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The English East India Company [EIC] is considered to be the first significant publicly-held joint-stock corporation in England, in Europe, and, in fact, in the world. Some would say that it was the first multi-divisional or multinational corporation in history. It was the largest merchant corporation in the world throughout much of its 250+ years of existence. It had a monopoly over England's trade with Asia, played a significant role in financing the British State, and eventually became the ruler of the Indian sub-continent.

The EIC was chartered on a symbolic date: December 31st 1600. It predated by almost a century the formation of an effective market in stocks in Britain which began to pick up as a market place for government bonds after the Glorious Revolution of 1688 and only became an active market in corporate shares in the 18th century. By share market, I am not only referring to the Stock Exchange (which was established in 1783) or to any other monopolistic or dominant market place. There was no market in shares in 1600 England in the most elementary sense: there were no brokers and jobbers, no price quotes or information hubs, no selection of shares of a variety of corporations to allow diversification, no set transaction procedures and no volume of trade to allow liquidity.¹ In fact England was considerably less developed than the Netherlands or Italy in these areas, and yet it was there, of all places, that the joint-stock corporation first appeared.

The EIC was established and shaped at an important juncture in the economic development of the West in general and of England in particular. For many centuries the

¹ For the development of the British stock market see: P. G. M. Dickson, *The Financial Revolution in England*, London, 1967; E. V. Morgan and W. A. Thomas, *The Stock Exchange: Its History and Function*, 2nd ed., London, 1969; J. Brewer, *The Sinews of Power: War, Money and the English State, 1688-1783*, Cambridge, 1990; L. Neal, *The Rise of Financial Capitalism: International Capital Markets in the Age of Reason*, Cambridge, 1990; E. Chancellor, *Devil Take the Hindmost: A History of Financial Speculation*, New York, 2000.

connection between Asia and Europe was based on the overland caravan trade. The maritime trade of the Indian Ocean and its branches was entirely in the hands of non-Europeans. This state of affairs began to change with the arrival of the Iberians in the 16th century. With the advent of the 17th century, Dutch and British Oceanic merchant shipping became the main connectors of Asian and European markets. Much of the maritime trade between different parts of Asia was also taken over by European ships.² The formation of the EIC was significant in this process. At the same time, the institutional organization of English (and European) overseas trade was transformed. This trade, which in medieval times had been based on merchant guilds and partnerships, became in the 16th century organized in regulated corporations. The regulated corporation was a formalized incarnation of the guild, one that was chartered by the Crown. Around the turn of the 17th century, a new form of organization appeared: the joint-stock corporation, in which members did not trade in their own stock but rather invested it in the hands of agents-managers. While most of England's short-distance trade was organized in regulated corporations, its long-distance trade experimented with the joint-stock form.³ The EIC was formed at this vital juncture of these two trends in world trade and in the organization of English enterprise.

The origins of an institution can serve as a means to understand that institution and, more generally, institutions of similar sort. The strategy of this research is to locate a

² N. Steensgaard, *The Asiatic Trade Revolution of the Seventeenth Century: The East India Companies and the Decline of the Caravan Trade*, Chicago, 1974; F. Braudel, *The Wheels of Commerce: Civilization and Capitalism, 15th-18th Century Volume 2*, London, 1981; F. Braudel, *The Perspective of the World: Civilization & Capitalism, 15th - 18th Century Volume 3*, London, 1981; W. H. McNeil, "The Eccentricity of Wheels, or Euroasian Transportation in Historical Perspective" *American Historical Review*, 92, 2, 1987, pp. 1111-1126; H. Furber, *Rival Empires of Trade in the Orient, 1600 – 1800*, Minneapolis, 1976.

³ E. F. Heckscher, *Mercantilism*, London, 1935; W. R. Scott, *Joint-Stock Companies to 1720*, Cambridge, 1910-12; R. Harris, *Industrializing English Law: Entrepreneurship and Business Organization, 1720 – 1844*, Cambridge, 2000.

key moment in the early history of a key institution and perform a micro study on this formative moment. Such a study can provide insights on a variety of levels and within a variety of theoretical frameworks. The current paper focuses on one of these frameworks: the relationship between the organizational structure and legal attributes of the business corporation, and the existence of an effective share market.

The theory and practice of large joint-stock corporations presupposes the existence of an effective share market. One cannot envision the law, the economics, or the law and economics of corporate governance and corporate finance as we know them today, without liquidity of shares, exit options for shareholders, diversification of investors' equity holdings and market determined value of shares and corporations.⁴ The case for the essentiality and efficiency of the publicly held joint-stock corporation heavily depend on the existence of an, at least somewhat, efficient share market. The EIC, not an insignificant corporation, does not fit this theoretical supposition. It was a widely held corporation without being publicly traded. Was it inefficient? And if so, why did it emerge? Why was the EIC formed in an environment devoid of a share market? How could it function as a joint-stock corporation in such an environment?

Answers to these questions can enhance our understanding of the later history of the business corporation, and possibly of contemporary issues of corporate theory and policy. For one thing, we can learn from features of the EIC and the companies that followed its model at that formative stage about the later course of development of the business corporation institution. Path dependency adherents might find the present study useful for this purpose. Then again, we can view the early history of the EIC as providing an opportunity for an empirical examination of modern theories. In it, modern empiricists

⁴ references

can find the historical substitute for labs.⁵ Factors can be isolated in a manner in which they can no longer be isolated in modern developed economies. The nature of the business corporation and the interrelationship between its various attributes and structures can be investigated. An examination of this case can also deepen our understanding of the possible function of publicly-held corporations in developing and transition economies that lack an effective share market. Such a use of this case study involves a move somewhat similar to that made by scholars of contract and cooperation when resorting to studies of pre-state periods. Corporations without markets and contracts without states are somewhat analogous.

Another possible framework for this study is that of institutional innovation in general. One can frame the puzzle presented above more broadly: how can any two symbiotic or interdependent legal-economic institutions evolve? This is the classic question of “What came first, the chicken or the egg?” Do such institutions develop simultaneously or sequentially? What impetus or incentives could there be for developing the first when it could not benefit from the advantages of functioning in integration with the second? In some cases a sequential path becomes possible due to exogenous impetus. In our case there could be a way out of the catch at hand. The stock market could have developed first, as a market for government bonds, and at the second stage the joint-stock corporation could have joined in and enjoyed a free ride on the institutional novelty that had already evolved in the service of the state. But as though to augment the puzzle, history did not unfold in this order. The order was the reverse; first the corporation and then, almost a century later, the market. My aim in this paper is to address this puzzle and

⁵ For the use of history as a lab and of the use of the notion of path dependency in law & economics scholarship, see R. Harris, ‘The Uses of History in Law and Economics’ in *Theoretical Inquiries in Law*, 2003, 4, No. 2.

explain the formation of the EIC as a joint-stock corporation in the pre-stock market era. Insights gained from this case study can explain other cases of interdependence between pairs of institutions and shed light on institutional evolution in general.

The last framework I would like to suggest for my case study is that of network externalities. Network externalities literature is concerned primarily with technology, infrastructure, telecommunication, computers and the like.⁶ Yet the concept can serve as a viable analytical tool with respect to legal-economic institutions. The publicly held joint-stock corporation was an institutional innovation. The first adopter of this institution, the EIC, could not capture many of the returns that were later associated with it. When a network of corporations expanded, a share market could evolve. Investors could diversify and exit. Markets for managers and for control could emerge. The returns on adopting the corporate form of organization could increase non-linearly. This paper only hints at the insights that could be gained by reading the case study within this theoretical framework.

Keeping these frameworks in mind, this paper is based on a study of the available sources for the years around the formation of the EIC. These include EIC Charters, by-laws, Court minutes, company correspondence and Crown correspondence. Though some of the records have not survived, those that remain provide an excellent view into membership, capital, shipping and decision-making.⁷ The study also intensively uses K. N. Chaudhuri's exceptional classic study on the early history of the EIC, often asking different questions based on new theoretical frameworks that were not available to him in 1965, but not undermining his contribution.

⁶ References to network externalities with respect to institutions.

⁷ The most significant missing records are the Court Books (containing Court of Committees and General Court minutes) for the periods August 1603 – December 1606 and January 1610 – December 1613.

This paper will proceed as follows. In section I, the financial need for establishing trade with Asia is evaluated. This section concludes that all expenses (on items including ships, provisions and labor and goods) were higher in long distance trade than in European and Mediterranean trade. This resulted not only from the considerably longer journey time but also from the fact that the EIC could not engage in bilateral trade with any single destination and had to enter the intra-Asian trade.

In section II, I discuss the array of institutions. It examines, from the perspective of the promoters of the EIC, the alternative forms of business organizations that could have been utilized for the new enterprise. The section concludes that the two forms commonly used in short-distance trade, the partnership and the regulated corporation, did not meet the financial needs of the EIC. The limited partnership, commonly used in maritime trade and by the Dutch in their successful Asian trade, was not an option because it was not recognized by the English legal system. Credit was not a significant option because of the risks involved, the inability to provide collateral, and the absence of insurance. The outcome of the demand (for capital) of section I and the supply (of institutions) of section II leads to a dead-end. The contemporary supply of institutions could not meet the new financial demands of the Asian trade. Thus the promoters of the EIC sought innovative institutional frameworks.

Section III analyzes the institutional innovation made by these promoters. They coupled the legal conception of the corporation with the financial conception of joint stock. The new institution enabled raising capital from new social groups hitherto unconnected to overseas trade, in the form of equity. This enabled investors to enjoy a remarkable degree of information, voice and exit while not actively engaging in trade.

Section IV maps the existing, and quite voluminous, theoretically informed literature and evaluates the explanations it offers for the emergence of merchant corporations and joint-stock corporations in general and the EIC in particular. Existing explanations range from the desire to enjoy the privilege of limited liability or transferable property rights, to a scheme that aims at monopoly and rent seeking, to a solution to agency problems, to vertical integration whose purpose was to save on market transaction costs, to an institution whose purpose was to convey credible commitments in the relationship between foreign rulers and English merchants. In this section I will show that even though some of these explanations provide interesting insights into other aspects of the reality of the EIC and its contemporaries, they do not address the puzzle that is at the core of the present paper. They cannot explain the formation of the EIC as a joint-stock corporation. The conclusion considers the usefulness of this case study to the understanding of the evolution of legal-economic institutions in a wider sense and to modern developed and transition economies lacking effective share markets.

The Dawn of English trade with Asia

At the close of the 15th century, the Portuguese, beginning with da Gama, were the first Europeans to develop regular trade routes and posts in Western India – notably Goa, Sumatra and other parts of the Indonesian archipelagos, and later also in Macao in China. The Spaniards soon followed, navigating past America and across the Pacific Ocean and reaching the Philippines and beyond, as did Magellan in their service in 1520. The 16th century was an Iberian century in Asia. The Spaniards and Portuguese enjoyed exclusivity among Europeans in its markets. In the closing decade of the 16th century, the

Dutch followed the Iberian lead and initiated commercial voyages and established commercial representations in Southern India, Java and the Spice Islands. Their commercial activity was gradually institutionalized with the foundation after 1595 of the early city-based pre-companies, and with the unification of these into the Dutch East India Company (VOC) in 1602.

