BUSINESS ORGANIZATION IN PRE-INDUSTRIAL EUROPE*

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ABSTRACT: Business in pre-industrial Europe was predominantly commercial, and its organization served the two basic requirements of commerce—representation in distant markets and financing. The various forms of organization included the sea loan, *commenda*, the share venture, the joint stock company, the *compagnia*, the holding company, the limited partnership, and commission. This paper examines these forms of organization and how they evolved to meet the needs of business enterprise.

JEL Categories: N13, N83, D23, G32, G34, K22

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In pre-industrial Europe, business primarily meant commerce. The typical businessman was a merchant rather than a producer. That is, he was a trader and a middleman, transferring goods from the hands of those who valued them less to the hands of those who valued them more. His profits came out of the resulting gains from trade. Being a middleman rather than a producer, the merchant was less a processor of materials than he was a processor of information. He profited from information by trading on it—by buying goods and reselling them at a higher price.[1] Because business was primarily commercial, it was the needs of commerce and trading that shaped its organization.

COMMERCE

A merchant could not conduct his business without relying on others: commerce involved reliance. To a significant extent, the evolution of business organization in this period can be seen as the evolution of ways of addressing the problem of reliance and the resulting vulnerability.

Reliance, trust, and the role of business organization

To engage in trade, there were two fundamental requirements. The first was action in more than one place. This was required because commerce generally took the form of venturing. Goods purchased in one place had to be taken to another in search of a buyer: only rarely could they be sold to order. Consequently, either the merchant himself had to travel with his goods or he had to rely on others—agents—to act for him in the distant market.

The second fundamental requirement of trading was a command over goods. To trade, a merchant needed to take a position—to own the goods in question between the time he purchased them and the time he resold them. The greater his ability to take a position—the greater his command over goods—the greater his potential profit.[2] Taking a position, however, required resources—either the merchant's own (his capital) or the resources of others (financing).[3]

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[1]See Casson (1997) on the economics of the middleman or intermediator.

[2]The term 'command over goods' is due to Reynolds (1952).

[3]The analysis here develops that of Postan (1973 [1957]). Postan distinguished between two principal functions of partnership (business organization)—finance and organization (agency). He described cases in

These two fundamental requirements each created a form of reliance. Unless he traveled himself, a merchant had to rely on agents to act on his behalf. Unless he depended entirely on his own capital and sold only for cash, a merchant was involved in financing. If he obtained financing from others to increase his command over goods, then they relied on him to repay. If he sold on credit, then he provided financing to others and relied on them to repay their debts to him.[4]

Since commerce involved reliance, it required trust. No-one would have employed an agent without a reasonable expectation of good and faithful service. No-one would have provided financing without a reasonable expectation of being repaid. Consequently, the reinforcement of trust was an important function of commercial organization.

Those involved in relationships of agency or financing could do a great deal themselves to reinforce trust by structuring their relationships appropriately. However, there also existed, external to the parties, a rich and complex commercial structure that reinforced trust between them. This structure was made up of families, merchant associations, intermediaries, and organized markets, as well as non-commercial entities such as the state, local lords, and the Church. Each of these entities reinforced trust between the parties either by guaranteeing the parties' promises to one another or by enforcing those promises.[5]

It is in this context of reinforcing trust that we can best understand the role of business organization. Business organization is a formalization of relationships of reliance in order to make them amenable to external enforcement. The means of such formalization is a contract. The mechanism of enforcement is a legal system.[6]

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which the former function predominated as "finance partnership" and cases in which the latter predominated as "service partnership".

[4]Agency and financing were the principal causes of reliance but not the only ones. For example, in some cases foreigners were excluded from participation in certain trades—in Venice, for instance, they were excluded from the spice trade. A relationship between a foreigner with the means to conduct trade and a native with the right to do so provided a way to circumvent such a restriction. Such a relationship might or might not involve agency or financing. See Postan (1973 [1957]) and Lane (1973).

[5]On enforcement and guarantee see Kohn (2003a).

[6]"A contract is a promise or set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty." Goldberg (1976) The modern literature

The different forms of business organization were defined by the contracts that gave them expression. Since there was no codified system of business law, the law of business organization itself was largely embodied in these contracts.[7] The role of the courts in this period was largely limited to interpreting and enforcing contracts in case of dispute.[8] Forms of business organization and the law of business organization evolved together with the evolution of contracts: "The development of commercial contracts is as crucial in the history of trade as that of tools and techniques in the history of agriculture."[9]

If addressing the problem of reliance was the basic function of business organization, there were two forces that shaped the evolution of its form. The first was the changing way in which merchants addressed the need for representation in distant markets. The second was the tradeoff between the advantages and disadvantages of size.

The evolution of methods of representation

Representation underwent an evolution during the period.
This was partly a result of the expanding volume of trade and changes in its composition.[10] It was partly a result of changes elsewhere in the commercial structure—in merchant associations and in organized markets, in particular—and of improvements

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on the economic function of contracts (e.g., Macaulay (1963)) emphasizes their role in clarifying the parties obligations no less than their facilitation of external enforcement. However, pre-industrial contracts tended to be brief and vague and it was common for only the party owed the obligation to receive a copy (Dahl (1998) p 94; Reynolds (1952) p 353). Since contracts were typically public, vagueness was perhaps a result of the need for secrecy from competitors and from tax collectors. And brevity and the fewness of copies were probably the result of cost: both writing materials and the services of the writer were expensive. Whatever the reasons, the nature of contracts in this period suggests that the facilitation of enforcement was the main reason for their use.

[7]"the term contract law… refers primarily not to the law of or about contracts, but to the 'law' a contract itself brings into existence… If we permit ourselves to think of contract law as the 'law' that parties themselves bring into existence by their agreement, the transition from customary law to contract law becomes a very easy one indeed."Benson (1990) p 32 quoting Fuller (1981)

[8]"Consistently until the end of the Law Merchant period, the role of the law was to be interpretive of agreements, rather than creative." Trakman (1983) p 10

[9]Lopez (1976) p 73

[10]See Kohn (2001a).

in transportation and finance.[11] And it was partly a process of 'technological progress' in which newer more productive arrangements replaced older less productive ones.

At the beginning of the period, merchants did not need representation, because they traveled with their goods themselves. In the early twelfth century, for example, Genoa traded by sea with the eastern Mediterranean and by land with the Low Countries and the Fairs of Champagne. In both cases, the trade was conducted by traveling merchants. The Mediterranean trade was in the hands of the Genoese themselves. Ships for Syria, for example, left Genoa in the fall and returned in the spring: one recorded fleet of three ships carried some one hundred merchants. The overland trade was largely in the hand of merchants from Arras, who traveled south, and of merchants from Asti, who traveled north. Both groups bought cloth in the North and carried it south in caravans to Genoa. There they sold it to Genoese merchants who specialized in the export of cloth to various Mediterranean destinations. The caravan merchants then purchased Mediterranean goods, mainly spices and silks, and returned with them to the North.[12] In England in the thirteenth century, foreign merchants brought their goods to the great international fairs. Convoys of Flemish merchants brought cloth and returned with wool. Gascon merchants brought wine from Bordeaux.[13] And in the Baltic too, German merchants traveled with their goods.[14]

Over time, merchants traveled less themselves and increasingly entrusted their goods to someone else—to an agent—to act for them in a distant market. Such an agent might be another merchant who carried goods for others as well as for himself, or it might be a factor, a supercargo, or a shipmaster.[15] By the late twelfth century, the merchants of

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[11]On the evolution of merchant associations, see Kohn (2003c); on the evolution of organized markets, Kohn (2003d); on transportation, Kohn (2001b); and on finance, Kohn (1999a through Kohn 1999g).

[12]See Reynolds (1929) Reynolds (1930) Reynolds (1931) on the overland trade and Byrne (1916) on the trade with Syria.

[13]Moore (1985), James (1971)

[14]Dollinger (1970) p 163

[15] The meaning of factor or *fattore* in the Middle Ages was salaried clerk or employee. In contrast, from the Early Modern period, factor in English came to mean commission agent or manager of a trading post. de Roover (1974)

Genoa and other Mediterranean cities were mostly sending their cloth to the Levant with agents. For example, in the spring of 1248 the *Saint Esprit* departed Marseilles for Acre with 65 passengers aboard carrying goods for some 122 other individuals who remained behind.[16] By the fourteenth century, Flemish merchants were sending their cloth to the English fairs with agents rather than traveling themselves.[17] Gascon wine merchants were settling in London and sending agents back to Gascony to purchase wine for them.[18] And in the Baltic, Hanseatic merchants stayed in one place and relied on agents to carry their goods from one market to another.[19]

The advantages of using an agent were several. First, the use of agents allowed a merchant to diversify. Traveling himself, he could trade with only one distant market at a time; using several agents simultaneously, he could trade with a number of markets. Moreover, the use of agents, together with the diversification that it allowed, enabled a merchant to increase the scale of his operations. He could thus apply his skill and knowledge to a larger volume of trade. Some merchants who used agents continued to travel themselves (especially early in the period). However, those who no longer traveled gained additional benefits. By staying at home, they saved the time involved in lengthy journeys abroad. They were also able to devote more attention to household business and to the demands of association and city politics.

