).

Considering the bank's nominal share capital and given the limited population in the province of Heredia, circulating an amount of 250 000 pesos, could have been sufficient to attend for local loan demand. This amount of capital by the BH represented only about 50% of the capital of the Banco de la Unión and 33% of that of the Banco Anglo, but since these operated at the national, not provincial level, they required more capital to carry out their business. However, in its actual operations the BH fell behind the other banks. In terms of the credit portfolio, the number of loans approved by the BH in June 1881 was far inferior to those achieved by the other two banks, reaching only 13% of those of the Banco Anglo and 23% of the Banco de la Unión. On the other hand, looking at dividends, the BH seems to have performed in line with the two other banks, at least in 1880 which is the only comparable year for which data was obtained. The BH's 8.5% estimated average dividend falls in the range of 8.25% and 13% of the Anglo Bank and Union Bank, which would indicate it obtained a normal level of profit for that year.

TABLE 8. BANCO HEREDIANO, LIBROS MAYORES, 1 AND 2

| <i>Categories</i> | <i>Balance at July 1st, 1879</i> | <i>Balance at December 31st, 1879</i> | <i>Balance at December 31st, 1880</i> | <i>Balance at June 30th, 1881</i> | <i>Balance at December 31st, 1881</i> | <i>Balance at December 31st, 1882</i> |
|---------------------------|--|---|---|---|---|---|
| <i>Credit</i> | | | | | | |
| Suscribed capital (pesos) | 18 000 | 15 525 | 24 639 | 36 536 | 39 884 | 23 925 |
| Accounts payable (pesos) | - | 76 988 | 138 662 | 178 838 | 147 795 | 50 000 |
| Current accounts (pesos) | - | 9 660 | 2 361 | 4 632 | 1 603 | 51 314 |
| Banknote emissions | - | - | - | 50 | 50 | - |
| Murrieta y Cía. (London) | - | - | - | - | - | 32 852 |
| Total | 18 000 | 102 173 | 165 662 | 220 056 | 189 332 | 158 091 |
| <i>Debit</i> | | | | | | |
| Accounts receivable | - | 99 979 | 165 428 | 208 117 | 185 434 | 106 022 |
| Cash | 18 000 | 2 068 | 151 | 54 313 | 49 178 | 290 |
| Plant and equipment | - | 125 | 113 | 107 | 197 | 45 |
| Judicial expenses | - | - | - | 75 | 100 | 1 022 |
| Properties in custody | - | - | - | 4 045 | 4 373 | 13 720 |
| Other (Juan Hernández) | - | - | - | 3 350 | - | - |
| Coffee | - | - | - | - | - | 36 742 |
| Letters of exchange | - | - | - | - | - | 250 |
| Total | 18 000 | 102 172 | 165 692 | 270 007 | 239 282 | 158 091 |

Source: Banco Herediano, Libros Mayores, num. 1 and 2.

CONCLUSIONS

In the first place, the country's favorable economic situation in 1879 was due to a booming coffee market with high coffee prices from 1875 to 1881. When the BH opened in 1879, the perspectives were considered good enough to undertake a risk in doing banking business. Secondly, the unsatisfied demand for credit in Heredia was not being covered by local moneylenders or coffee mill owners who were locally the primary financing sources. A third element was that Heredia was a relatively wealthy province at the end of the 1870s, thus its population offered a potentially significant market for credit, which the new Bank could expect to fill.

TABLE 9. COMPARATIVE PERFORMANCE OF COSTA RICAN BANKS, 1875-1885

| <i>Indicators</i> | <i>1875</i> | <i>1880</i> | <i>1885</i> |
|--|-------------|----------------------------|-------------|
| <i>Nominal capital (pesos)</i> | | | |
| Anglo-costarricense | 500 000 | 775 000 | 705 800 |
| Unión-Costa Rica | - | 500 000 | 500 000 |
| Herediano | - | 250 000 | - |
| <i>Credit portfolio (loans, accounts receivable) (pesos)</i> | | | |
| Anglo-costarricense | 1 127 376 | 1 242 265 | 1 163 115 |
| Unión-Costa Rica | - | 708 055 | 1 204 351 |
| Herediano | - | 165 427 (January, 1881) | - |
| <i>Dividends (percent)</i> | | | |
| Anglo-costarricense | 26 | 8.25 | 10 |
| Unión-Costa Rica | - | 13 | 13 |
| Herediano | - | 8.5 (December, 1879) | - |

Sources: Gil (1982, pp. 57-58; 80-81), for data on Banco Anglo and Banco La Unión (Archivo Nacional de Costa Rica); and Banco Herediano, Libros Mayores, 1 and 2.

However, the BH faced problems early. Its main obstacle arose from the world coffee market crisis, resulting in an abrupt price fall in 1881-1882. The Banco Herediano seems to have shown apparent success up to the second half of 1881, but thereafter had to reduce the number of new loans and practically cease these after the first semester of 1882. Very importantly, the bank partners greatly overestimated their capacity to obtain outside capital, a necessary precondition that they had recognized from the moment the Bank was established; and the failure to obtain a loan in Europe, forced them to turn to in-country capital sources to complete the inadequate initial supply of capital.

Compared to other banks established in Costa Rica towards the end of the nineteenth century, the BH managed to rapidly build up a loan clientele during its first two and a half years, taking advantage of a niche market created by a boom in coffee production in Heredia. Internal conditions in the Bank (administrative weakness, profits less than expected and many shareholders going bankrupt after 1881) and others of an external nature (abrupt fall in coffee prices, competition from better-capitalized banks) resulted in its closure upon completing the initial five-year contract for the company. Four decades were to pass before another regional bank was to be established in Costa Rica.

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