The English developed an interest in these parts of the globe only slowly and belatedly. English explorers devoted much of their attention to discovering the North West and North East passages to India, which they never found. English pirates aimed at plundering the ships of other European nations en route rather than establishing their own trade. English merchants, wishing to import Asian goods, operated through Russia by way of the Russia Company, and through the Eastern Mediterranean by way of the Levant Company. Prior to 1600 only a couple of sporadic attempts – a notable one in 1591 – were made by English merchants to reach the Asian markets by sea, sailing around Africa.

By the close of the 16th century, conditions were created for direct English trade with the East Indies. First, the victory in 1588 over the Spanish Armada boosted the image of the English Navy, gave confidence to merchants, and made sailing routes south on the Atlantic and past the Cape of Good Hope, more accessible to English ships. Second, the exclusion from Lisbon and, consequently, from sharing in the Portuguese East Indies trade concerned the English. Third, there was the growing Dutch presence in the region that culminated in a treaty with the King of Bantam in 1597. The Dutch sent close to 20 expeditions to the East Indies between 1598 and 1601.

The overland caravan routes of Central Asia and the Middle East, notably the Silk Road, and the Red Sea route that supplied the Levant and Russia companies with Asian goods, became outmoded. The Dutch and Portuguese were able to get their goods at source, drying out the supply of English merchants and at the same time reducing their own transportation costs and increasing their profit margins. This occurred when the demand for spice and pepper grew due to their essential role in the food preserving process. The effective Portuguese and Dutch domination over the spice trade alarmed English merchants. At that stage, some members of the Levant and Russia companies and other English merchants began to contemplate the establishment of an English East India Company.⁸

I. Demand Side – EIC’s Capital Needs

What were the challenges and problems that a small group of English merchants had to face in the attempt to establish maritime trade with Asia at the close of the 16th century? What did this group have to invest in such a project? The promoters of the EIC had to determine, at a very early stage, whether to finance their project by using their own personal wealth, by taking loans, or by raising what we now call equity capital from outsiders in return for shares in the expected profits. Before making this decision they had to estimate their capital needs. In this section I will try to analyze the demand side considerations that guided the initial financial and legal decisions of the promoters of the EIC. It was clear to them from the outset that a voyage beyond the Cape of Good Hope into distant and scarcely known lands would consume more capital than any other contemporary overseas trading undertaking. The first EIC voyage that departed in

⁸ K. N. Chaudhuri, *The English East India Company*, London, 1965; W. R. Scott, *Joint-Stock Companies to 1720*, Cambridge, 1911, vol. 1.

February 1601 only returned to the Thames in June 1603.⁹ A return voyage to the Asian destinations was thus expected to last at least 2-3 years. In comparison, a return voyage to Spain or the Baltic took no more than a few weeks. Thus an Asian turnaround was likely to be at least 15 times longer than a long European one. Two obvious financial consequences of the differences between European trade and Asian trade were the size and quality of ships that could survive the journey, and the turnover time of capital.

Ships

The EIC had to acquire ships that could survive voyages considerably longer and rougher than any of the European or Mediterranean voyages hitherto taken by English merchants and skippers. The ships had to be constructed as armed merchantmen. They had to be strengthened and equipped for both trading and fighting, as they were to sail far from the protection of the navy among pirates and rival merchants.¹⁰ The ships also had to be large enough to carry enough goods to justify the longer and more expensive voyages.

How could the EIC economize on its investment in ships? It could charter the ships it needed. This was obviously less consuming in terms of capital than buying or constructing ships. But could the EIC find ship owners to contract with? By chartering their ships to the EIC for an Asian voyage, the owners would share the risks involved without sharing the profits. Part-ownership - the division of the ownership of the ship into transferable parts, sixteenths, sixty-fourths and the like - was a widespread way of

⁹ For a diary of the first voyage, see "A Letter written to the right worshipfull the governours and assistants of the east Indian marchants in London" (London, 1603).

¹⁰ G.V. Scammell, "Shipowning in the Economy and Politics of Early Modern England" *The Historical Journal* 15, 3, 1972 pp. 385-407; V. Barbour, "Dutch and English Merchant Shipping in the Seventeenth Century" *The Economic History Review* 2, 2, 1930 pp. 261-290.

holding property rights in ships in England of the time.¹¹ This form of ownership does spread risks. Part owners indeed bear somewhat lower risks than owners of full ships. But they were still outsiders to the merchant firm, having no control over the voyage and no share in the profits.¹²

Marine insurance could offset the risks involved for the chartering ship-owners or part owners. But such insurance was not yet available in England in the early 17th century.¹³ Bottomary contracts, pre-insurance risk management schemes, were also not in use in England of the time.¹⁴ The unavailability of insurance affected not only the obtaining of ships, but the financial structure of the enterprise as a whole.

The EIC bought 4 used ships for its first voyage and the same ships were used for its second voyage. When in 1607 the EIC Court decided to replace lost ships and expand its activities by chartering ships, no tenders were submitted by any of the many English ship owners.¹⁵ Further, the 50-100 ton ships used in European waters and the 100-200 ton ships typically used in the Atlantic, which were available on the market, were not large enough for the Asian trade. For lack of other alternatives, the EIC had to construct its own ships. The EIC established its own dockyards for constructing, fitting and repairing its Asian-bound ships. These dockyards became a focus of company attention, employing

¹¹ R. Harris, *Industrializing English Law: Entrepreneurship and Business Organization, 1720 – 1844*, Cambridge, 2000, pp. 186-190.

¹² The part owners of such a ship would have to reach a collective decision to charter their ship to EIC. This was an endemic collective action problem associated with part-ownership that came on top of the adverse payoffs.

¹³ F. C. Spooner, *Risks at Sea - Amsterdam Insurance and Maritime Europe, 1766-1780*, Cambridge, 1983; A. H. John, 'Insurance Investment and the London Money Market of the 18th Century' in *Economica*, 1958, p. 137. ;Meir Kohn "Risk Instruments in the Medieval and Early Modern Economy" draft chapter 12 (1999) in *The Origins of Western Economic Success: Commerce, Finance, and Government in Pre-Industrial Europe* (Forthcoming).

¹⁴ [explain what is bottomary Kohn and reference]

¹⁵ K. N. Chaudhuri, *The English East India Company*, London, 1965, p. 91.

local labor, and requiring large capital investment in building materials. The ships were large by contemporary English standards; many of them in the range of 200-600 tons. The fact that they were small in comparison to the 1,000-ton carracks already in use in the 16th century by the Spanish and Portuguese for their Asian voyages, and fewer and smaller than those of its main competitor, the VOC, is instructive.¹⁶ Obtaining ships large enough to meet the challenges of the route and the competitors was a major concern of the EIC. But financial constraints prevented the EIC from operating ships of optimal size and number. When these were eased the company turned to constructing ships. When they were further eased in the 1620s, the number of 700-900 ton ships built by the EIC increased.¹⁷ In 1639, when trade was somewhat more stable, the EIC chartered its first ship. In the second half of the 17th century and throughout the 18th century, when India trade became a routine matter, and the insurance market had developed (with the incorporation of Royal Exchange Assurance and London Assurance and the formation of Lloyd's), the EIC switched, with some hesitation, to chartering ships.¹⁸ To sum up, ships were an item high on the expenses list of the promoters of the EIC. This was an item that forced them to economize, seek additional capital investments and consider new organizational forms.

Provisions and Equipment

The longer Asian voyages naturally required different provisions than short-distance European voyages. Not only the duration of the voyage but also the difficulty in

¹⁶ Data on VOC ships

¹⁷ K. N. Chaudhuri, *The English East India Company*, London, 1965, pp. 226-334, for tonnage of ships and the voyages in which they were used.

¹⁸ S. Hejeebu "Microeconomic Investigations of the English East India Company" (PhD Dissertation University of Iowa, 1998) chapter 2, studied in a thoughtful and detailed manner the various stages in the vertical integration and out-contracting of shipping. She discusses asset specificity, monitoring costs and underutilization as factors that did not favor rent in the later period. The involvement of corporate insiders in renting ships to the company was the major cause for keeping with the renting practice.

re-supplying along the route determined the large stock of provisions ships had to carry all the way from England. A typical 600-ton ship in 1607, carrying 150 men, was equipped with bread for 21 months at 24 lb. per man per month, pickled pork for 10 months at 4 lb. per 5 men per day, peas for 9 months at 0.5 pint per man per day, 28 tons of beer, 41 pipes of wine for crew plus 3 for the captain's table, and 600 gallons of sweat oil.¹⁹ Further, as mentioned, the division that appeared later in the century between civilian and military ships, between the merchant fleet and the navy, was not yet in sight. This affected not only the construction costs but also ships' armor and equipment and the size of the crew that had to be fed and supplied. When these expenses were added to the expense of constructing ships, financial considerations became more central.

Labor

Beyond acquiring and equipping the ships themselves, the EIC had to hire crews and factors (overseas agents). A small ship had a crew of 80, a large one a crew of 200. Altogether a single voyage involved hiring a crew of 300 to 900 men for a period of at least 2-3 years. In addition, there were EIC-paid employees in the dockyards, warehouses and offices. No other trade or manufacture of that era involved a workforce on this scale. The EIC worked hard to reduce wage expenses. Often, part of the pay for the period of preparation in England was in the form of food and beer. Sometimes young factors joined a voyage without salary so that they would learn the language and the markets in the hope to be employed on salary in a future voyage. The more senior employees, such as factors

¹⁹ K. N. Chaudhuri, *The English East India Company*, London, 1965, p. 234. [based on the first letter book of the East India Company, p. 102].

and captains, received part of their salary as a bonus connected to profits.²⁰ Captains and senior factors were sometimes allowed to trade privately, on their own account, as a means to supplement their salaries. But taking into account the length of the voyage, the fierce European competitors, the dangers of the sea, the mortality rate on board and in Asia, and the possibility that a voyage would end up with a financial loss, some compensation had to be made in cash, often in advance, to the employees or their families. This again was an expense that was costlier to the EIC than to short distance traders.

Goods

Last, but most significant, were the costs of financing the goods. As early as the first voyage, it became clear that trade at the Asian end could not be conducted on board the ships or during short stops at ports en route. The markets in India and Indonesia could not quickly absorb large quantities of English goods or specie, definitely not without a price drop. The purchase of goods at these destinations for import purposes was often a slow process. Thus factors had to be left behind in various Asian ports for long periods of time in order to complete EIC transactions.

More important, EIC managers realized within a few years that bilateral trade with the ports of Surat (in Gujarat, North-West India) or Bantam (in Java, Indonesia), the company's two first destinations and later its two main factories (agencies), was not possible. There was no demand in that part of the globe for the leading English export commodity, wool. Most other shippable English goods were also not very popular in

²⁰ Sometime they even received shares in the profits, but just as a component of their employment agreement. Only rarely, and with respect to the most valuable and long serving employees, was this share granted by way of membership in the EIC, which entitled them to share in management as well as profits.

these markets. An easy solution was to buy the sought-for Asian goods with precious metals; in this case, silver rather than gold. This could also allow shorter stays in Asia.