The next transition in representation was from reliance on traveling agents to reliance on resident agents.[20] Such a resident agent might be another merchant acting as a partner of the first or as a commission agent, or he might be an employee. From the mid-thirteenth century, the Italian trade with northern Europe relied increasingly on agents

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[16]Berlow (1979)

[17]Moore (1985)

[18]James (1971)

[19]Dollinger (1970) p 163

[20]Some historians have attached great significance to this transition: “This evolution involved such a drastic change in the methods of doing business that the transition from one system to the other could be called, without exaggeration, ‘the commercial revolution of the end of the thirteenth century’.” de Roover (1948) p 11

stationed permanently in the major markets there—in Bruges, Paris, and London.[21] The Mediterranean trade too relied increasingly on agents living in colonies and *fondaci* in distant cities.[22] A similar transition occurred in northern European trade, both in the trade between England and the Continent and in the Baltic trade.[23]

A resident agent had significant advantages over a traveling agent.[24] A permanent presence meant better market information—the key to successful trading. It also meant greater freedom in the timing of purchases and sales: there was no rush to buy or to sell before the fleet or caravan departed. Continued residence also allowed agents to develop contacts with locals—including the local authorities. Using a local as an agent was one way to circumvent restrictions on trading by foreign merchants.[25] Resident agents could establish their own credit and ascertain the credit of others, enabling them to buy and to sell on credit; it also helped that they remained to pay and to collect the debts.[26] A resident agent lost less time to travel, and the resulting increase in productivity justified the employment of better qualified agents. Of course, these advantages had to be weighed against the cost. Maintaining an agent full time in a distant market was expensive, and it could be justified only if the volume of business was sufficiently large.[27]

The use of resident agents depended on reliable means of sending information, goods, and funds from one place to another. Merchants relied on travelers, on private messengers, and, increasingly, on regular mail services to communicate with their agents in distant markets; both merchants and agents devoted much of their time to

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[21]de Roover (1971); de Roover (1958)

[22]"When voyages became more regular and colonies were established in distant centers, traders no longer had to travel with their wares. With trade concentrated at familiar ports, it was no longer necessary to send special agents who would wander around looking for buyers and sources of supply." Lane (1973)p137. See also Kedar (1976) p 26; Pryor (1983)p193.

[23]On the Baltic trade of the sixteenth century, see Christiensen (1941).

[24]See Christiensen (1941) for a discussion of the advantages of resident agents in the Dutch Baltic trade of the sixteenth century.

[25]Sometimes the authorities plugged this loophole by restricting the ability of locals to act for foreigners.

[26]Willan (1959) Ch 1; Spufford (1988)

[27]Spufford (1988)

correspondence.[28] Goods were sent unaccompanied with professional carriers—ships' captains or operators of pack and wagon trains.[29] Innkeepers and brokers helped arrange transportation, and the development of bills of lading and marine insurance made the sending of goods more reliable and lessened the risks.[30] The developing market for bills of exchange facilitated the remittance of funds.[31]

The evolution of methods of representation was not entirely a progression: older methods continued to coexist alongside newer ones. Even in the sixteenth century, whenever a resident agent was uneconomical or infeasible, merchants and agents continued to travel.[32] For example, in the overland trade with Asia and initially in the transoceanic trade with Asia and with the Americas merchants or their agents traveled with their goods.[33] In Bruges in the fourteenth and fifteenth centuries and in Antwerp and London in the sixteenth, resident agents were the rule. However, in all these markets traveling merchants and traveling agents were common.[34] As trade with Spanish America expanded and developed in the sixteenth century, it recapitulated the development of the Mediterranean trade four centuries earlier—first traveling merchants, then traveling agents, and then resident agents.[35]

Economies of scale in commerce

The second force shaping the evolution of forms of business organization was the tradeoff between the advantages and disadvantages of size—between economies and

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[28] Willan (1959); see Kohn (2003b) for more on merchant correspondence.

[29] Reynolds (1952); see Kohn (2001b) for more on transportation.

[30] de Roover (1945); Lane (1973). See Bensa (1925) on bills of lading; see Kohn (1999g) for more on insurance.

[31] Usher (1943) Ch 1; Lane (1973); Edler (1938). See Kohn (1999d) for more on bills of exchange.

[32] Also when they could not establish a permanent presence because their trade was illegal, as with interlopers in the regulated trades. Willan (1959) Ch 1

[33] Lane (1973). The Russia Company had resident factors in Russia, but sent traveling agents from Russia to Persia (the round trip took as long as five years). Willan (1959) Ch 1

[34] de Roover (1971); Van Houtte (1977); Bratchel (1978)

[35] Pike (1966)

diseconomies of scale. There were two types of economies of scale in commerce—those that were intrinsic to the process of trading and those that were not.

Trading was risky. So there was a considerable advantage to diversification—to not putting all one's eggs in one basket. One could increase diversification either by reducing the size of the individual trade or by increasing the size of the enterprise to encompass a larger number of trades of the same size. Business organization helped a merchant do both: it allowed him to take a part of a trade rather then bearing the risk of the whole thing, and it allowed merchants to create larger enterprises.

Taking a smaller position in a given trade, while it reduced the risk, also reduced the return to information. Given information an a particular opportunity for profitable trade, a larger scale of trading allowed fuller exploitation of that information. A larger position was consistent with diversification only if the enterprise was itself large.

As we have seen, trading involved reliance and so a need for trust. Larger organizations, other things equal, made more trustworthy counter-parties. First, they had a greater capacity to meet their commitments: they could, for example, be better diversified. Second, they had a greater reason to meet their commitments, because the reputational loss from not doing so was greater: reputation is indivisible.[36]

There were other economies of scale in commerce, not directly related to the process of trading itself. Merchants had to protect themselves against predation, and there were economies of scale in protection. Merchants were engaged in a rivalry for trade, which involved acquiring privileges from governments. There were economies of scale in dealing with governments.

The realization of economies of scale in trading required joint enterprise. That is, it required merchants to work together in a single business structure that traded jointly. The realization of non-trading economies of scale required joint action but not necessarily joint trading. Merchants came together in merchant associations for protection and to vie for trade, but they each traded separately.[37]

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[36]For more on this see Kohn (2003a).

[37]For more an merchant associations, see Kohn (2003c).

Joint enterprise involved not only economies of scale, but also diseconomies. The problems of reliance *within* the enterprise grew rapidly with size. With the means available then for management, control, and communications, the cost of managing internal relationships of agency and financing rose rapidly.[38]

The evolution of business organization was at least in part driven by the desire to improve the tradeoff between the economies and diseconomies of scale of the business enterprise.

MERCHANT HOUSES, VENTURES, AND COMPANIES

To understand the different forms of business organization in pre-industrial Europe, we need to distinguish among three different and distinct entities—the merchant house, the venture, and the company.

The merchant house

The basic unit of economic organization in commerce, as it was in agriculture or industry, was the household or 'house'. At the core of the merchant house there was usually an extended or nuclear family. In different places and in different times, brothers might be part of the same household or they might have independent establishments of their own. In some cases, a house might be centered on a bachelor, a widower, or a widow.[39]

The typical life of a merchant house was short. Once a successful merchant had made his fortune, he would typically take his capital out of commerce and reinvest it in land to provide a secure income for his heirs.[40] It was landed property rather than a business that gave a family economic continuity.

The venture and the company

Merchant houses entered into two different forms of business organization—the venture and the company.

The venture was a formal structure for the undertaking of a specific trade or trades. The trade—a purchase of goods and their subsequent resale—is the elementary particle of

[38]For more on management see Kohn (2003b).

[39]For more on the merchant house, see Kohn (2003b).

[40] See Kohn (1999a).

commerce. Some ventures were 'one way', involving a purchase in one place and resale in another. Other ventures were 'round trip', with the proceeds of one sale being used to purchase new goods to be returned to the place of origin for resale there. A venture was defined by a specific trade or trades: when the trade or trades in question were completed, the venture was terminated.

Merchant houses entered into ventures with other merchant houses or with other individuals. The purpose of the structure was to formalize relationships of agency and financing between the parties involved in undertaking the trade or trades in question.

As a vehicle of financing, the venture structure helped merchant houses mitigate risk. By participating in multiple simultaneous ventures, they gained the benefits of diversification. By combining with others in a joint venture, they could limit their exposure to a large or very uncertain undertaking to only part of the total sum involved.

Unlike the venture, the company was an ongoing structure, engaging in multiple trades and ventures both simultaneously and over time. The duration of the company was defined in terms of time: typically, it terminated after a predetermined number of years, although certain events could trigger earlier termination.

A merchant house might constitute itself as a company—although many did not. The purpose of doing so was primarily to formalize relationships of agency or financing between members of the house and nonmembers. Alternatively, several merchant houses might combine together to form a company: the structure of such a company formalized their relationship with one another as well as their relationships with outsiders.

At the beginning of our period, the distinction between venture and company was very clear. However, as formal structures evolved over the centuries, the distinctions became blurred. Some types of venture evolved into ongoing enterprises, much like companies. And some types of company took on aspects of a venture.[41]

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[41]Earlier historians have tended to contrast one particular form of venture organization—the *commenda*—with one particular form of company organization—the *compagnia* (e.g. Cipolla (1994), Lopez (1976), Braudel (1982)). However, as we shall see, there were different forms of both types of structure. These same historians tended to see the company as superceding the venture as the traveling trade gave way to resident trade. Here, too, we shall see that the story is considerably more complex. Indeed, to a

Asset partitioning

The use of ventures and of companies to formalize relationships of financing posed a problem in terms of responsibility for debt and security for debt. When a single merchant house incurred a debt, the responsibility was very clear: the house had an unconditional responsibility to pay. In the event it did not, any and all of its assets could be forfeit to satisfy the debtor. However, when several merchant houses entered into a joint venture or combined to form a company, it became less clear who was responsible for which debts and which assets secured them.

It is useful to think of the problem in terms of the partitioning of assets—of dividing them into separate pools dedicated to securing different debts.[42] How, for example, are assets partitioned between those that secure the debts of ventures and companies on the one hand and those that secure the personal debts of the participating merchants on the other?

Do creditors of a merchant have a claim on all the assets of any enterprise in which he is a participant? If they do not—if the assets of the enterprise are legally protected from the creditors of a participating merchant—then we have some form of 'forward asset partitioning'.

Conversely, do creditors of a venture or company have a claim on all the assets of all the merchants participating in the enterprise? If they do not—if the assets of a participating merchant are legally protected from the creditors of the enterprise—then we have some form of 'backward asset partitioning' or 'limited liability'.[43]

As different forms of venture and company evolved and developed, so did legal concepts of the partitioning of assets. This evolution had important implications for different types of financing relationship and hence for the availability of financing.

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large extent, one form of venture organization—commission—eventually came to predominate, to some degree at the expense of company organization.

[42]Hansmann, Kraakman et al. (2001)

[43]The terminology of forward and backward asset partitioning is due to Mahoney (2000). Hansmann, Kraakman et al. (2001) uses the terms affirmative and defensive asset partitioning.