Table 1: Exports of EIC in Bullion and Goods

As Table 1 shows, more than two-thirds of EIC exports were in the form of precious metals, primarily silver. But exporting specie from England was highly objectionable. The Crown and much of public opinion believed that this would have a detrimental economic and political effect on England. The issue of exporting specie was one of constant contention and negotiation between the Crown and the company.²¹ Each of the charters included a provision that allowed the export of only a limited quantity of specie.²²

The patterns of supply and demand in Asia were such that in order to be profitable and not to export too much silver, the EIC had to develop what was called a country trade; that is, trade between ports in Asia. This trade was not merely triangular; it eventually developed into an Asia-wide trade system stretching from Yemen to the Spice Islands, from Basra to China, and from Persia to Japan, with hubs in Bantam (Java) and Surat (India).²³

²¹ K. N. Chaudhuri, *The English East India Company*, London, 1965, pp. 111-136.

²² J. Shaw, *Charters Relating to the East India Company from 1600 to 1761*, Madras, 1887. See The Charter of 1600 and the Charter of 1609.

²³ The Portuguese were the first to realize the impossibility of bilateral trade between Europe and Asia that will not be based on the export of American Silver. When the English and the Dutch faced similar problems they reacted quite similarly, though within a different institutional framework. For comparative perspectives see: A. Attman, *American Bullion in the European World Trade 1600 – 1800*, Göteborg, 1986. For the contemporary debates in England on the out flow of bullion see: B.E. Supple “Currency and Commerce in the Early Seventeenth Century” *Economic History Review* 10, 2, 1957, pp. 239-255.

Figure 1: Map of EIC Trade Destinations and Inter-Asian Trade

Thus the time that passed between the raising of capital in London for purchasing silver and goods and constructing and equipping ships, and cashing in, in the English markets, on imported pepper, spices, indigo and silk, grew steadily. Within a few years of the initiation of their Asian trade, the EIC managers realized that turnover time had become a crucial factor in their capital needs.

EIC managers were further pressed to raise additional capital when they realized that if they wanted to compete with the VOC, they could not wait for the return of a voyage and the cashing of its goods before embarking on the next voyage. The Dutch were sending large fleets to the Indies annually at the appropriate season. They were capturing markets, trading posts and English ships. The English realized that they should aim to do the same.

An analysis of the demand side shows that the problems faced by the EIC were not of investing in infrastructure in the form of forts, ports, warehouses and the like, as some scholars assume. They were not of entry barriers or sunken costs. What the new enterprise needed was circulating capital rather than fixed capital. These needs were fundamentally different from the needs of English merchants trading with Europe. Obtaining such capital became crucial for the survival of English trade with Asia. The institutional solutions that suited problems of short distance trade, notably the guild, the partnership and the regulated corporation, were not good enough for this new type of potentially highly-profitable business. Institutional innovation became essential. The identification of financial need as the motive for institutional innovation is valuable

because it calls our attention to the true explanatory direction. Other explanations which are offered in the literature for the emergence of the EIC and other merchant corporations, stress managerial or agency problems or rent-seeking behavior. These explanations, that will be discussed in section IV, do not address these dominant financial concerns. This, in my view, lessens their explanatory power.

The identification of circulating capital rather than fixed capital as the basic need of the new project is also important in that it questions the validity of other explanations offered in the literature that stress the need for an initial investment, a need that expires after the establishment of the infrastructure. I will return to the alternative explanations in section IV, discussing their strengths and weaknesses. The identification of circulating capital as a major constraint has explanatory power with respect to the design of the new institution – a joint-stock corporation with a separate capital account for each voyage. The new institution had to be constructed with the aim of meeting the high and unique financial demands of England's Asian trade.

II. Supply Side - The Basic Organizational and Financial Alternatives

What basic organizational platforms could the promoters of the EIC adopt? We have to understand them and their limits in order to understand the selection of the corporate platform for our institutional innovation. In this section I will survey the four basic platforms that could harbor the emerging English trade with Asia: the state, the individual proprietor, the partnership and the corporation. I will also examine the financial alternatives open to the EIC with respect to raising credit rather than equity finance.

Part of the State Hierarchy

Merchants could organize their trade within the State hierarchy. The Spanish and Portuguese did this quite successfully after the late 15th century in America, Africa, and, most relevantly, in Asia. But this was not a viable option for the English state by 1600. Elizabeth was financially constrained due to the decline of financial feudalism, the massive sale of Crown and Church lands, and the tension between the Crown and Parliament.²⁴ James I, crowned in 1603, was subject to even harsher financial and political constraints due to his tense relationship with Parliament. In the 16th century, the English had begun to experiment with non-State overseas endeavors by way of privateering, discovering, and trading adventures. They were about to begin a major privately-initiated settlement project in North America. The English were also aware of the stagnation of the State-controlled Iberian trade organizations in Asia and the rising privately-owned Dutch trade with that part of the globe. These circumstances created an opening for a privately-initiated, financed, and owned merchant enterprise. At the same time, they ruled out the option of a State-financed and controlled Asian adventure.

Sole Proprietorship

Very few individuals in England possessed the wealth needed to single-handedly finance an enterprise on the scale of the EIC. Individuals struggled with meeting the financial threshold of entering European trade.²⁵ Members of the landed aristocracy could potentially possess the wealth needed for such an undertaking. But most of their wealth was not liquid and they lacked the skills, motivation or social legitimacy to actively

²⁴ F. C. Dietz, *English Public Finance, 1558-1641*, 2nd ed. London, 1964. R. Ashton, *The City and the Court: 1603-1643*, Cambridge, 1979. ; M. J. Braddick, *The Nerves of State - Taxation and the Financing of the English State, 1558-1714*, Manchester, 1996.

²⁵ R. Grassby, *The Business Community of seventeenth Century England*, Cambridge 1995.

engage or invest large sums in a business enterprise, certainly not a highly risky one. A sole proprietorship was therefore not an option.²⁶

General Partnership

The next alternative was the general partnership. The form (the *compagnia*) had been developed in Italy for use in domestic enterprises. The general partnership made its way through Europe and was already a familiar form of business organization in England long before 1600. In principle, partners shared profits, losses, and management. Italian maritime trade was often organized in partnerships. In England, the form was applied beyond domestic manufacture and trade, also in short-distance trade. It was often used not independently but within the framework of the regulated corporation. A few members of such a corporation who originally traded separately joined their accounts for a voyage or for a period of time. The infrastructure of the regulated corporation, to which we will turn shortly, allowed the general partnership in England to expand beyond the domestic economy and into short-distance overseas trade, on a level unknown on the Continent.

But the farther the destination market was from the center, the less suitable the general partnership was. Overseas trading ventures stretched over at least two localities. These became remote from each other when English trade expanded beyond Northwestern Europe. Not all partners were present at both ends. Often the financier/lender/older merchants stayed at home while the captain/young merchant sailed to the target market. Because asymmetric information was prevalent, agency problems were acute. As a result, partners who stayed home sought a partnership that would not put them on equal terms with traveling partners.

²⁶ More than 150 years later, the Duke of Bridgewater invested single-handedly in one of England's first canals. This was an exceptional event that did not re-occur with any other canal or railway project, an exception that only confirms the rule.

Limited partnership unrecognized in England

The asymmetry among partners gave rise to asymmetric partnership contracts. Such contracts, known in Italy as *Commenda*, evolved into what we know today as the limited partnership. In fact, the asymmetric partnership contract and the overseas trade of northern Italian cities developed hand in hand. The traveling partner was in fact in control of the business and was fully liable for its debts. The passive investing partners, known as sleeping partners, were not involved in decision-making. In return, their liability was limited to the capital they originally invested in the partnership fund. Formally, each partnership contract applied to a single voyage. At the end of the voyage accounts were settled and the entire capital, whether at a profit or a loss, was divided among the partners. Many of the partners of one voyage often reorganized into a new partnership contract for another voyage. When the risks and uncertainties involved in the voyage and trade were high, the motivation for using limited, rather than general, partnership increased. The limited partnership reached its highest degree of development in Venice where each limited partnership included a large number of passive partners and few, and at times only one, active partners. The number of limited partnerships simultaneously engaged in overseas trade was large. Many of the investors invested modest sums in a large number of limited partnerships, thus spreading their already limited risks even further.²⁷

²⁷ M. Kohn, "Business Organization In Pre-Industrial Europe" draft chapter 14 (2003), *The Origins of Western Economic Success: Commerce, Finance, and Government in Pre-Industrial Europe* (Forthcoming); R. S. Lopez, *The Commercial Revolution of the Middle Ages, 950-1350*, Cambridge, 1976; M. M. Postan "Partnership in English Medieval Commerce" *Medieval Trade and Finance*, Cambridge (1973) pp. 65-91. R. de Roover, "The organization of trade" *Economic organization and policies in the middle ages*. M. M. Postan, E. E. Rich and E. Miller, eds. Cambridge, 1971.

The limited partnership spread from Italy to other parts of Continental Europe including, France, Germany and the Netherlands but was not recognized in England where it arrived too late. By the time the limited partnership arrived, the common law was already past its formative period. It rejected the limited partnership because it was in conflict with the, by then, well-formulated common law forms of action and doctrines that governed contracts and partnerships. It was also rejected because of hostility to Roman law and Law Merchant in significant quarters of the English legal system and to the internal institutional dynamics within this system.²⁸ These had nothing to do with the needs of merchants or the policies of the Crown. This rejection had a striking effect on the formation of the EIC and the institutional differences between it and the Dutch VOC.

The Dutch used various sorts of partnerships in their maritime trade. When it came to long distance trade, with its information asymmetry, agency problems, and high risks, the Dutch resorted to variations of the Italian limited partnership. The Dutch Asian trade, initiated in 1595, was organized into partnerships that were, in retrospect, called *voorcompagnie*?n or precompanies. These were based on two classes of partners, active *bewindhebbers* and passive *participanten*. The passive partners were not members of the undertaking, did not participate in decision-making, could not act as agents on the partnership's behalf, and their liability for debts was limited. They invested through active partners who supposedly represented them. These precompanies were a variation

²⁸ Despite the initial use of *Commenda*-like agency contracts in the 13th and 14th centuries, this form of organization did not further develop in England into the type of financial and business organization that it turned into on the Continent. The reason for this merits further investigation. By the 16th and 17th centuries, the regulated corporation and the joint-stock corporation had emerged. These forms created a path dependency and made the limited partnership less attractive and less attainable to English entrepreneurs. It was introduced only in 1907 by statute. J. H. Prior, 'The Origins of the *Commenda* Contract' *Speculum*, 52, 1, 1977, pp. 5-37; W. Holdsworth, *A History of English Law*, 17 vols., London, 1956-1972, Vol. 8, pp. 196-197; M. M. Postan, 'Partnership in English Medieval Commerce', *Medieval Trade and Finance*, 1973, Cambridge; R. Harris, *Industrializing English Law*, Cambridge, 2000, pp. 19-21, 29-31, 273-274.

on the limited partnership form. They can, in my mind, be viewed as associations of limited partnerships. Each limited partnership was composed of an active merchant and passive investors. Each active merchant pulled in his passive partners. Each precompany was an association of active merchants. These partnerships were not incorporated and did not seek a charter that would grant them a monopoly or a corporate personality. The number of ships sent to Asia by the five leading municipally-based precompanies reached, by 1598, the impressive number of 22. It is important to emphasize that the Dutch were able to develop intercontinental trade on such a scale without the use of the joint-stock corporation because they were able to stretch the limited partnership institution very far.