THE ORGANIZATION OF VENTURES

For as long as either merchants or their agents traveled with their goods, the natural structure for business organization was the venture. Parties entered into a formal relationship for the duration of the trip. Initially the predominant form of structure was the sea loan and then increasingly the *commenda*—a type of profit-sharing contract. Each of these two structures saw use in formalizing relationships both of agency and of financing. For ventures requiring broader participation, either because of their size or of their risk, there evolved two forms of organization that accommodated multiple participants—the share venture and the joint stock company. As merchants came to rely increasingly on resident agents, they attempted to adapt these various forms of venture organization to this purpose.

The sea loan

In twelfth century Genoa, the most popular form of venture organization in the city's Mediterranean trade was the sea loan.[44] This was primarily a vehicle of financing, but it was sometimes adapted to serve an agency function.

Initially, the sea loan (*foenus nauticum*) was typically used by a traveling merchant to finance the goods he was taking to the East or by a shipowner to finance such a voyage. The term of the loan was for the duration of a specific journey, usually round-trip. The advance could be in the form of cash or of goods (that is, trade credit). Repayment was contingent on the safe arrival of the goods or of the ship in question. Payment was due 15 to 30 days after safe arrival to allow for the sale of goods. surety

Although the lender bore the casualty risk, he did not bear the business risk: the borrower was obliged to repay the loan even if his trading proved unprofitable. To ensure repayment, sea loans were secured. Initially, they were usually secured by the general credit of the borrower—that is, by all the assets of the borrower's household.[45] In case of default, the borrower agreed to pay double the amount due "out of my land and my house or out of anything that I am known to have in this world."[46] Often, the borrower's wife

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[44]Much of the following is based on Hoover (1926).

[45]Some loans were secured instead with specific real estate or by guarantees from third-party sureties.

[46]Lopez (1955) Ch. 9

cosigned the contract to indicate her consent to this commitment. By the end of the thirteenth century, however, it became more common for the loan to be secured by specific assets associated with the venture—goods, a ship, or shares in a ship. By then, the law recognized the partitioning of the assets of the venture from the general assets of the household. The signature of the wife was no longer required. This partitioning of assets, and the resulting dedication of specific assets to securing the loan, facilitated lending. This was because the lender no longer needed to investigate and assess the general credit of the borrower. With lending made easier in this way, the sea loan became a popular financial investment for small investors in Genoa and elsewhere.

The sea loan was also adapted for use as a combined instrument of agency and financing in a form known as the *pignus* loan (pledge loan). A merchant sent goods with a traveling agent. The agent lent the merchant a sum of money, and the goods were formally considered to be a pledge for the loan, to be sold off in case of default (the goods were of greater value than the loan). The loan was payable upon the lender-agent's safe arrival at the destination with the goods (if the goods did not arrive safely, there was no obligation to repay). However, it was understood between the parties that the borrower would 'default' and that the lender-agent would sell the pledged goods to recover the debt. Any excess of the proceeds of the sale over the amount of the debt was to be returned to the borrower, either by investment in a return shipment or by remittance.[47] If the proceeds of the sale failed to cover the loan, the borrower was liable for the difference when the lender-agent returned home.[48] The pignus loan was used both in the maritime trade of Genoa with the East and in the overland trade with the North.[49]

The *pignus* loan enabled the traveling agent—usually himself a merchant carrying his own goods as well as the goods of others—to gain some economies of scale in trading by trading a larger volume of goods. And it enabled him to do so without a resulting increase

[47]The goods were to be sold before two witnesses to ensure that there would be no dispute as to the amount of the proceeds.

[48]This obligation was secured by the general credit of the borrower, sometimes with the addition of a surety.

[49]See Hoover (1926) on the former and Reynolds (1931) on the latter. Both are based on notarial records from around 1200.

in his exposure to business risk: the business risk of the goods he carried as agent remained with the merchants who sent them. Instead of a share in the profit, the agent received a fee—presumably implicit in the pricing of the loan. However, the agent bore the casualty risk of the goods in his care, which created appropriate incentives.[50]

This arrangement also allowed traveling merchants acting as agents to finance the working capital of the sedentary merchants in Genoa who provided them with trade goods. The sedentary merchants received a substantial part of the sales proceeds immediately, rather than having to wait until the goods were sold at their distant destination.[51] The greater wealth of the traveling merchants enabled them to play this role.[52] The risk to them of making such loans was small because of the excellent security—a pledge of goods under the control of the lender.[53] It should be clear that although the traveling merchants were the agents and the sedentary merchants the principals under this arrangement, there was no implication that the agents were inferior in wealth or in status to the principals.

As the use of resident agents increased, the sea loan was adapted to financing the shipment of goods to or from an agent overseas. Such a loan was payable on arrival of the goods at their destination in the coin current there. Since this was normally different from the coin in which the loan was made, this type of contract involved the exchange of currencies and was known as a *cambium nauticum.* The funds, received by the lender's

[50]There was a different kind of *pignus* loan in which a ship's captain transporting goods for a merchant would lend him an amount equal to a fraction of the value of the goods as a sort of insurance.

[51]This combination of agency and financing would reappear in seventeenth century Amsterdam, when commission agents provided their customers with financing.

[52]At the end of the twelfth century, the Genoese trade with the Mediterranean was no longer monopolized by the aristocracy, as it had been until 1179. However the traveling merchants tended to be of the noble class and quite wealthy. In contrast the 30 to 40 Genoese cloth merchants who bought cloth from the North and had it finished for the Mediterranean trade were of the artisan class and much less well to do. The traveling merchants of the overland trade, mostly from Arras or from Asti, were also quite wealthy. Reynolds (1929; Reynolds (1930; Reynolds (1931)

[53]Sometimes the goods would be placed in the hands of a different traveling merchant that both borrower and lender trusted, as added protection for the borrower. Reynolds (1931)

agent, could either be reinvested for the return trip or remitted by means of bills of exchange.[54]

The commenda

From the late twelfth century traveling merchants increasingly shifted from the sea loan to a different form of venture organization—the *commenda*.[55] The *commenda*—called *colleganza* in Venice—had been increasingly common since the early twelfth century.[56] Like the sea loan, it had aspects both of agency and of financing. Initially, agency predominated, but later it became more or less a pure instrument of financing. Like the sea loan, the *commenda* appeared first in the maritime trade of the Mediterranean, but like it too it saw some use in the overland trade with the North.[57] In subsequent centuries, use of the *commenda* spread to other parts of Europe.

There were two parties to a *commenda* contract. The *stans* or *commendator* provided goods to be traded or money to purchase such goods. The *tractator* traveled with the goods to a distant market and traded them there. The contract was for the duration of a single journey, usually round-trip. As with a sea loan, the provider of the financing bore

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[54]For example, Venetian agents in the Levant who purchased spices in anticipation of the arrival of the galley fleet financed their purchases by drawing a *cambium nauticum* on their principals in Venice. Ashtor (1983)

[55]The sea loan was declared usurious in 1234. The result seems to have been mainly a switch the *cambium* version which was not usurious because it involved the exchange of currencies (the shift to the *commenda*, also free of the taint of usury, seems to have begun well before 1234). The *cambium nauticum* continued in use through the fourteenth century, for example financing the maritime trade between Genoa and Bruges. Its eventual decline coincided with a growing market for marine insurance that made other forms of financing less costly (see Kohn (1999g))

[56]The precise origins of this contract are obscure, and it seems to have borrowed from a number of sources—the Muslim *qirad*, the Byzantine *chreokononia*, the Jewish *'iska*, and the Roman *sociatas*. Pryor (1977)

[57]Some historians have suggested that *commenda* was relatively rare in the overland trade because it was inherently better suited to maritime trade. It is not obvious why this should be so. A possible alternative explanation is that the overland trade at this time was largely financed by northern caravan merchants, rather than by the Genoese. (Reynolds (1929; Reynolds (1930; Reynolds (1931)) Consequently, it would have left little trace in the Genoese records.

the casualty risk: if the goods were lost en route for reasons beyond the control of the *tractator*, he did not have to compensate the *stans*. On his return, after a short grace period to sell the goods, the *tractator* had to render account and to divide the profits with the *stans*. If the latter was satisfied, the two would often enter into a new contract for another venture.[58]

There were two forms of the contract. In its bilateral form (known variously as *sociatas maris* or *sociatas vera*) the *stans* provided two thirds of the necessary financing and the *tractator* one third, with the profits split fifty-fifty. In the unilateral form (known as *commenda* or *colleganza* or *accomendatio*) the *stans* provided all of the financing and received three-quarters of the profit, with one quarter of the profit going to the *tractator*.[59] The bilateral contract seems to have been the earlier form, with the unilateral contract developing from it.[60] In both cases, the contract took the form of a notarial declaration on the part of the *tractator* alone.[61]

In the early twelfth century, the *tractator* was very clearly the agent of the *stans*. The *stans* might be an established merchant, no longer wishing to travel, who employed a younger man to travel for him.[62] In such cases, the *tractator* was more or less an employee. Compensation in the form of a share in the profits created good incentives. The contract usually gave the *stans* the right to decide on the details of the venture—the destination, the ship, and so on.[63] The bilateral form of the contract was common, with

[58]Lopez (1976) p 76

[59]In both cases, the *tractator* received all the profit in his own capital plus 1/4 of the profit on the capital of the *stans*. With the bilateral contract, he received 1/3 of the profit on account of the capital that he himself provided plus 1/4 of 2/3 of the profit on account of the capital provided by the stans, making 1/2 of the total profit. Lopez (1955) ch 9

[60]The unilateral form seems to have emerged and become predominant after 1179, when the monopoly of the oligarchy over Mediterranean trade was broken. Byrne (1916)

[61]de Roover (1971); Pryor (1977); Krueger (1962).

[62]de Roover (1971)

[63]Lopez (1955) p 176

the investment of the *tractator* serving as a performance bond.[64] Performance of the contract was usually also secured by the *tractator* with all his personal property, much as it was with a sea loan.[65] Some contracts explicitly allowed the *tractator*, in addition to acting for the *stans*, to carry goods to trade on his own account and to carry goods for other merchants.[66] The need for explicit permission suggests that these were not automatic rights.

However, as with the sea loan, a formal relationship of agency did not necessarily imply subservience of the agent to the principal. By the late twelfth century, the *tractator* was often himself an established traveling merchant using the *commenda* as a way of expanding the scale of his trading.[67] By then, the *tractator's* right to trade on his own account and his right to accept goods from multiple principals were taken for granted. Indeed, it was normal for such a merchant-agent to accept goods under *commenda* from a number of principals to trade alongside his own goods.[68] This arrangement provided the merchant-agent with a greater command over goods, while allowing him to share the risk with others.[69] Given his status, a performance bond was no longer necessary, and the

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[64]Lane (1966); Mueller (1977) The use of the bilateral contract was most common when the credit of the tractator was less well established—for example, if he was a young man of little wealth and not of a well known family Berlow (1979).

[65]Lopez (1955) ch 9

[66]Byrne (1916) With multiple principals, the expenses of the trip were supposed to be prorated among them. Disputes over the allocation of expenses were not unusual.

[67]Lane (1944) Critical Note 4. One example is provided by the same group of Genoese merchants that used the *pignus* form of the sea loan. A merchant sailing for the markets of the Eastern Mediterranean would accept cloth under *commenda* from a number of Genoese cloth dealers. Reynolds (1931) p371

[68]Reynolds (1929) Reynolds (1930) Reynolds (1931) The consent of one principal was not necessary for a contract with another. The arrangements were entirely transparent because the notarial registers which recorded the contracts were public records. Byrne (1916)

[69]He might simultaneously, for reasons of diversification, commend some of his own goods to other merchant-agents. The *tractator* on one contract was often the *stans* on another. Lopez (1976) p 76; de Roover (1971); Krueger (1993) Krueger (1962)

unilateral form of the contract predominated. Contracts no longer gave the *stans* the right to decide matters such as destination and ship.[70]

In this type of arrangement, one could see the *stans* as financing the merchant-agent's working capital through a form of trade credit—that is, by providing goods against later payment.[71] Trade credit in the form of equity rather than debt made sense given the high risks and potentially high returns involved. Where risks are high, debt financing is problematic because of the high probability of default. Equity financing avoids this problem, because the amount to be paid to the provider of financing is flexible. Unfortunately, this flexibility introduces a problem of its own—ensuring that the provider of financing receives what is due to him.[72] However, a high potential return (a significant upside) can make equity financing a viable option despite this problem.

By the mid-thirteenth century, the *commenda* was evolving from an instrument of trade credit into a pure instrument of finance.[73] Merchants traveling in the Mediterranean trade raised considerable sums of money from different investors under *commenda*. Each merchant raised funds from numerous investors and each investor diversified by placing funds with several different merchants. For example, when the doge of Venice, Ranieri Zeno, died in 1268, nearly half his fortune was invested in some 132 different *colleganza* contracts; and when Armano, a Genoese merchant, died in 1239, there were some 26 men and women providing him with financing under *commenda*.[74]

For the *commenda* to develop from an instrument of agency into an instrument of trade credit and ultimately into a pure instrument of financing, the partitioning of assets

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[70]Lopez (1955) p 176

[71]In the case of Genoese merchants traveling to the Eastern Mediterranean, the shore-bound cloth dealers who provided them with trade credit were financed in turn by trade credit from the caravan merchants who brought the cloth from the North. Reynolds (1931). Compare this arrangement with the *pignus* loan, discussed earlier, by which the merchants traveling to the East financed the working capital of the cloth dealers. The choice between the two instruments may well have been influenced by which of the two parties was in a position to provide trade credit to the other. See fn 29 above on the relative wealth of the two groups.

[72]As applied to the modern corporation, this problem is known as the 'corporate governance' problem.

[73]Postan (1973) Ch. 3.

[74]Spufford (1988)

had to evolve accordingly. In the early agency form, the *tractator* was seen as acting for the *stans*, with the goods carried by the former remaining the legal property of the latter.[75] The *stans* was legally responsible for any debts incurred by the *tractator*.[76]

As the *commenda* developed into an instrument of trade credit, the position changed. The *tractator* was now considered to be trading on his own account. The goods received in *commenda* from the *stans* became the legal property of the *tractator*.[77] The *stans*, therefore, was no longer responsible for any debts incurred by the *tractator*. He stood to lose no more than the value of the goods he had provided.[78] That is, there was backward asset partitioning or limited liability.[79] While the creditors of the *stans* had a claim on the share of the profits owed to him by the *tractator*, they had no claim on any of the goods the *tractor* was carrying for others.[80] Hence, there was also forward asset partitioning.

These changes made the commenda a much more attractive financial instrument. By the end of the thirteenth century, there were highly developed markets for *commenda* financing in several Mediterranean cities—most notably in Venice.[81] The investors were often non-merchants, and they came from all walks of life—landed aristocrats, clergy, artisans, housewives, widows and orphans, and foreign investors. As the market developed in Venice, it began to be tapped by local retailers, artisans, and banks as well as by traveling merchants (contracts with these were known as 'local *colleganza*').[82] Such financing was relatively 'arm's length' with little direct monitoring by the investor. The

[75]Postan (1973) Ch. 3

[76]Mitchell (1904) There was neither forward nor backward asset partitioning.

[77]Lane (1944) Critical Note 4.

[78]Mitchell (1904).

[79]de Roover (1971); Lopez (1976); "Although it has sometimes been called a partnership, it seems to hold a position closer to ordinary loans than to partnerships. Profits and risks are shared by the parties as in a partnership, but otherwise the relation between the parties resembles that of lender and borrower. The former does not become jointly liable with the latter in transactions with third parties, third parties do not need to be aware of the lender's existence." Lopez (1955) p174

[80]Berlow (1979)

[81]See Berlow (1979) on Marseilles.

[82]Lane (1966) The term of these contracts was generally for one year.

stans often freed the *tractator* of the obligation to render an account, agreeing to accept his word "without an oath or witness".[83]

In this arm's length market, the problem of protecting investors would seem to have been particularly acute. Investors were typically not related to those they were financing, so there was no family enforcement of good behavior. Moreover, investments were small and investors many, so that potential loss of repeat business was not much of a threat to the recipient of financing.

The problem was perhaps mitigated by the highly organized form of the Venetian galley trade that this market largely went to finance. The galley trade was regulated by the state and monitored by public officials: there were official scribes on board the galleys and official representatives in the overseas colonies. As a result, there was good public information on trading prices in overseas markets—helping investors assess what profits were due to them. And because trade was closely regulated, it was easy to punish merchants who had cheated investors by excluding them from further trade.[84]

In unregulated maritime trade, the sea loan remained the financing instrument of choice rather than the *colleganza*: the use of debt rather than equity financing obviated the need for monitoring and accounting.[85] Similarly, in the case of local *colleganza*—where state monitoring was unavailable—profit sharing was generally replaced by the payment of a fixed rate of return on the investment, so avoiding any need to calculate profits.[86]

As traveling merchants and reliance on traveling agents gave way in the Mediterranean to reliance on resident agents, use of the *commenda* adapted to the new situation. Already in the late twelfth century, a *tractator* sent from Genoa to Syria, instead of returning immediately, might remain there for a period of years.[87] The *tractator* would send back the proceeds of the originals *commenda* to the *stans* in the

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[83]Lopez (1976) p 76

[84][De Lara, 2000 #2762] has analyzed the problems of this market and how they were addressed.

[85]Williamson (1999; Williamson (2001)

[86]The rate of return was usually linked to the rate bankers paid on *depositi a discrezione* rather than being fixed in advance. Lane (1966); Mueller (1977)

[87]Byrne (1916); Pryor (1983)

form of merchandise. The *stans*, if satisfied, would send out a further shipments with messengers under a conditional *commenda*—to be delivered to the original agent if possible and to be sold by the messenger if not. Messengers were also sent under *commenda* to collect debts from agents in Syria and to invest the proceeds in goods for the return.

In Venice, the practice seems to have differed. While in Genoa the *commenda* was used to structure a series of ventures between the two parties, in Venice the *colleganza* was converted into a sort of quasi-permanent partnership between them. The *tractator* remained in the East, receiving goods from the *stans* and shipping goods back to him. The relationship was structured as a *colleganza*, but for a fixed number of years rather than for a single venture. The Venetian courts were unhappy with this arrangement because of the limited liability the contract afforded the *stans*. They thought that someone dealing with the *tractator* might believe the relationship to be an ordinary partnership and therefore not realize that the *stans* did not bear responsibility for the *tractator*'s debts. For this reason, a law was passed in 1271 limiting the *colleganza* to a maximum of two years and prohibiting the sending of profits or receiving of additional goods without the *tractator* returning to Venice.[88]

During the fourteenth century, the use of the *commenda* declined in the Mediterranean, and by the fifteenth century it was used only rarely.[89] Resident agents operated either under the structure of a company or under commission. However, forms of organization similar to the *commenda* continued to be used elsewhere. Contracts much like the *commenda* were common in England from the fourteenth century.[90] In the fifteenth and sixteenth centuries, merchants of the north German Hansa used the *Wederlegginge* and merchants in south Germany the *Fürleggung*, both similar in form to the *commenda*.[91] The Spanish trade with the Americas in the sixteenth century initially relied heavily on the *commenda* form of organization.[92]

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[88]Lane (1944) Ch. 3; Kedar (1976)

[89]Its use was largely limited to very long distance trade—for example, for a venture to India. Lane (1966).