The intense competition between these companies and the desire to coordinate the struggle against the Portuguese and the English led to the integration of six city-based partnerships of this form into the united East India Company (the VOC) in 1602.²⁹ It appears that the creation of the VOC was not motivated solely by capital needs and financial constraints. The Dutch were able to pass the initial entry barrier using older organizational forms. The Dutch East India Company was an extension of traditional Continental and Dutch partnerships. It maintained the two-tier system of the precompanies. In many respects it was only a cartel of these partnerships, which in turn were associations of traditional marine limited partnerships that aimed at a higher degree

²⁹ N. Steensgaard, 'Dutch East India Company as an Institutional Innovation', M. Aymard, *Dutch Capitalism and World Capitalism*, Cambridge, 1977, pp. 235-257; J. C. Riemersma, 'Oceanic Expansion: Government Influence on Company Organization in Holland and England (1550-1650)', in *Journal of Economic History*, 1950, 10, pp. 31-39 ; E. Gepken-Jager, *VOC 1602 - 400 Years of Company Law*, in (Forthcoming) pp. **; J. de Vries and A. van der Woude, *The First Modern Economy: Success, Failure, and Perseverance of the Dutch Economy, 1500-1815*, Cambridge, 1996, pp. 129-134; O. Prakash, *The Dutch East India Company and the Economy of Bengal 1630-1720*, New Jersey, 1985, pp. 8-11.

of coordination. Committed coordination required the assistance of the State. It was achieved by way of a charter that defined the relationship between the city and the partnership to prevent free riding, defecting or a take-over by Amsterdam.³⁰ The charter reserved a degree of autonomy to the six city-based chambers that grew out of the precompanies. Investment, management and profit sharing occurred on the chamber level. The institutional structure of the VOC was well within the Continental legal and commercial line of development. It was path dependant on the line which began in medieval Italian ports, if not in classical Roman law. As already hinted, because the limited partnership was not recognized by English common law (until the 20th century) England was not situated on the same developmental line. What was for the Dutch a minor and natural institutional evolution required of the English a quantum leap. As this was impossible, the English got on a different path.

The Regulated Corporation

The regulated corporation, which emerged in England in the 16th century, was built upon the old legal conception of the corporation. From a formalistic legal perspective, the regulated business corporation had legal status similar to that of municipal and district corporations, the corporate bodies of Oxford and Cambridge, the Royal Society, the Society of Antiquaries and the guild-like companies of the City of London. All these types of corporations could be incorporated in the same patterns, enjoyed the same powers, capacities and privileges, and were subject to the same remedies.

³⁰ This charter also granted a monopoly, but this was not the motivation for the creation of the VOC. Domestically it did not exclude competitors from joining in and internationally it did not have much value with respect to Portuguese and English competitors.

The regulated corporation still had some elements in common with the guild: it regulated and disciplined the business activities of its members. However its nature was less social, religious, and ritualistic than that of the guild; it was more purely profit-oriented. Members of the regulated corporation, like guild members, traded in their own stock, taking risks and liabilities individually. Each member had to finance his own transactions, to buy goods abroad and sell them in England, or the other way around, at his own expense, was allowed to compete (subject to some regulation) with other members, and at the end of the day profited or lost, personally. From its inception, the regulated corporation was based on a formal legal charter granted by the Crown. Regulated companies collected entrance fees, annual payments, and duties on imported and exported goods. Money collected in this way was used to provide facilities for members, such as warehouses and docks, envoys, embassies and consulates, convoys and other forms of assistance obtained from the State. The regulated corporation was incorporated as a separate legal entity having a hierarchical managerial structure, composed of General Court, Court of Directors, Officers of various sorts and a Governor. The corporate entity was used for owning the joint infrastructure and for making decisions regarding it. Members shared the investment and risks in these infrastructures but not in trade transactions. They formed a collective decision-making mechanism with respect to it but made individual decisions regarding their actual commerce.

Regulated corporations played a major role in the development of English overseas trade in the late 16th and 17th centuries. England's short-distance trade to nearby Western European ports was taken over by regulated companies. The Merchant Adventurers Corporation was probably the first English company to be formed on this

model. It was chartered in 1505, receiving both incorporation and a cloth trade monopoly with Flanders. The Spanish Company, whose trade also covered Portugal, was chartered in 1577. The Eastland Company for trading with the Baltic Sea and Scandinavia was chartered in 1579. The 1505 charter of the old Merchant Adventurers was extended from Flanders to the Low Countries and Germany at around the turn of the 17th century. The French Company was chartered shortly afterwards.

In a way, the regulated corporation was an organizational form that was developed as a partial substitute for non-existing limited partnerships in England. It was partially a retrograde attempt at reviving the merchant guild within a new environment - that of the sovereign and centralistic State. The regulated corporation could potentially solve some of the fixed capital needs of long-distance trade by providing common infrastructure.³¹ But as we have seen, the most important need of the EIC was working-circulating capital. The structure of the regulated corporation did not address this growing need. The institutional features of the joint-stock corporation were meant to assist in meeting such needs.

Credit

The EIC worked hard to overcome the constraints placed on raising equity capital by the unsuitability of the available institutions for long-distance trade. It was able to obtain credit from its employees by deferring payments. It sometimes bought goods on the Indian markets on short-term credit. But this was marginal credit. Could the promoters of the EIC raise at least some of the highly needed core capital by way of loans rather than equity? The risks involved in the trade and in the voyage represented a basic

³¹ There was a limit to this, too. A typical regulated corporation asked its members to pay only moderate sums as membership dues for financing common infrastructure.

difficulty. As EIC had no substantial assets or stocks in England in its early years, it could not offer its creditors good collateral. Ships hunted by the Portuguese, the Dutch and the Monsoon off the coasts of Java were not the kind of collateral most creditors were willing to accept. Lenders could lose all of their money in the event of a totally lost voyage. To justify the high risks taken by the lenders, they had to demand high interest rates. As risks were hard to measure in such a pioneering trade, so were interest rates. Further, high interest was a violation of the usury laws.³² Profit-sharing could solve both these problems. Taking high interest loans threatened the promoters as well. While a total failure of the voyage would result in a loss for promoters and creditors alike, a moderately successful voyage, one in which only some of the ships returned safely and the demand for the imported Asian goods was modest, could still end in a loss or even bankruptcy for promoters. An ex-ante commitment to pay high and fixed interest to creditors, who enjoyed a priority, could put the promoters themselves and other equity holders in a disadvantaged position.

Even if we assume that the problems involved in structuring the loan transactions were solvable, we still have to identify potential suppliers for such large loans.³³ An active market for government debt did not develop before the Glorious Revolution of 1688 and the incorporation of the Bank of England six years later. The market for corporate bonds emerged even later. When the State sought loans in the Stuart and Commonwealth reign, it usually put pressure on the City of London or the overseas trading corporations including the EIC. Forcing the EIC to lend money was clearly not an

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³³ P. T. Hoffman, G. Postel-Vinay and J. L. Rosenthal, 'Information and Economic History: How the Credit Market in Old Regime Paris Forces Us to Rethink the Transition to Capitalism', in *The American Historical Review*, 104, No. 1, 1999, pp. 69-94.

option for financing the early EIC itself. Bank loans were not an option either. When faced with a capital shortage by 1610, the VOC began using short-term loans to bridge the seasonal need to equip the outgoing fleet before selling the goods of the incoming fleet.³⁴ This enabled the VOC to keep two fleets in Asia and a third preparing for departure. The VOC borrowed the money from the Bank of Amsterdam (*Wisselbank*) a municipal bank established in 1609 with a regional monopoly over bills of exchange.³⁵ In fact, the Bank lent money only to the Municipality of Amsterdam and to the VOC.

In England things were different. The EIC had nowhere to borrow on this scale. England and London had no comparable State or municipal bank. The English State had not imported this sort of Italian tradition. During this period there were also no private merchant banks. Goldsmiths who provided some banking services could not lend money of the magnitude relevant to the EIC. Borrowing from the public at large required a major institutional innovation in the form of intermediaries such as banks, a well-developed credit network or a market place for corporate bonds. The EIC predated all such innovations.

Shares in Joint Stock

This section is not yet written. It will discuss the early history of this financial scheme, in public finance and in private business, particularly in Italy. It will also discuss the legal problems that were created with respect allocation property rights and transferring interests, in joint-stock funds.

³⁴ The VOC borrowed 5,600,000 guilders in 1610–20, 8,500,000 guilders in 1620-30, and 11,300,000 guilders in 1630-40. See J. de Vries and A. van der Woude, *The First Modern Economy: Success, Failure, and Perseverance of the Dutch Economy, 1500-1815*, Cambridge, 1996, p. 389 and table 9.3, column H.

³⁵ J. de Vries and A. van der Woude, *The First Modern Economy: Success, Failure, and Perseverance of the Dutch Economy, 1500-1815*, Cambridge, 1996, pp. 129-134.

III. The Institutional Innovation

Coupling the Charter of the EIC with Joint Stock

The idea of using joint stock on the platform of a corporation was tried a few times before 1600.³⁶ The experiments involved raising stock from several merchants and using it within one common trading account and one chartered corporation. The idea was tried for the first time by the promoters of the Russia Company (also known as the Muscovy Company), founded in 1553 and chartered in 1555.³⁷ The model was tried for a second significant time by the Levant Company (Turkey Company), formed in 1581 for trade with Turkey and the Eastern Mediterranean.³⁸ Both companies encountered hard commercial and financial times and were eventually reorganized as regulated corporations in 1622-3 and 1592 respectively. The fact that the EIC selected in 1599 the joint-stock corporation form despite these failures and turned out to be the first long-lasting, and by far the most influential, early joint-stock corporations makes its case worth studying as a key event in the history of the joint-stock corporation.³⁹

³⁶ There were a few other joint-stock ventures before 1600. Most of these were short lived. Many of them can be viewed as analogous to buying a lottery ticket. They were one-shot investments in highly speculative projects such as piratical or discovery ventures.

³⁷ The initial paid-up capital did not cover the high expenses of establishing the new trade nor the need to replace the losses of ships and cargo. This meant that, in later years, more calls were made on shares, with no dividends in sight. As a result, in 1586, the company was financially reorganized in several separate accounts, each for a period of one to three years. This model was closer to the one adopted by the EIC in the following decade. Beyond the difficulty of collecting from the original shareholders, this change stemmed from the intention to raise money in wider circles, to give more discretion to traders, to pay dividends more frequently, and to simplify accounting. See T. S. Willan, *The Early History of the Russia Company 1553-1603*, Manchester, 1956, pp. 41-47, 211-216, 273.

³⁸ The Levant was a very small and closely held joint-stock corporation, numbering only 12 shareholders, all of whom were active merchants. It was closer in its scope to a large partnership than to the EIC. See A. C. Wood, *A History of the Levant Company*, Oxford University Press, London, 1935, Reprinted 1964, pp. 16-23; M. Epstein, *The Early History of the Levant Company*, London, 1908, pp. 1-66.

³⁹ I do not imply that scholars should learn only about successful ventures. There is much to be gained from studying failures. My decision in this case, taking into account my constraints, was to focus on the EIC and not on the Russia or the Levant companies. The classic study of the early joint-stock companies is: W. R. Scott, *Joint-Stock Companies to 1720*, Cambridge, 1910-12. For a recent survey of the finance of the early trading companies, focusing on the EIC, see J. B. Baskin & P. J. Miranti, *A History of Corporate Finance*, Cambridge, 1997, pp. 55-88. For a the history of 17th century joint-stock companies, see R. Harris, *Industrializing English Law*, Cambridge, 2000, pp. 39-59.

Figure 2: The Major Regulated and Joint-Stock Companies, 1500-1700

On top of a legal structure identical to that of a regulated corporation, the East India Company placed an element of joint stock that was only loosely connected to the charter and to the new corporate entity that was established through it. In September 1599, a group of London merchants held a number of meetings that in retrospect turned out to be the founding meetings of the English EIC. These promoters worked on two parallel tracks, one for raising capital for voyages to the East Indies and the other for obtaining a Royal charter of incorporation that would grant privileges and benefits to their company. At the first recorded meeting on 22 September 1599, the list of subscribers included 101 individuals willing to commit a total capital of over £30,133. Individual sums varied between £100 and £3,000, with £200 as the most common sum. By the time the charter was granted (December 31, 1600), there were no fewer than 218 names of chartered members, presumably all subscribers. Further subscriptions were taken until the departure of the first voyage (February 13, 1601)⁴⁰ and by then the total capital had reached £68,937.⁴¹ The promoters set up a committee that negotiated with the Privy Council for a charter of incorporation, trade and tax privileges, license to export specie, and political and military support. In October of 1599, the talks failed because Elizabeth was negotiating a peace treaty with the King of Spain and believed that by granting the charter she would hinder the relationship with her new ally. But the

⁴⁰ In the contemporary Julian calendar the year began on March 25, thus the voyage left 14 months after chartering.

⁴¹ W. R. Scott, *Joint-Stock Companies to 1720*, Cambridge, 1911, vol. 2, pp. 91-95.

deterioration of relations with Spain and further Dutch successes convinced Elizabeth to grant the charter the following year.⁴²

The EIC was formally incorporated as “one body corporate and politick” on December 31, 1600 for a period of 15 years. The charter allowed the corporate body to possess and convey land, to sue and be sued, and to have a common seal. It did not refer to the limitation of liability of members of the company. It is not surprising that this was not included since the modern doctrine of limited liability had not yet emerged. But it was clear, by virtue of the EIC’s corporate legal personality, separate from the individual legal personalities of its members, that the debts of the company were not identical to the debts of its members, as a group or individually.⁴³ James I, in the 1609 charter, granted that the EIC “for ever be, and shall be one body corporate and politick”⁴⁴ and enjoy indefinitely all the abovementioned privileges of incorporation.

Pairing the financial tool of joint stock with the legal concept of the corporation represented a major innovation. However, this created a whole set of problems and gaps that had to be dealt with. From the start, the promoters of the company were determined to finance the company with joint stock, but they do not seem to have bothered to ask the State for permission for such a move. While the charter created an organizational platform for the joint stock, it did not create full overlap between the organizational structure and the financial structure.

The further raise of capital beyond the charter and beyond the first voyage was made in separate accounts. A new account was formed for each of the voyages to Asia.

⁴² H. Stevens, *The Dawn of British Trade to the East Indies*, New York, 1886.

⁴³ The creditors of any members could not take hold of corporate assets. Corporate creditors could reach the personal assets of members only after dissolving the corporation.

⁴⁴ J. Shaw, *Charters Relating to the East India Company from 1600 to 1761*, Madras, 1887, p. 16. The Charter Granted by James I, 31 May 1609.

Members could decide whether and how much to invest in each account. Expenses at home and abroad that related to a specific voyage were recorded into its account. At the end of the voyage the proceeds from the sale of the goods that were imported were divided pro-rata among the investors in that voyage. Altogether twelve voyages were financed by separate accounts between 1601 and 1612:

Table 2: Capital Subscriptions for the Separate Voyages

It is clear from Table 2 that the real challenge for the promoters of the EIC was not to convince investors to subscribe for the initial sum of £68,373, as substantial as it was in contemporary standards, but rather to maintain the relationship with investors so that they would be forthcoming in future voyages. Altogether almost £400,000 were raised in the years 1603-12 for voyages 2-12, about 6 times the initial investment. An additional £418,691 was raised for the first joint stock in 1613, making the total capital raised £ 882,975 by 1613.

It is important to note that while the basic financial structure of the EIC was set before its Charter of Incorporation was granted, the Charter did not reflect this structure. It was practically identical in content to the charters of contemporary regulated corporations. It listed 219 members, but did not refer to them as shareholders. This later gave rise to dual terminology, referring to members of the corporation as “brethren”, “at freedom” or “at liberty” and to shareholders in its stock as “adventurers”. The charter did not grant different privileges to subscribers of different sums and did not relate to issues such as the issuing of further shares, additional calls on shares, dividend payments, or the like. It was taken for granted that profits on the initial investment would be divided based

on the share of each adventurer in the joint stock. But it was also taken for granted that each adventurer would have one vote in the General Court, irrespective of the amount subscribed for. This was a concept that was taken from the model of the regulated corporation, in which each member had one vote. The charter did not reflect the later financial evolution of the EIC. It did not envision the creation of a separate account for each voyage. It did not envision the resulting discrepancies between initial membership and future membership and between finance and management. Interestingly, the promoters of the EIC did not view the charter as preventing or constraining the development of the corporation as a joint-stock corporation. My argument is that the corporation was structured as it was, coupling the structure of a corporation and a per voyage financial investment, in order to enable the raising of the needed circulating capital. In order to attract investors, the EIC offered them voice, information and exit. Below I will examine the institutional structures provided investors, beginning with voice.

Voice

The charter of incorporation of the EIC defined its basic governance structure. It included a Governor, a Deputy Governor, a Committee of 24 – also called the ‘Court of Committees’ (and after 1709, the ‘Court of Directors’) – and a General Court. In fact, the full official name of the EIC (until 1709) was “The Governor and Company of Merchants of London Trading into the East-Indies”. The General Court was composed of all members of the company. Every member, of whatever status and however large a share in the joint stock, had one vote in the General Court. The Court was to convene at least

once a year, in the first week of July, and elect the Governor, the Deputy, officers and Committees. The duties of the Governor and Committees were defined in the charter on a general level, not always distinguishing between the two. They included direction of the voyages, provision of ships, purchase of merchandise before departure and sale upon return, and responsibility towards the Crown with respect to the execution of the charter. The Governor also had duties relating to convening and chairing the various meetings. The General Court was empowered by the charter to remove from office the Governor or any of the members of the Committees on the grounds of “not demanding themselves well in their said office”.⁴⁵

Committees (directors) of the EIC, unlike those of the VOC, could come from among all shareholders, were nominated for only one year, and could be removed from office. Voting in the General Court, for Committees and other issues, was based on one vote for each member. Only gradually was the strict equality of the EIC voting system relaxed. The 1609 Charter granted one vote for every 500 shares. This made 500 shares the minimum holding to qualify for voting. In practice, most of those who passed this threshold had one vote, or at most two.⁴⁶ This change may have been made in order to convince those shareholders who did not subscribe to any voyage beyond the first (in which the standard subscription was £200) to further invest. The EIC was established as an unprecedentedly democratic, representative, and egalitarian institution at a period when other political and business institutions were not. Only late in the 17th century was the system of one member one vote replaced by a system closer to the modern model of

⁴⁵ J. Shaw, *Charters Relating to the East India Company from 1600 to 1761*, Madras, 1887. The Charter of 1600.

⁴⁶ This arrangement was retained in the 1661 Charter. See J. Shaw, *Charters Relating to the East India Company from 1600 to 1761*, Madras, 1887, p. 32, The Charter Granted by Charles II on April 3 1661.

one share one vote.⁴⁷ This obviously strengthened the influence of large shareholders in directors' appointments and in management affairs and made the 18th century EIC a much more oligarchic entity than the young EIC. But by then, the presence of a share-market mitigated some of the disadvantages of hierarchy and authority.

The Charter authorized the EIC to make by-laws that further detailed the structure and function of the three basic organs mentioned above. For example, the by-laws ordered that a General Court would be summoned whenever ships arrived from the Indies and that the Court of Committees would be called upon receipt of letters from the Indies.⁴⁸ It was ordered that non-members could not attend a meeting of the General Court (and that speakers would be bareheaded, would address no one but the Governor, and would not interrupt the speeches of others).⁴⁹ The Court of Committees was to execute the orders of the General Court with respect to the selling of imported goods and the purchase of provisions and merchandise. Every task within the power of the Committees was to be performed by at least two of its members, not by a single member. Such tasks could not be assigned to others and were to be performed personally by Committees members only. The Governor was given the responsibility of summoning the Courts and of executing their orders. He was also given a double voice in votes.

⁴⁷ The 1693 charter established a system of one vote for every 1000 shares up to a maximum of 10 votes for holders of 10,000 shares or above. In the 1698 Charter, a somewhat different method was fixed: 1 vote for holders of £500 in shares and above, 2 votes for holders of £1,000 and above, 3 votes for holders of £2,000 and above, 4 votes for holders of £3,000 and above and a maximum of 5 votes for holders of any amount over £4,000. A minimum of £2,000 in shares was set as the qualification for directorship. See J. Shaw, *Charters Relating to the East India Company from 1600 to 1761*, Madras, 1887. See The Charter Granted by Charles II on April 3 1661, Charter of 1693, Charter of 1698.

⁴⁸ A. Dom, *The Lawes or Standing Orders of the East India Company*, London, 1621, p. 2.

⁴⁹ A. Dom, *The Lawes or Standing Orders of the East India Company*, London, 1621, pp. 4, 7.

Information Hub

The Charter, together with the by-laws, created a participatory framework for managing the EIC. This framework did not remain only on the books. It actually functioned in the real life of the company. The records of the early days of the company are packed with examples of how information that reached the executives was in fact shared with the Committees and members according to the prescription of the Charter and the by-laws. Elections of the Governor took place regularly.⁵⁰ Annual meetings of the General Court were held during the first week of July, as prescribed.⁵¹ At these, in addition to the Governor, the Deputy Governor, Committees (directors), Treasurer, Secretary and Account Keeper were also elected. The Courts were updated regularly with respect to reports from messengers, from other ships, and the out-ports of the return of ships from the East Indies; and of the docking, list of goods, payment of customs, and sale at markets and auctions of the goods.⁵² Letters, arriving overland or by sea from factors in Bantam, and accounts of voyages of ships were regularly reported and usually read at Court.⁵³ These letters at times urged the company back home to send more goods and specie. Intelligence regarding preparations, voyages, intentions and successes of the competitors, arriving from Lisbon, Madrid, Paris and the Netherlands was sometimes

⁵⁰ On April 11 1601 Thomas Smythe was discharged and Alderman Watts chosen, on July 6 1602 Sir John Henry was elected Governor. Calendar of State Papers, East Indies [CSP], 126, 134.