[90]Postan (1973 [1957]) #1817]; James (1971); Rogers (1995)

[91]Postan (1973 [1957]) #1817]; de Roover (1971)

The share venture

Both the sea loan and the *commenda* provided a structure for commercial ventures. The share venture, a contemporaneous form of organization, provided a structure for a different type of venture—the joint ownership of fixed capital.[93] Its use was later extended to other types of venture—even, in the sixteenth century, to commercial ones.[94]

Why would merchants own fixed capital at all, and why would they do so jointly? There was nothing in the nature of a merchant's business—purchasing goods to resell at a profit—that necessitated the ownership of fixed capital. Of course, merchants might require the use of such items of fixed capital as warehouses and ships. But they generally preferred to rent rather than buy. In commerce, liquidity was of the essence, and merchants were loathe to tie up their resources in illiquid fixed capital.[95] Moreover, the ownership of some types of fixed capital involved a great deal of risk. A ship, for example, was a significant investment and might easily be lost in a storm, run aground, or be taken by pirates.[96]

Sometimes, however, ownership of fixed capital was desirable. For example, an ownership stake in a ship might be necessary to ensure cargo space for a lucrative voyage.[97] In such cases, the share venture provided a solution to the problems of illiquidity and risk. It addressed risk by dividing ownership of a ship among a number of

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[92]Sayous (1929); Pike (1966) A large community of Genoese merchants in Seville played a major role in developing this trade. In Spanish the *tractator* was called a *compañero.*

[93]Much of the following relies on Byrne (1930). Lane (1944) emphasizes that the form of organization that we are calling the share venture was in legal terms an arrangement for joint ownership.

[94]The commenda was sometimes used for commercial joint ventures, with several merchants combining together as *stans*. This seems to have been a common practice among the northern caravan merchants trading into Genoa. (Reynolds (1931) p378) And it seems to have been the practice in the wine trade of fourteenth century England: a Gascon merchant resident in London would combine with native merchants to send an agent to Gascony to purchase wine for them all to sell in England. (James (1971)).

[95]See Kohn (2003b).

[96]See Kohn (2001b) on the hazards of owning a ship.

[97]Scammell (1972) p400-401

investors—from 16 to as many as 70—each of whom would purchase a single share.[98] Many of the investors were merchants planning to sail on the ship in question, but the risk could be spread even further by selling shares to other investors not directly involved in the venture. Such investors often diversified by investing in the shares of several ships. Shares were more liquid than the underlying asset: they could readily be traded, inherited, used to secure a loan, or given in *commenda*.[99] In sum, owning a share in a ship was a much more attractive investment for a merchant than actually owning the ship itself.

Indeed it was in the ownership of ships that the share venture seems first to have appeared. There is evidence of this arrangement in Venice from the eleventh century and in Genoa from the twelfth (shares were called *loca* or *luoghi* in Genoa and *carati* in Venice).[100] The shared ownership of ships later spread to northern Europe. It was common in the Hansa, less common but known in England, and it became extremely popular in the Netherlands in the sixteenth century (the structure was known there as the *rederij*).[101]

The share venture was so useful a structure that it soon found other applications.[102] It was used to finance industrial fixed capital such as mills and mines in Italy, Germany, and the Netherlands. In the Netherlands, in the 1590s the structure was adapted, too, to finance commercial ventures. Dozens of *redirijen* were formed to finance trading ventures to Africa, the Americas, and the Indies.[103] Those trading to the Indies came to be

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[98]The number of shares often corresponded to the number of mariners, with each shareholder responsible for advancing the expenses and wages of 'his' mariner.

[99]They were often pledged as security for loans raised to finance a voyage—to purchase trade goods and supplies and to pay the mariners' wages.

[100]Lane (1934) p 116; Byrne (1916) The medieval *locum* seems to be a descendant of the *locum maris* of Classical antiquity. Roman law recognized joint ownership through the *sociatas*, which seems to have been very similar. It was applied to all sorts of property. [Hansmann, 2001 #2925

[101][Glamann, 1972 #991] Parker (1977) de Vries (1976) de Vries and van der Woude (1997) Barbour (1950)

[102]See Kohn (1999f)

[103]Gelderblom (2003)

known as the *vóórcompagnieën*, and they were later united to form the Dutch East India Company.[104]

The share venture also played a role in public finance, with merchants using it as a vehicle for joint investment in state-sponsored projects (in this case the structure was known as a *maona*).[105] Genoa used the *maona* to finance the colonization of Chios and Phocaea in 1346. Venice used it to finance the operation of its galley fleets that sailed on a regular schedule to Alexandria and to other destinations. While the galleys themselves were owned by the state, management of the fleets was auctioned off to private entrepreneurs. Since the investment needed for such a venture was significant, groups of merchant houses combined together to enter a bid, using the *maona* to formalize their joint ownership of the franchise.[106] Tax farms were another common application: in 1530, for example, the Pisani brothers of Venice combined in a share venture with other merchant houses to take over the farm of the Venetian wine tax.[107]

Because the share venture was a structure of joint ownership of property rather than of joint trading, asset partitioning was relatively straightforward. Presumably, creditors of one of the joint owners would have had claim to his share of the property, but not on that of the other joint owners (forward asset partitioning). The share venture rarely took on debt: if any additional financing was required, it generally took the form of additional shares.[108] For example, shipbuilders commissioned to construct a ship and suppliers provisioning the ship were often willing to accept shares in lieu of cash payment. However, if debt was taken on, it could be secured by the jointly-owned property. In case

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[104]The *vóórcompagniën* combined in 1602 to form the *Verenigde Oostindische Compagnie* under a charter of monopoly. van Dillen (1970) (quoted in Çizakça (1996))

[105]The Romans used the *sociatas publicanum*, a similar structure for joint ownership of tax farms. [Hansmann, 2001 #2925

[106][Lane, 1944 #1709]. The shareholders were called *parcenevoli* or part-owners

[107]Lane (1944)

[108]With regard to the Dutch *rederijen*, no lawsuit has ever been discovered involving the liability of a share-holder, presumably because they never took on debt from outsiders. Riemersma (1952)

of default and loss of the property, the joint-owners stood to lose at most the amount they had invested—*de facto* limited liability.[109]

Unlike the sea loan and the commenda, the share venture was purely a vehicle of financing: it was not used to formalize relationships of agency. However, multi-investor ownership did itself create a kind of agency problem: someone had to act for the owners in managing the jointly owned asset. The share contract generally assigned this role either to one or more of the shareholders or to someone engaged specially for the purpose.

In the early share ownership of ships in the Mediterranean, many of the merchant shareholders sailed with the ship. One of them might be elected *patronus* to command the ship, or the owners might engage a ship's master to perform this role. However, all important decisions were made by calling a meeting of those on board—a sort of floating board meeting.

In the later use of the share venture in the North, shareholders generally remained at home and employed a professional master to take sole command.[110] As an incentive device, the master often purchased or was given a share in the venture (in the Netherlands, a one eighth share for the master was customary).[111] The shareholders appointed one of their own as manager of the enterprise and held frequent shareholder meetings to decide policy.[112] However, not all shareholders participated: some were passive investors who relied on the active shareholders to represent their interests. Shares were often sub-divided and sold to investors. In such cases, the original shareholder might continue to play an active role in the venture, with those holding parts of his share

[109]Lane (1944) Ch. 3

[110]Christiensen (1941) offers the most detailed account of the arrangements.

[111] "Owners would give or sell part-holdings to masters, mates or pilots in the hope of ensuring their wholehearted dedication to the pursuit of profit." Scammell (1972) p400-401. See also Riemersma (1952). A similar practice had been common in the Mediterranean.

[112]The reder who managed the enterprise received a percentage of the total return as a reward. Gelderblom (2003)

relying on him to represent them.[113] When the passive shareholders were relatives or close friends, as was often the case, this arrangement worked reasonably well. When not, it worked less well: "…those who lacked the will, time or ability to manage their money could buy shares and hope—frequently in vain—to draw some profit as sleeping partners.….”[114]

With ship-owning ventures, the division of profits was simplified by the limited duration of the agreement. In the Mediterranean, it was usually for a single voyage, with accounts drawn up and profits divided among the shareholders on the ship's return. The ship's scribe was responsible for accounting for the venture's revenues and expenses and for dividing the profits among the shareholders.[115] In the Netherlands, the enterprise was of indefinite duration, with the designated shareholder-manager responsible for keeping the books.
However, after each voyage or each second voyage profits were paid out, and shareholders could decide whether to continue the arrangement for another voyage or to liquidate the enterprise.[116]

The joint stock company

The origins of the English joint stock company, unlike those of the share venture, do lie in commerce. From the fourteenth century members of merchant associations had sometimes traded collectively.[117] In the sixteenth century, building on this idea, groups of merchants set up associations *ad hoc* for the purpose of engaging in specific joint trading ventures.[118] The resulting structure of the joint stock company was then employed, much

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[113]See, for example, van Dillen (1970) (quoted in Çizakça (1996)) on the *vóórcompagnieën.* In this case, the original shareholders—known as *bewindhebbers*—received a fee of 1% of costs and profits for managing the enterprise.

[114]Scammell (1972) p 400-401

[115]The ship's scribe was a public official, and as such he also registered the share contract at the outset of the venture.

[116]Christiensen (1941)

[117]See Kohn (2003c) on merchant associations in general.

[118]Scott (1912), the great historian of the joint stock company, saw it as having evolved in this way from the regulated company (see below). He also suggested that it might have evolved from a multi-

like the share venture on the Continent, for such non-commercial purposes as colonization and the joint ownership of industrial fixed capital.

The English regulated company, out of which the joint stock company evolved, was not really a ‘company’ in the sense we have been using it—a legal structure to formalize relationships of financing and agency. Rather, it was a merchant association very much like a guild. The earliest regulated company was the Company of the Staple, founded in 1363—an association of merchants who had obtained from the crown a monopoly of the export of wool. Another early example is the Company of Merchant Adventurers, incorporated in 1407—an association of merchants who exported woolen cloth to the Low Countries (they obtained a monopoly of this trade in 1560). Each member of such a company, while subject to the company’s rules, traded independently. However, groups of members might sometimes purchase goods together “in joint-stocke”—stock meaning inventory—presumably to avoid competing with one another and so driving up prices. The goods they purchased in this fashion they then divided up for each to trade on his own account.[119]

The first association set up specifically for a particular venture was the Russia or Muscovy Company.[120] It was formed in 1553 to finance an expedition in search of a northeast passage to the Indies. Some 200 Londoners, mostly merchants, purchased shares in the enterprise. Presumably, the reason for creating this structure was the spreading of risk. The investment was not enormous: the initial sum raised by the Russia Company was £6,000 at a time that the Merchant Adventurers traded ten times that amount annually. However, the risks were indeed substantial: only one of the three ships sent out actually made it back. Of course, the expedition failed to find a northeast passage. However, it did find instead a new northerly route to Russia, and in 1555 the

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investor *commenda*. “Indeed the change form a regulated company or a *sociatas* in the middle of the sixteenth century to a joint-stock, as the latter existed in the second half of that century, was so small that it was one that would come almost insensibly by the normal course of commercial and industrial development.” p 13 Scott believed that imitation of the continental share venture was the least likely explanation of its origin.

[119] Scott (1912)

[120] Willan (1956)

company received a charter from the Crown granting it the monopoly of the new trade it had opened up. The charter of the Russia Company served as a model for all later joint stock companies.[121]

Because the joint stock company, unlike the share venture, was an essentially commercial structure, it needed to address both the fundamental requirements of commerce—representation in distant markets and command over goods. With regard to the first, it provided a framework in which an agent or agents represented all the shareholders of the company in distant markets and traded there on their joint account. With respect to the second, it provided a framework for the shareholders to finance the enterprise.

By 1589 the Russia Company was employing five agents in Russia, each in a different trading center.[122] The chief agent was stationed in St. Nicholas on the White Sea, the port of arrival of English ships. Each of the other agents reported to him, and he in turn reported to London. The remoteness and the isolation of the agents made monitoring more than usually difficult. Agents received a modest salary from the company, but this did not seem sufficient to purchase their faithful service:

> The inadequate salaries and the temptations of life 'in so barbarous a countrey' were believed to be the reason why the Company's servants tried to 'mend their estates' by embezzling the Company's goods and by engaging in private trade.…[although] the Company's servants were forbidden to engage in private trade and took an oath to that effect. The London agent, the pursers on the ships, and the chief agent in Russia were all ordered to stop such 'privat traffick', which the Company described in 1567 as 'the only hinderer of our affaires'.[123]

A supposed monopoly, the Company found itself in competition with the private trading of its own agents. Its attempts to suppress private trading resulted mostly in rampant corruption as agents bribed both Company officers and Russian officials to protect their

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[121] For more on the joint stock company as a form of financing see Kohn (1999f).

[122] Each 'agent' was, in fact, a household headed by the appointed agent and including a number of clerks and apprentices.

[123] Willan (1956) p 37-8

lucrative commerce.[124] Later joint stock companies, most notoriously the East India Company, suffered from similar difficulties.

As a structure for financing, the early joint stock company was no less problematic. As with the share venture, the large number of investors meant that management of the enterprise had to be delegated to a few individuals trusted to act on behalf of all. The potential for problems in this case, however, was greater because the enterprise was engaged in trading rather than merely in holding and managing property. The delegated managers faced a much broader range of decisions and they were therefore much harder to monitor and to control.

In delegating management, the joint stock company had the advantage of inheriting the formal structure of the regulated company from which it was derived.[125] As merchant associations, regulated companies possessed a well developed system of governance. Their members elected officers—governors and consuls—who were responsible for managing its affairs. These officers were audited and monitored by an elected board or 'court of assistants' and ultimately by a general assembly of all the members. The principal responsibilities of this governance structure were to set and to enforce rules, mostly relating to the company's monopoly privileges, and to negotiate on behalf of the company with the authorities at home and abroad.[126]

The joint stock company took over the structure of governance of the regulated company. However, because the joint stock company traded on behalf of its members, something the regulated company did not do, the responsibilities of its officers were greatly enlarged. The governor became in effect a CEO; the court of assistants, a board of directors; and the general assembly, a shareholders' meeting.[127]

Primitive accounting methods made it difficult to monitor the affairs of the company. The problem was mitigated, at least in principle, by the venture form of organization. The company was formed for a single venture: at the conclusion of the venture everything was to be liquidated and the profits distributed. The shareholders, if satisfied with the

[124] Willan (1956) p 195

[125] Scott (1912); Watts and Zimmerman (1983)

[126] See Kohn (2003c) on the functions and working of merchant associations.

[127] Willan (1956)

results, could then reinvest in further ventures.[128] However, this arrangement did not work well in practice and ventures of supposedly limited duration tended to drag on, sometimes for decades. The usual reason for this—as, for example, with the Russia Company—was that continuing losses meant that there was nothing to distribute.[129]

The structure of governance, therefore, performed far from perfectly.[130] The officers, usually major shareholders, ran things largely for their own benefit. As a result, shareholders (themselves mostly merchants) needed to be actively involved in the company's affairs to protect their interests. The relatively few passive investors were either relatives of active investors or public officials in a position to help or to harm the company depending on how well they themselves were treated.

The problem of delegated management was not, however, the biggest problem of the joint stock company as a formal structure of financing. Indeed, the problem of delegated management is common to any multi-investor enterprise, and it has hardly been solved satisfactorily even today. The biggest problem with the early joint stock company as a structure for financing was the highly unsatisfactory nature of asset partitioning.

The joint stock company inherited from the regulated company not only a governance structure but also a structure for the ownership of property. The regulated company, like the guild on which it was modeled, held property as a corporation.[131] Merchant associations had reason to hold certain long-lived assets, chiefly real property, for the benefit of their members. Since these assets continued in use for long periods, beyond the lives of individual members, it was useful to vest their ownership in the association itself rather than in the members of the association. Incorporation made this possible. As a corporation, the association was a 'legal person' able to own property in its own name.[132] Incorporation and legal personality implied forward asset partitioning: creditors of a member of the association had no claim on the assets of the corporation. Joint stock

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[128]Baskin (1988)

[129]Willan (1956)

[130]Shammas (1975)

[131]Watts and Zimmerman (1983)

[132]The corporate charter both created the corporation as a legal person and established its governance structure.

companies were generally incorporated, and they too therefore enjoyed forward asset partitioning.

Backward asset partitioning, on the other hand, was problematic. The rights and obligations of a shareholder were very different from those of a shareholder in a modern corporation. The purchase of a share in one of the early joint stock companies required an initial subscription, but if the company later needed additional funds a shareholder was liable for a call for additional capital. There was therefore no way of knowing in advance what the total investment would ultimately be. For example, the initial subscription for a share in the Russia Company in 1553 was £25. But by 1572 a series of calls had raised the par value of a fully paid-up share to £450. Few shares, however, were fully paid up: in the absence of dividends, many shareholders chose to ignore the calls.[133]

In theory, because of the liability for calls, shareholders were permanently liable for all the company's debts. In practice, however, when a shareholder failed to pay up, there was little that could be done about it. The only sanction available to the company was cancellation of the share and the consequent forfeiting of future dividends. But this was not much of a threat when no dividends were being paid anyhow. And the law did not provide a way for the company's creditors to proceed directly against the individual shareholders. The result was a sort of *de facto* limited liability—or at least limited involuntary liability.[134] Shareholders who were merchants generally did pay up for reputational reasons, but nonmerchant shareholders often did not. This uncertainty about

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[133]There is no evidence that any dividends were paid by the Russia Company over the first two or three decades of its existence. (Willan (1956)). One way shareholders of some companies found to finance their calls was to subdivide their shares and sell off a part to others. A holding of a minimum of a quarter share in the Society of the Mines Royal conferred membership, with pro rated voting rights. Rees (1968) Ch. VI

[134]It was not until the mid-nineteenth century that limited liability was legally recognized. "Accustomed to a system which sent individual debtors to prison for their economic mistakes, early modern Englishmen shrank from sanctioning a device which permitted investors, through the formation of a corporation, to reap the rewards of success but pass the price of failure onto their creditors." Shammas (1975) p 104

the extent of shareholder liability made it difficult and costly for joint stock companies to obtain credit.[135]

The various problems with the joint stock company structure as a vehicle of financing combined to impair the liquidity of its shares. The purchaser of a share faced potentially unlimited future calls as well as possible liability for past calls that had not been met. At the same time, because of ineffective corporate governance, he had very little control over the decisions that would affect his future liability. It is not surprising, therefore, that most sales of shares were to existing shareholders rather than to outsiders and that over time shareholding became increasingly concentrated among a small group of insiders.[136]

THE ORGANIZATION OF COMPANIES

The company, our second type of formal structure, was fundamentally different from the venture. The venture provided a structure for two or more merchant households to enter jointly into a specific and limited enterprise. The company, in contrast, began as the formalization of the household itself as a business entity. The company structure allowed the members of a household to formalize their relationships with one another and, especially, with outsiders. Later, the company structure was adapted to allow several households to combine together as a single business entity.

The company developed primarily to support relationships of financing, but it also served an agency function. Problems with agency led to experimentation with the company structure, resulting in new varieties of company organization such as the holding company and the limited partnership.

The company

Throughout the pre-industrial economy, the family was an important adjunct to the commercial structure. It reinforced trust and thereby supported relationships of agency and financing. Internally, it acted as an enforcer of promises of one member to another. Externally, it acted as a guarantor for its members in relationships of agency or financing

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[135] Shammas (1975)

[136] Willan (1956) Outsiders also had to be approved by the existing shareholders and they had to pay an entry fine.

with those outside the family. So effective was the family as an enforcer that merchants strongly preferred to rely on relatives as agents whenever possible, and it was always to the family that merchants turned first for financing.[137]

The family performed much of its function as an enforcer and guarantor informally, without the use of legal contracts. As an enforcer, the family had its own mechanisms of order that did not depend on the courts. As a guarantor of its members to those outside the family, there was no need for a formal contract: whether the family wished it or not, the custom of the community held it responsible for the actions of its members.

In northern Italy, where the company structure originated in the thirteenth century, the family and the household were typically coterminous.[138] Fathers, sons, brothers and other relatives lived together—in a house, a compound, or a palace, depending on their circumstances. Members of the family considered themselves, and were considered by others, a single business unit.