⁵¹ For the meetings of 1607, 1608, 1609, see Calendar of State Papers, East Indies [CSP], 155, 176, 187. The 3rd volume of EIC "Court Book", covering the period January 1610 to January 1614, is lost.

⁵² For the reports to the Courts on the return of the first voyage of the Ascension in 1603, see Calendar of State Papers, East Indies [CSP], 138-139. For reports to the Courts on the return of the Dragon in 1609, supervising the unloading, and the goods brought home privately by the mariners and on negotiation with the King over the purchase of all pepper by him, see Calendar of State Papers, East Indies [CSP], 195-203.

⁵³ Entry 387 (p. 162-3), entry 405 (p. 170), entry 407 (p. 171), entry 411 (p. 173), entry 418 (p. 176-7), entry 427 (p. 179),

read and sometimes recoded in the files.⁵⁴ These often reported on the large fleets prepared in competing states, and the large profits made by their merchants, again hinting at the need to raise more money and prepare more ships to carry more silver and goods.

At the annual meeting of the General Court on July 1st 1608, it was decided that an earlier by-law requiring the recording of absences and lateness in coming to meetings would become effective. Fines would be charged to the account of such members that could not justify their absence. At Court meeting on October 5 1607, this decision was applied for the first time; fines were collected from latecomers for the use of the poor and those of absent members put against their accounts.⁵⁵ This interesting episode can be interpreted as evidence of the disinterest of passive investors in making use of their voting rights and an indication of rational apathy. It can, however, also be interpreted in line with my argument. It was important for the active merchants that the passive investors do more than just sign in their contribution to the initial equity of the EIC. They wanted to convince them to pay in full whatever they signed for in the joint stock of the first voyage. Moreover, they wanted them to continue to contribute beyond that first voyage. By the time the order was applied, the 4th voyage, an unsuccessful one, was out and future voyages were being marketed to investors. In order to convince them to contribute, the EIC offered them information and voice. The company wanted to make sure that they would be exposed to information with respect to the prospects for trade and would take part in the decision-making concerning future voyages, in order to convince

⁵⁴ Entry 366 (p. 150), entry 371 (p. 153) entry 376 (p. 157), entry 382 (p. 160), entry 386 (p. 161). The last entry is a remarkable and detailed report in Court by an English surgeon in the service of the VOC on the Dutch preparations for a new voyage, places of meeting, location of spices and intentions to attack the Portuguese.

⁵⁵ Calendar of State Papers, East Indies [CSP], 176, 177.

them to further invest. This interpretation is from a supply side perspective, which is the perspective of the promoters and engineers of this institutional innovation.

Non-Merchant Investors

The above episode connects us to the social element of the story. The new institution, the joint-stock corporation, can be viewed as an institution that aimed to pull together the resources of several social groups, City merchants on one hand, and aristocrats, the gentry, officials, and professionals on the other. The second category of social groups could not, and did not want to, take active part in overseas trade. They were involved in other activities, did not have the needed skills, were not willing to take the risks involved, and viewed this activity as socially belittling. For these reasons, they could not become members of regulated corporations or partners in merchant houses. Their peers in continental Europe had the option of investing in risky and profitable enterprises as dormant partners in limited partnerships. They could have the upside of sharing profits without the downside of sharing losses and debts. More importantly they could enjoy the fruits of trade without the negative social stigma. In England such an option did not exist until the emergence of the joint-stock corporation.

The leading historian of the 17th century EIC, K.N. Chaudhuri said “From the very beginning of its trade the East India Company operated as an outlet of investment. It thus drew its capital from a heterogeneous body of investors who can be classified broadly into two groups.”⁵⁶ Chaudhuri identifies the first group as that of City merchants who invested large sums, were actively involved in administering the company and often were directly involved in trade by buying goods from the company and selling them at home or re-exporting them to the Continent. The second group was that of passive

⁵⁶ K. N. Chaudhuri, *The English East India Company*, London, 1965, p. 33.

investors, coming from several other social groups. The active investors dominated the Court of Committees while the passive ones expressed their voice through the General Court. At times of difficult trade and low returns, such as in the period after 1620, a conflict of interest emerged between the smaller and the larger Courts, reflecting the tension between the two social groups. Chaudhuri based his statement on his intimate familiarity with the records and persons involved. Others, less immersed in the EIC, could not learn much about the social dimension from legal or business records which did not distinguish among members based on social origins.

Theodore Rabb used a different historical methodology, a quantitative large-scale social history study. His aim was to identify the social origins of close to 7,500 members admitted between 1575 and 1630 to any kind of business company (colonial, domestic, regulated overseas, joint-stock overseas, exploration) existing in that period. He identified 80.6% of the EIC members as coming from the merchant class. Though this percentage may seem high, it is important to note that it is considerably lower than the percentage of merchants in regulated corporations which was 91% in Merchant adventurers and 94.2% in Spanish Company.⁵⁷

Table 3: Non-Merchant Shareholders in Merchant Corporations

In absolute numbers, the EIC, the largest of the merchant companies in terms of admission to membership throughout the period, drew in, thanks to the fit between social yearnings and its institutional structure, 381 non-merchants who invested in trade in the

⁵⁷ The percentage of merchants in the French (93.8%), Eastland (93.4%) and Levant (92.1%) companies fell between these two figures. The Muskovy Company with 78.7% was the only large trading company with a percentage close to the EIC, and it was, as expected, the only other joint-stock company. T. K. Rabb, *Enterprise & Empire: Merchant and Gentry Investment in the Expansion of England, 1575-1630*, Cambridge Mass, 1967, p. 104.

period 1600-1630.⁵⁸ Further, about 150 of the members of the EIC were also members of the French company; about 160, of the Spanish company; and about 230, of the Levant company (at a point when this was already a regulated corporation).⁵⁹ They were involved in Mediterranean and European trade. For them the EIC was a passive investment rather than their primary place of employment. For many of them, there was no synergy between the Asian trade and goods and their main line of business. They were willing to explore new investment opportunities but they could not have done so had the EIC been a regulated corporation or a general partnership requiring daily involvement.

The Exit Option

Members of the corporation were given the option to invest in future voyages. Some did while others did not. Often, when not enough capital was raised from existing EIC members, resort was made to outsiders. These were invited to invest in the stock and to join the corporation. In this sense, the corporation included potential, not necessarily actual, investors. The potential investors had a voice in the decision to undertake a new voyage and to raise more money, but those who decided not to subscribe for a specific voyage could not get a share of its profits. Contributions to each of the first twelve voyages were made by different individuals, all supposedly members of the corporation. Membership allowed potential investors to receive first-hand information about the outcome of past voyages, the status of ongoing voyages and the prospects and business plans with respect to future ones. They were given the opportunity to exit, not by selling

⁵⁸ The total of 1,318 also included 937 merchants.

⁵⁹ . T. K. Rabb, *Enterprise & Empire: Merchant and Gentry Investment in the Expansion of England, 1575-1630*, Cambridge Mass, 1967, p. 109. Rabb did not cross multiple memberships with class. But his assumption, and mine, is that only a handful of non-merchants were (honorary) members of regulated corporations.

their shares in the non-existing markets, but rather by deciding whether or not to join in unfolding business opportunities. This was not a full exit, because the initial outlay remained invested in the EIC. To exit this initial investment a member had to match with a buyer - without the aid of a functioning market or of pre-structured low-cost transactions. Networks based on kin and family connections always assisted in this. But this was not an adequate solution for the widely-held corporation that the EIC turned out to be. The option for full exit was somewhat facilitated by the institutional structure of the EIC by which the corporation served as a focal point for sellers and buyers. In a way, the regular meetings of its Courts were a good marketplace. There, potential buyers could locate a seller, get information on the quality of the good (shares) offered by learning about the state of affairs in Asia, and get some sense of the market price of that good. These meetings functioned more like annual fairs than like modern capital markets. But it was more than could be had before or elsewhere. The idea of freely transferable shares was not yet recognized. The sale of shares was subject to approval by the corporation and to registration in its books. If a transaction could not materialize, the investor had to hold his share until the end of the voyage, hoping that it would be successful and that there would be a final settlement of accounts for the voyage. Thus, the more viable exit option at this stage in the history of the EIC involved opting out of an undesired voyage and rather than exiting the corporation altogether.

IV. Assessing Alternative Explanations in the Literature

The existing, theory informed, explanations for the rise of the chartered merchant corporations can in my view be classified according to the relationship on which they

focus.⁶⁰ I'll begin by examining the relationship between the incorporators and the English state, followed by the relationship between them and the Asian rulers, between various entrepreneurs or firms and lastly between the corporation and its agents in Asia. My aim is to show that these relationships do not have the same explanatory power that explanation offered here, focusing on the relationship between various investors, has. The category of explanations focuses on the relationship between the corporation and the English Crown is the most varied. Within this category a widely accepted explanation holds monopoly to be the main motivation for incorporation. The monopoly seeking incorporators transacted with the Crown, offering a variety of payments and services in return for the exclusive right to trade with defined overseas territories.⁶¹ They wanted to exclude other English merchants in order to enjoy monopoly prices in the English market for the goods they imported. By forming a collective body the merchants involved were able to better organize their lobbying group. By making this collective body into a legally binding corporation the merchants were better adept to dealing with free riding and defection. The corporation was a more effective rent seeking institution than loose associations of individual merchants. The group was able to extract more privileges from the rulers of England. The merchants could also enforce more effectively the monopoly they were granted by the Crown vis-à-vis each other and other English merchants.

This explanation is of value. One can explain by it the rise of the chartering system, the grant of monopolies, state finance, constitutional crises, the formation of the

⁶⁰ Some of the explanations discussed in this section were not intended by their authors to be applied to the formation of the EIC. I nevertheless think that such an application is instructive with respect to the formation of the EIC. The critical examination of these explanations here should not be viewed as a disapproval of their value in explaining the development of the regulated corporation, of other joint-stock corporations or of other institutions.

⁶¹ A relatively recent statement of this explanation is: Jones, S.R.H. Jones and S.P. Ville, 'Efficient Transactors or Rent-Seeking Monopolists? The Rationale for Early Chartered Trading Companies', in *Journal of Economic History*, 1996, 56, No. 4.

regulated corporation and more. But it does not explain the formation of the EIC as a joint-stock corporation. It does not explain the functioning of the publicly held corporation in an environment devoid of a share market. This explanation doesn't really distinguish between regulated corporations and joint-stock corporations. The first form could provide income to the Crown and monopoly privileges to the merchants just as well as the second. Why than innovate? Further, the value of monopoly to the promoters in the case of the EIC was limited. As I have shown, the investments involved in establishing the trade were not in fixed capital in the form of infrastructure or other public goods. By making these investments the EIC did not open the way to competing free riders. It was the need for a high amount of circulating capital that created the barrier. Those who could not raise it could not trade with Asia. A state monopoly was not instrumental for maintaining this barrier.⁶² Even if the promoters of the EIC would have considered monopoly to be valuable, the English Crown did not and could not provide it. English competitors, the Levant Company and the Russia Company, were allowed to imported Asian goods overland, because the EIC was granted only a territorial monopoly and not a monopoly on the importation of specific goods, such as spices. More importantly, the real competitors were outside the scope of Elizabeth's control, in Portugal, Spain and the Netherlands. They competed with it not only in the Asian markets but also in the markets of Europe and Britain. The grant of formal monopoly rights did not in fact create a monopoly.

A second explanation that focuses on the same relationship argues that the incorporators obtained from the state a new form of property that was not hitherto

⁶² Only decades later when trade became routine and the investment needed at engaging in it was at the reach of individuals and small partnerships did a state monopoly become more meaningful. But than enforcement was complicated and interloping common.

available. What was novel in this property was the free transferability of property rights.⁶³ The regulated corporation, similarly to the guild, did not allow easy transferability of property rights. Membership was personal and revenues depended of active participation in trade. This created an intergenerational transfer problem.⁶⁴ Fathers had to force their sons, if they had any and these were competent, to replace them these corporations because the membership rights could not be sold to outsiders. Otherwise the family was to lose at death the membership with all of its economic value. It is argued that the joint-stock corporation was developed to allow transferability of property rights in trade associations. It is assumed that only the state could create this new type of business organization possessing new form of property - the share. This explanation has two major weaknesses. First, the shares in the EIC were not created by the state, but rather despite the fact that the Royal charter, being identical to those of regulated corporations, contained no reference to shares and their free transferability. Second, the shares in the EIC, that were invented by the corporation itself, were not transferable in the modern sense. There was no market for trading them. As argued in this article the EIC developed an institutional mechanism for exit that was not based on a share market, or on the freedom to transfer shares, and was based only to a limited extent on the sale of shares.

A somewhat similar explanation points at the privilege of limited liability of shareholders as the reason for incorporation. The incorporators turned to the state in order to receive a protection for their personal assets from the creditors of the corporation.

Partitioning of assets of this sort is relevant only when a corporation relies on debt

⁶³ R. B. Ekelund & R. D. Tollison, 'Mercantilist Origins of the Corporation' in *Bell Journal of Economics*, 1980, 11, No. 2, pp. 715. ; R. B. Ekelund & R. D. Tollison, *Politicized Economies: Monarchy, Monopoly, and Mercantilism*, Texas, 1997.

⁶⁴ These forms did not allow mid-life exit or short-term exit. But such options were not within the horizon of contemporaries.

finance. The EIC, as shown above, could not and did not rely on debt financing. Thus limitation of shareholders liability to corporate debts could not be of value in this case.

A second relationship that received scholars' attention is that between English merchants and Asian rulers. The EIC was invented as an institution that would allow foreign rulers to convey credible commitments to English merchants who considered attending their ports and markets by this facilitating efficient cooperation.⁶⁵ Asian rulers had no easy way to credibly commit to English merchants to enforce their contracts and respect their property rights. The corporation could, as did the merchant guild several centuries earlier, provide the ruler with the mechanism for making credible commitments. It would allow the merchants to act collectively in retaliation for breach of commitment on the ruler's part. The corporation is intended to force upon all merchants the retaliation, in a manner that will make defection very costly. Realizing the fact that he will not be able to trade with defecting merchants the ruler will honor his commitments. Recognizing that their threat is real, and that the ruler understands it, merchants will view the ruler's commitments as credible and will increase the level investment and trade in the ruler's territory. While this explanation seems to fit well the realities of the 13th and 14th centuries and the evolution of the institution of the merchant guild it does not fit well the emergence of the English merchant corporation in the 16th and the 17th centuries. European trade with Asia evolved before the emergence of the merchant corporations. Overland trade flourished for centuries and maritime trade for about a century before the formation of the first corporations. Thus, the explanation fails to recount the timing of the appearance of the business corporation. This could hint for the possibility that other ways

⁶⁵ The designers of this approach applied it in the context of medieval trade and the merchant guild. See A. Greif, P. Milgrom and B. Weingast, 'Coordination, Commitment and Enforcement: The Case of the Merchant Guild', in *Journal of Political Economy*, 1994, 102, 4.

were found for rulers to provide credible commitments to merchants.⁶⁶ After all, the guild to which the performance of the function enabling credible commitments in the past declined, for good reasons, particularly the emergence of the state, by the 15th century. The state, particularly the centralized English state, could by the 15th century and definitely by 1600, perform the coordination functions previously performed by the guild.⁶⁷ In addition, it is not clear why the joint-stock corporation solved this credible commitment problem better than the regulated corporation or the guild. Further, in the Asian context of 1600 a ruler could play one against the other groups of merchants coming from different European cities and states. Indeed rulers often played English merchants against Portuguese merchants and Dutch merchants. In such a context coordination among merchants on a national level based on the guild or the corporation was not sufficient. A national corporation such as the EIC or the VOC could not coordinate all European merchants for an orchestrated retaliation, in a manner that would prevent defection and would allow a ruler to commit credibly. Each of these considerations, not to say the cumulative weight of them, leads to the conclusion that the joint-stock corporation in general and the EIC in particular did not emerge in order to solve commitment problems for rulers and merchants.

A third relationship to be examined is that between different entrepreneurs or firms. It is argued that the merchant corporation was created as an alternative to market transactions. It was the outcome of a vertical integration of various stages in the trade

⁶⁶ Though it is possible that the level of trade was below its efficient level.

⁶⁷ English Crown had support, by way of negotiations and embargos, the earliest English regulated merchant corporations – Merchants of the Staple and Merchant Adventurers, making the merchant guild irrelevant in the relationship of merchants and foreign rulers.

chain that connected Asia and Europe.⁶⁸ A preliminary but implicit tenet of this approach is that hierarchies are better suited than the market for handling long distance trade. Giant firms replaced the multitude of separate firms, each involved in only one link of the intercontinental trade chain. These giant firms covered the entire chain, from the producer in Asia (or elsewhere) to the final consumer in England, and vice-a-versa, within their own hierarchy. Rather than having market transactions between one link and the next, the firm's hierarchy controlled the allocation of resources throughout the chain. In Coaseian terms, the high transaction costs involved in market transactions of this global nature made hierarchical allocation more efficient. The boundaries of merchant firms expanded considerably to internalize costly transactions. An important distinction between this explanation and the first is that it views the merchant corporations as efficient, not inefficient rent seeking, institutions.

Yet, it is not at all clear that the early chartered corporation, and particularly the EIC, were a product of vertical integration. A unique characteristic of overseas trade was that it involved transacting across un-integrated markets, say the Western European and the Southern Asian.⁶⁹ The gains were made by substantial arbitrage among such markets. Indeed the less integrated caravan trade declined. But this was a result of new discoveries and new technologies that allowed oceanic trade to bypass it. It did not decline due to transaction cost reducing institutional developments. The mere buying in one market and selling in another distant market was not a vertical integration in any sense, it was for

⁶⁸ Carlos, M. Ann and S. Nicholas, 'Giants of an Earlier Capitalism': The Chartered Trading Companies as Modern Multinationals' in *Business History Review* 1988, 62, No. 3; A.M. Carlos and J. B. Kruse, 'The Decline of the Royal African Company: Fringe Firms and the Role of the Charter' in *Economic History Review*, 1996, 49, No. 2. A.M. Carlos and S. Nicholas, 'Theory and History: Seventeenth-Century Joint-Stock Chartered Trading Companies' in *Journal of Economic History*, 1996, 56, No. 4.

⁶⁹ Braudel,

merchants the core of business. The EIC did not integrate production or retail. It integrated for a while shipping, but it was not exceptional for merchants to be ship owners. The EIC did not seem to be considerably more, or considerably less, integrated than previously existing English overseas trade with Europe or the Americas. It was indeed more integrated than the traditional caravan trade. It integrated more information than overland traders or individual sea going traders. Scholars were right in identifying this feature of the EIC and other large merchant corporations. But this was an important byproduct of the institutional innovation, not its cause. The cause of change was the need for more capital in order to perform the same functions other firm performed in the past but this time covering longer distance between markets.

The last relationship that received scholarly attention is the one between the corporation and its agents.⁷⁰ The joint-stock corporation was an institution that was formed in order to minimize agency costs involved in employing agents (factors) in ports and markets that were a year or two away from the London headquarters of the corporation.⁷¹ Rather than dealing with independent envoys in Asia, be they local or English, the EIC employed factors. The corporate form, so it is held, enabled a more effective direction and supervision of these agents.

There is substantial evidence that the structure of the EIC intensified agency problems rather than mitigated them. Other organizational forms of overseas trade better

⁷⁰ This can be viewed as a variant of the previous explanation: the EIC was not created to integrate activities in the goods market but rather in the labor market, replacing independent agents with internally employed agents. The literature is not always clear to distinguish among these variants.

⁷¹ A.M. Carlos and S. Nicholas, 'Agency Problems in Early Chartered Companies: The Case of the Hudson's Bay Company' in *Journal of Economic History*, 1990, 50, No. 4.; A. M. Carlos, 'Principal-Agent Problems in Early Trading Companies: A Tale of Two Firms', in *American Economic Review*, 1992, 80, No. 2, pp. 140. A. M. Carlos, 'Principal-Agent Problems in Early Trading Companies: A Tale of Two Firms', in *American Economic Review*, 1992, 80, No. 2, pp. 140; A.M. Carlos and S. Nicholas, 'Theory and History: Seventeenth-Century Joint-Stock Chartered Trading Companies' in *Journal of Economic History*, 1996, 56, No. 4.

handled, in my view, agency problems, by better aligning interests of agents and principals. Small enterprises in which the owners actively engaged in voyages and trade had no monitoring problems. Partnerships, limited partnerships and profit-sharing employment contracts (such as the ones used for West Indies agents) reduced the conflicts between financiers that stayed back home and captains, merchants and factors that traveled. The regulated corporation, in which each merchant traded on his own account, enjoying common overheads, was less exposed to agency problems. The EIC in which all the investors stayed in England and factors traveled, was the prototypical agency problems institution. The company struggled for generations with these conflicts. Various schemes were used with the purpose of mitigating potential conflicts between the principals in London and the agents in Asia. Santhi Hejeebu discussed recently these means and convincingly demonstrated their limits.⁷² She showed that a leading mean of dealing with agency problems was to allow agents to develop private trade and make private gains. The fact that the EIC was so obsessed with agency problems, and did not solve them well within the firm, strengthen the view that it was not created for mitigating them. It was created for other purposes, in my view for raising capital from passive investors, and was forced to deal with, at times costly, agency problems.

Conclusion

⁷² The corporations paid their agents above market wages, so that they'll be motivated to comply by the concern over the possibility of losing the job and with it the premium. The EIC demanded bonds, often made by third parties, which could be executed in case of shirking or cheating by the agent. It used to a degree promotion through the rank as an incentive for agents to align their interests with those of the corporation for longer periods of time. See S. Hejeebu "Microeconomic Investigations of the English East India Company" (PhD Dissertation University of Iowa, 1998) S. Hejeebu "Contract Enforcement in the English East India Company" (unpublished manuscript, 2002); P. Casas-Arce and S. Hejeebu "Job Design and the Benefits of Private Trade" (Unpublished Manuscript, 2003).