In Venice, the family company was known as a *fraterna*. When one member of a *fraterna* entered into an obligation, it entailed the joint and several liability of all its members. This liability was secured by the inherited property of the family, which has held jointly by the *fraterna*. The creation of a *fraterna* required no legal procedure: its existence was assumed. On the death of a father, the sons were automatically considered members of a *fraterna* unless they took legal steps to separate their inheritances.[139]

In Genoa and Tuscany, the family company was known as a *compagnia*—those sharing bread. This was typically a partnership of father and sons or of brothers who shared the same household. Unlike the *fraterna*, the *compagnia* was often a formal structure involving a contractual relationship among the parties. The formality may have been the result of different inheritance laws: when, as in Florence, the legal default was a division of the estate among the heirs, a legal agreement may have been necessary to

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[137] See Kohn (2003a) for more on the economic role of the family.

[138] Greif (1996)

[139] Lane (1944); Lopez (1955); ch 10 Lane (1973). The *frayresque* of Provence seems to have been similar to the *fraterna* (Reyerson (2002) ch 4). In England, too, as late as the eighteenth century, the family firm (general partnership or co-partnership) required no special procedure or written documents. Grassby (2001)

‘reconstitute’ the family patrimony.[140] As with the *fraterna*, the partners in a *compagnia* bore unlimited joint and several liability for an obligation taken on by any one of them.

In its relationships with others, the main advantage of the family company over an individual acting alone was the company’s greater reliability as a counterparty. The pooling of capital made it a more trustworthy debtor, because a larger total capital reduced its dependence on credit and so lowered the risk of involuntary default. This was particularly important for those family companies that became merchant banks. The company was a more trustworthy debtor, too, because repayment did not depend on the life of a specific individual: violence and especially disease were constant threats even to those in the prime of life.[141] Finally, the family company, because of its greater longevity, had a greater reputational interest in honoring its debts. To some extent, each of these advantages accrued to an individual trading on his own but guaranteed by his family. However, formalization of the family’s joint and several liability for the debts of its members reduced legal uncertainty and lowered the transactions costs of collecting debts.

Even without the formal structure of a company, it was common to use kin as agents. For example, in the late fourteenth century, the family of Veckinchusen located its members in many of the key trading cities of the German Hansa.[142] Sivert lived in Lübeck and his brother Hildenbrand in Bruges; there were uncles, cousins, and in-laws as well in Dorpat, Reval, Riga, Ghent, and Cologne. On one occasion, in a typical pattern of transactions, Sivert sent a shipment of cloth from Lübeck to a brother-in-law in Dorpat. The latter sold it and used the proceeds to purchase skins which he sent in turn to Hildebrand in Bruges. All this was done without any formal company structure. Agency relationships among Hanseatic traders were typically based instead on the *gegenseitige Ferngesellschaft* or mutual agency contract.[143] Under this arrangement each individual traded in his own name and was responsible for his own debts. Because bookkeeping was often haphazard, disputes were common despite the ties of kinship.

In many cases, however, relationships of mutual agency were

[140] Goldthwaite (1987)

[141] Grassby (2001) p309

[142] Gies and Gies (1972) Ch 16

[143] de Roover (1971)

structured through the use of a family company. This was common practice in Venice. For example, Federico Corner, the wealthiest merchant of the mid-fourteenth century stationed a brother in Cyprus to send back spices, cotton, and other Levantine goods for sale in Venice.[144] In return, he sent cash or goods (once including a 1600lb copper kettle for the sugar plantation the company had acquired on Cyprus). Formal family partnerships (*compañias*) were common, too, in sixteenth century Spain. Among the merchant families of Burgos, one partner would remain at home while others would be stationed permanently in important overseas markets such as Bruges, Antwerp, Nantes, Rouen, or London.[145]

The advantage of using the structure of a company in these cases was that the responsibility of the company for the actions and the debts of each partner was explicit. This made it easier for agents located away from home to obtain credit.[146] The disadvantage of the structure was the obverse of its advantage: any partner, because he could commit all could ruin all. This danger increased with distance as mutual monitoring became more difficult.

A common way to restrict the powers of a distant agent was through the use of the proxy contract (*procuratio*), a sort of power of attorney.[147] For example in one proxy drawn up in Genoa in 1259, each brother gave the other broad powers to buy and sell, borrow and lend, "but all this he may do only up to the sum of £500 Genoese… and up to that sum he may obligate me and my goods."[148] The proxy did not affect the liability of the company with respect to third parties: the courts did not recognize any distinction between 'authorized' and 'unauthorized' transactions. However, it did provide a basis for a suit by other partners against the agent who had exceeded his instructions. The mutual proxy was also widely used in Venice, and given the informal nature of the *fraterna*, it was often the only formal contract between partners.

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[144]Lane (1973)

[145]Grafe (2001) ch 3

[146]This was particularly important for those companies that specialized as merchant banks: see Hunt (1994).

[147]Lopez (1976); Reyerson (2002) ch 4

[148]Lopez (1976) p 190

In the absence of suitable family members, family companies often had no choice but to rely on non-kin as agents in distant markets—usually as salaried factors. Here too the greater reliability of the family company as a counterparty proved to be an advantage. The problem with employing an agent—whether kin or non-kin—was how to elicit good and faithful service.[149] With kin, the internal discipline of the family provided the necessary enforcement: in the pre-industrial economy, the threat of being cut off from one's family was a frightening one. With non-kin a different mechanism of enforcement was required. This usually took the form of promised future benefits such as higher salary and promotion that would be forfeit if the agent proved dishonest or incompetent. However, to affect the behavior of the agent, such promises had to be credible. It was the relative stability and reliability of a family company that gave its promises the necessary credibility.[150]

By the fourteenth century, it was increasingly common to find non-kin among the partners of a company and even companies formed by non-relatives. For example, in the fourteenth century, Gascon wine merchants resident in London entered into partnerships with native merchants: "Long association with their English hosts and business associates led quite naturally to these partnerships: the English looked after the interests of their Gascon partners when they were absent and the Gascons looked after the goods of the English at Bordeaux and carried out their commissions."[151] And in the early sixteenth century, the Venetian *fraterna* of the three Pisani brothers entered into partnerships with non-family agents resident abroad.[152]

The reasons for extending the company beyond the family were our usual suspects—agency and financing. A partnership might provide a non-family agent with better motivation than a salary. And the mobilization of capital from outside the family was

[149]See Kohn (2003b) for more on the difficulties of relying on agents and on the mechanisms that merchants employed to address these difficulties.

[150]Greif (1996). Greif sees the advantage of the family company in securing the loyalty of agents as a major reason for its emergence: "The family firm, however, was not established to govern agency relations among family members but to govern agency relations between family and non-family members." p487

[151]James (1971) p79

[152]Lane (1944)

sometimes necessary to provide the company with a large enough total.[153] Of course, the extension to 'non-family' generally meant more distant relatives and in-laws rather than complete strangers.[154] For example, one of Francesco Datini's first partners was the nephew of his foster mother. Another was a brother-in-law, and yet another a grandson of his old guardian.[155] And even when the company extended to non-kin, it generally tried to maintain the same fraternal atmosphere as the purely family company.

The need for greater capital was particularly acute among those larger companies that came to specialize in merchant banking. As financial intermediaries they borrowed extensively, and a sufficient capital was necessary for them to be able to do so at reasonable cost.[156] Particularly notable in this respect were the Florentine 'supercompanies' of the fourteenth century—the Peruzzi, Bardi, and Accaiuli—which had as many as twenty partners and hundreds of employees. The great south German merchant banks of the sixteenth century—especially the Fuggers and Welsers—were also large partnerships that extended beyond the family.[157]

In the early companies of the thirteenth century, the capital structure was rather informal. Partners were expected to invest all their available funds in the company. If possible, a fixed interest rate was paid on the total capital. If there was any surplus beyond this, it was divided among the partners in differing proportions according to their contribution to the company. By the fourteenth century, the structure had become more formal. Perhaps this was a result of the increasing number of non-kin partner, or perhaps it was a response to partners' not fulfilling their obligation to contribute to the company's

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[153]This was again especially true in Florence because of its inheritance laws: "With access to family wealth limited, the Florentine entrepreneur had little choice but to go into partnership with others in order to increase his operating capital." Goldthwaite (1987)p13

[154]Among the Italians trading in Bruges, for example, "Kinship in business as well as social life played an important role and many firms were family concerns to which outsiders were reluctantly admitted." de Roover (1948) p 21

[155]Origo (1986) p 101

[156]Kohn (1999e)

[157]The company structure was known in south Germany as the *Magna Societas.*

capital (much like the problem we observed with the joint stock company).[158] The Alberti partnership of 1323, for example, set up a *corpo* or capital of £25,000, divided into twenty-five equal shares that were distributed in various proportions among the partners. If a partner failed to pay his full subscription, he was assessed a charge of 8% on the deficiency. If he contributed more (*supra corpo*), he earned a flat rate of 8% on the excess.[159]

The governance structure of a *compagnia* was relatively simple. All the partners had a voice in the management of the company, and they exercised this voice through a board which met regularly. However, day-to-day management was in the hands one of the partners who functioned as head of the company.[160] Of course, with multiple partners and delegated management, *compagnie* faced the same sort of governance problems as did share ventures and joint stock companies. However, most partners were actively involved in the company rather than being passive investors.

For family companies, governance was based on the internal order of the family. The management hierarchy of the company was typically the generational hierarchy of the family, and succession went according to the customs and laws of inheritance. Members of the family who invested passively in the company and took no active part in its management relied on kinship ties to safeguard their interests.[161] When the company extended beyond the family, formal rules and procedures played a greater role in its governance.

Of course, the identification of company with family had its disadvantages too. The patriarch was sometimes slow to make way for the younger generation despite old age or illness. And succession by seniority and affinity did not always put the best qualified candidate in charge, and it often led to ugly struggles for control.[162] Family ties weakened

[158] This is the explanation given by de Roover (1958) for the more formal capital structure of the Alberti company.