The English merchants who decided to embark on trade with Asia soon realized that the older institutional frameworks that were used to organize short-distance trade created substantial constraints for long-distance trade. The Asian trade required considerably more capital, mainly, and somewhat unexpectedly, circulating capital. It was not only the distance between the English and Asian markets, but also the climate, tastes, demand patterns and arbitrage gaps between those markets that caused the EIC to ship bullion and goods for significant periods of time between Asian ports and markets, exchanging one with the other, before shipping goods to England and cashing in on them. The promoters of the EIC realized that their own wealth was not sufficient. They also realized that they could not borrow nor raise equity capital based on the old institutional platforms of the regulated corporation or the partnership. An institutional breakthrough was needed.

The coupling of the financial conception of joint stock with the legal conception of the corporation provided that breakthrough in the history of business organization. It provided an innovative and attractive institutional framework for the relationship between active and passive investors. It opened the way for passive investors to take part in England's overseas trading enterprises. Passive investors were willing to invest in a joint-stock corporation such as the EIC because this allowed them not to take active part in the trade itself. Even those aristocrats who could not afford the stigma of being involved in trade, merchants who spent all their time trading with European destinations, and craftsmen and widows who did not have the skills to engage in overseas trade could join in. For them, extending credit to enterprises such as the EIC was not an attractive channel of investment. The nature of the risk of trade was such that creditors were not better

secured than equity holders, and the latter were not exposed to higher risk. Further creditors expecting high interest rate due to the higher risks faced the prohibition of the usury laws. Investing in the equity of the EIC promised the higher return expected from such a risky undertaking and involvement in control.

Becoming shareholders entitled information, voice and exit to a degree that is remarkable by early modern and even by modern standards. General Court served as an information hub in which members were regularly presented with news from Asia, plans for future voyages and updates on the arrival and sale of goods in England. The same Court was a forum for voice, where members could not only speak, but also had equal votes, on issues of nomination and policy. Allowing members to decide whether to initiate collectively and subscribe individually to the joint stock of any future EIC voyages created the exit option. EIC offered a very elaborate mechanism of management and accounts to regulate the relationship between passive members and the active Governor and Committees. The new institution mitigated some of the agency-related pitfalls usually associated with passive or minority shareholders in public corporations. Admittedly it created other agency problems that become a major concern for later generations.

This institutional innovation became possible due to the peculiar legal and economic history of the limited partnership on the Continent and of the corporation in England. By the time the English economy could benefit from utilizing the organizational form of limited partnership, the English legal system was already outside the path of development of Continental law. English law rejected the concept of the limited liability partnership for reasons that had nothing to do with the needs of the English mercantile

groups or the interests of the Crown. They had more to do with attitudes towards Roman law and Law Merchant in general and with the internal dynamics of the common law. As a result, English merchants did not have a readily available institution when they needed one for long-distance trade. The Dutch stretched the limited partnership a long way, eventually building the gigantic VOC on this basis. The organizational backwardness of the English delayed their entrance into some distance markets. But the English also enjoyed the advantages of the latecomer. They alone were not contained within the Continental path of development. They could thus skip the conventional institutional form and develop a unique form - the joint-stock corporation. In escaping Continental path dependence the English were able to utilize a unique application of the corporation. The corporation was definitely not an English conception. But its frequent use in business contexts was a unique English phenomenon. Whereas on the Continent the corporation was used almost exclusively for non-business purposes, in England it was also used for forming regulated corporations. Thus, it, and not the limited partnership, was the natural candidate for mutation to enable organizing long distance trade and establishing the EIC. The coupling of joint stock with the corporation created, in turn, a new phase of path dependence. The EIC created a model that was followed by later corporations in overseas trade and beyond. The English path marginalized the limited partnership as well as the trust as institutions for organizing business. It adapted an institution that could not be easily developed outside the realm of a sovereign and centralized state. It created a connection between incorporation and monopoly, between public law and private enterprises, between business organization and regulation, which lasted for centuries to come.

The junctures in the development of the publicly-held business corporation were not steps in a linear march towards the modern form of the business corporation. The moderns are not necessarily more rational, smarter or more experienced than the promoters of the EIC. They could not advise them, through hindsight, on how to better organize the EIC. The publicly-traded corporation as we know it today was not the most efficient institution for 1600. It was impossible to create in 1600 due to path dependency or political constraints. It did not suit the environment of 1600 which lacked a market in shares. The modern attributes of the business corporation could, possibly, have been employed efficiently after the emergence of the stock market around 1700. The description of the 17th century history of the EIC as a period of trial and error, of correcting initial blunders, is not accurate in my view. It did not take the early moderns a century to figure out how to do it right. The organizational development of the EIC was in a constant interaction with a changing environment. Its designers responded to the rise of the stock market, to the crisis of the English State, and to changes in the Asian markets. The organizational history of the transformation of the EIC from a publicly-held corporation to a publicly-traded one deserves a separate study. It is, however, beyond the scope of the current paper.

We can probably gain some insights from the formation of the EIC for the formation of business organizations in modern day economies that lack effective stock markets. Rather than forcing upon such developing and transition economies models that fit advanced economies at the present time, we might want to consider a model that functioned well in pre-stock market England. This model overcame the limits of the sole proprietorship and the partnership and enabled the development of a large-scale widely-

held corporation. Neither a large shareholder nor a managerial group controlled this corporation. Its small shareholders were relatively protected. These are features that many growth consultants desperately try to create in transition economies. A study of the formation of the EIC will not provide them with a detailed and structured plan. But it might provide them with a loose end for disentangling the Gordic knot that preconditions the establishment of publicly-held corporations on the formation of a share market and vice versa.

Tables and Figures

Table 1

The Exports of the East India Company in Bullion and Goods

Year	Money	Goods
1601	21,742	6,860
1603	11,160	1,142
1606	17,600	7,280
1607	15,000	3,400
1608	6,000	1,700
1609	28,500	21,300
1610	19,200	10,081
1611	17,675	10,000
1612	1,250	650

Source: Chaudhuri (1965) p. 115

Table 2

Capital Subscribed for the Separate Voyages

Year	Voyage	Capital in £
1601	1 st	68,373
1603	2 nd	60,450
1606	3 rd	53,500
1607	4 th	33,000
1608	5 th	13,700
1609	6 th	80,163
1610	7 th	15,634
1611	8 th	55,947
1611	9 th	19,614
1611	10 th	46,092
1611	11 th	10,669
1612	12 th	7,142
Total		464,284

Source: Chaudhuri (1965) p. 209

Table 3

Non-Merchant Shareholders in Merchant Corporations

Company	Membership	Merchants %	Merchant Knights %	Non-Merchants %
Merchant Adventurers	269	91	8.6	0.4
Eastland	197	93.4	6.1	0.5
Levant	572	92.1	6.2	1.7
Spanish	1096	94.2	4.2	2.6
French	548	93.8	3.3	2.9
Muscovy (Russia)	211	78.7	14.2	7.1
East India	1318	80.6	5.0	14.4

Source: Rabb p. 104 (only long-lasting overseas trading companies)

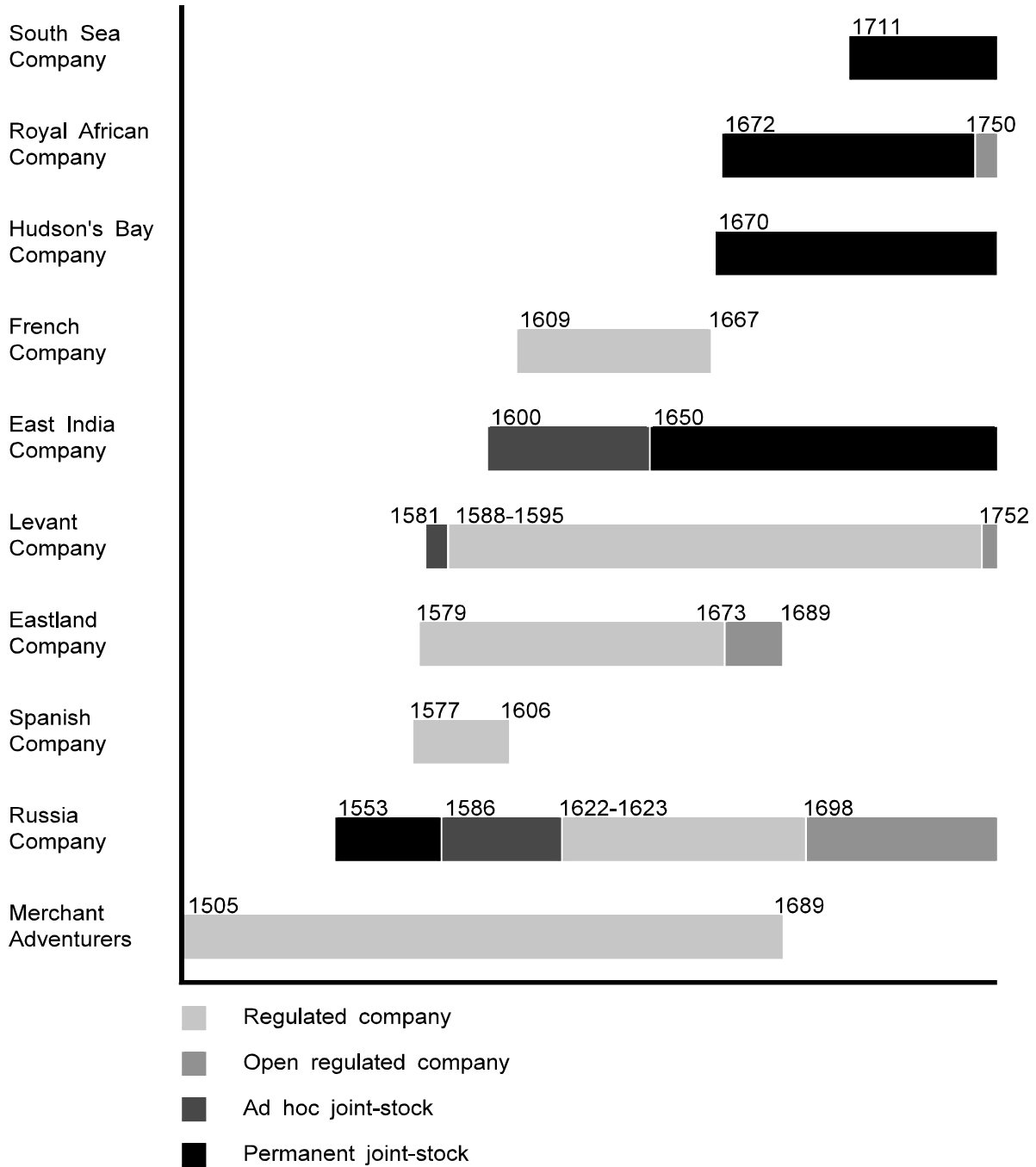
Figure 1

Map of EIC Trade Destinations and Inter-Asian Trade



Figure 2

The Major Regulated and Joint-Stock Companies, 1500-1700



Source: Harris (2000) p. 52