[159] de Roover (1958), Origo (1986)

[160] [Roover, 1974 #294 p 209]; de Roover (1963) Ch. V

[161] Harris (2000) Ch 1

[162] Grassby (2001) Also, as Grassby notes: “Children and kin did not always measure up to expectations…”

over the generations as relationships became more distant.[163] For example, the Alberti company of fourteenth century Florence split repeatedly: in Bruges around 1400 there were branches of three different Alberti companies.[164]

The problem of governance was mitigated by the fixed term of the company agreement. The contract set the term of the company at a fixed number of years—commonly two or three, but sometimes as many as twelve. In various circumstances, such as the death of the head of the firm, the agreement might be terminated early. In any event, termination of the agreement did not generally mean the end of the company. After settling accounts and distributing the profits, the company was typically reconstituted under a new agreement. In this way, a company might continued in existence, with some turnover of the partners, for decades.[165]

The fixed and relatively short term of the agreement facilitated governance in two ways. First, periodic liquidation reduced the burden of accounting and simplified the calculation of profits: after everything was converted into cash, it was quite clear how well the enterprise had fared. For a commercial enterprise, with no long-term assets, there was no obstacle to operating in this fashion. The second advantage of periodic termination and renewal was that it kept management on a short leash and gave the partners a greater degree of control.[166] If unhappy, they could easily withdraw by declining to join the reconstituted company. The periodic accounting and the ability to withdraw were especially important in light of the unlimited liability that partners bore for the debts of the company.

The major organizational problem of the company was not, however, governance but rather the misbehavior of agents. This was especially true of the large merchant banking companies with branches in many distant cities. Such branches were sometimes managed by partners but more usually by salaried factors (*fattori*). Because of the slowness of communications, a branch manager had to be given sufficient authority and

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[163] Mathers (1988), de Roover (1958) p 57-8

[164] de Roover (1958)

[165] The renewable fixed-term contract was the rule in Italy (Origo (1986), Hunt (1994)) and also elsewhere: on England, see Grassby (2001), and on Germany see Bergier (1979).

[166] Greif (1989)

independence. Moreover, to reap the benefits of being a branch of a great company, the branch had to be backed by the 'full faith and credit' of the company. So the branch manager, if not a partner, received full power of attorney to act for the company. The problem with this structure was that—whether through malfeasance or incompetence—the branch manager had the power to harm or even to destroy the parent company. The danger was especially great for merchant banks, where branch managers handled large sums of money and made large loans.

The 'holding company'

The problems with branch managers that large companies experienced in the fourteenth century gave rise to a new form of organizational structure in the fifteenth—a structure that his been likened by some historians to the modern holding company. The most famous example of this structure is associated with the Medici of Florence.[167]

The Medici set up each of their branches as a separate *compagnia.* The senior partners of the parent company in Florence became partners in each branch company. Their commitment and the use of the Medici name gave the branch company credibility and enhanced its credit. The manager of the branch was also made a partner in the branch company. This gave him powerful incentives for good performance.[168]

Since the branch manager received a part of the profits he generated, his compensation was linked directly to his performance. No less important, however, was his unlimited personal liability for any losses that he incurred. He was not, however, liable for losses incurred by other branches or by the parent company: his branch was a separate company and he was not a partner in the parent company nor in any of the other branch companies.

Although the branch manager was a partner, he was very much a subordinate. The contract establishing the branch company set clear bounds on the his freedom of

[167]Another well documented example of this structure is that of the companies of Francesco di Marco Datini of Prato (Brun (1930); Origo (1986); Dahl (1998))

[168]Baskin and Paul J. Miranti (1997), de Roover (1948) pp34-5; de Roover (1963) pp 77-86.

"While [Datini] formed several companies, these associations must not be regarded as having merely the purpose of bringing capital together;… Datini used these companies and partnerships to secure himself the loyalty of those who worked for him." Luzzatto (1953) p48 action.[169] He was not to extend credit to his friends or to nonmerchants (read nobles) or to exceed a specified credit limit without written permission. He was not to accept gifts above a certain value (to prevent corruption). He was not to trade on his own account or for others. He was to insure all shipments, but not to underwrite insurance or enter into wagers. He was not to hire anyone without the approval of head office. And his personal behavior was to be beyond reproach. In addition, he was given detailed written instructions at the time of his appointment and then at frequent intervals by mail. Of course, he had to exercise considerable discretion and judgment, but if he exceeded his instructions, the responsibility was his alone.[170]

The senior partners retained formal control of the branch company by holding a majority of the shares and they closely monitored the branch company's performance. Each branch company kept a complete set of accounts, which was open to inspection by visiting senior partners. A summary of these accounts was to be rendered annually. As usual, the principal sanction for unsatisfactory performance was loss of future benefits. In this case, that meant dissolving the branch company, which the senior partners reserved the right to do.[171]

It is not clear how much this complex structure really ameliorated the problem of controlling distant agents. It is certainly clear from the troubles of the Medici that ingenious structure was no substitute for close monitoring. When Lorenzo de Medici neglected to monitor his branches, they soon got into trouble.[172] Moreover, the great south German banks of the sixteenth century did not adopt the 'holding company' form,

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[169]de Roover (1948); Dahl (1998) p98

[170]Dahl (1998) p98

[171]de Roover (1948)

"This threat—of removing from the firm his capital, experience, and prestige—was Francesco's only real hold over his partners, and he did not scruple to use it." Origo (1986) p129

[172]de Roover (1948)

preferring a straightforward company structure. They were famous, however, for the meticulous and constant monitoring of their branches.[173]

Asset partitioning in companies

With the family company, the issue of asset partitioning did not really arise. Since the company was just a formalization of the household as a business entity, the assets of the household automatically became the assets of the company. There was no separation in accounting and no legal separation. While ventures and associations might be regarded as legal entities distinct from their participants, there was no such distinction when it came to the company.[174]

In terms of liability, the formal structure simply clarified and made explicit the family guarantee of its members that was already implicit. Those members of the family who were partners were mutually liable for one another's debts, while those who were not partners were not liable. All partners had unlimited joint and several liability. An obligation entered into by any one of them was binding on all.[175]

This arrangement certainly had its dangers: as we have seen, a single partner could potentially ruin the whole company. However, unlimited liability was also an advantage in that it made it easier for a company to borrow. This was especially important for those companies that specialized as financial intermediaries. This point is nicely illustrated by the decision of Siena in 1310 to weaken its commitment to unlimited liability. The effect

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[173]"Perhaps a shortcoming of the Medici was that, unlike the Fugger in the sixteenth century, they did not have traveling auditors and inspectors who would go from branch to branch to examine the books and to take inventories." de Roover (1963) p 85

[174]Unlike the corporation, the company had no legal personality distinct from its members. The partners themselves, not the company, were the holders of property. The partners themselves, not the company, were party to contracts. And the partners themselves had to be named in litigation. Harris (2000) Ch. 1

[175]"The early *compagnia* was less a formal partnership in internal affairs than a legal organization in its relationship with third parties. These had to know both that not all family members could always bind it and that all its assets were liable for its debts." Harris (2000) p 20

The ability of one partner to represent and commit all was a concept unknown in Roman or Germanic law (under Roman law all of the partners had to agree before a commitment was binding on them), and it evolved only gradually in the medieval Law Merchant. Mitchell (1904) on the competitive position of Siena's merchant banks was disastrous, and they soon surrendered their leading position in international money markets to the Florentines who retained unlimited liability.[176]

With the extension of the company to include non-family, asset partitioning became an issue. Initially, it seems, there was a simple solution. The business entity defined by the company was expanded from including a single household to including several households. In terms of liability, all the households participating in a company became part of a single 'legal family'. And to prevent a household's assets from being double-pledged, law and custom prohibited any household from participating in more than one company.[177]

The emergence of the 'holding company' structure, however, placed this simple solution in question. Each of the branch companies was a separate legal entity with its own capital, its own partners, and its own accounts. In a number of cases, the courts did not allow the assets of one branch to be seized to pay the debts of another.[178] As we have seen, the position of the junior partner who managed the branch was clear: he had unlimited liability for the debts of his own branch company and no liability for those of other branch companies. But what about the senior partners? What was the extent of their liability?

It is clear that the senior partners violated the prohibition against participating in more than one company. Their participation could not, therefore, be interpreted simply as a merging of their household into the 'extended family' of the company. Indeed, participation in multiple companies must have looked a lot like participation in multiple ventures. Could the participation of the senior partners in a branch company, therefore, be interpreted as participation in a 'venture'? If so, their liability would be limited to the capital they had invested. But would this not mislead the creditors who would naturally think that the full faith and credit of the senior partners stood behind the company?

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[176]Greif (1996)

[177]Origo (1986) p 101. Hansmann, Kraakman et al. (2001) argues that this prohibition served the same function as forward asset partitioning. By divided assets into disjoint pools, it prevented the insolvency of one enterprise from bringing about the insolvency of others.

[178]Hansmann, Kraakman et al. (2001)

In an attempt to clarify the situation, Florence passed a law in 1408 establishing a new type of company, the *accomandita*, with two classes of partner. One class, active partners, were partners in the full sense of the *compagnia* with unlimited liability. The other class, dormant partners, took no role in managing the company and their liability was limited to the amount they contributed to the company's capital.[179] The 'holding companies' did make some use of this form of organization. For example, Francesco Datini typically started a branch company as an *accomandita* and then converted it into a regular company when the junior partner had proven himself. The problem with using the *accomandita* structure—and the reason that Datini made the switch—was that it precluded the company from trading under the name of the dormant partner: this was a major handicap for a financial intermediary.[180]

COMMISSION

As trade expanded and markets developed, commerce came increasingly to rely on resident agents. We have seen that merchants tried to structure the agency relationship through both the venture and the company forms of organization. We have seen, too, that neither of these structures performed this function particularly well. As a result, merchants increasingly took an altogether different approach—commission.

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[179]Kuehn (1981) Unlike an ordinary company, an *accomandita* had to be registered with the merchant's court. Dormant partners, although they had no day-to-day control of management, did have the right to choose the managers and to liquidate the company.

[180]Hansmann, Kraakman et al. (2001). For example, the Medici branch in London in the late fifteenth century was managed by Gherardo Canigiani and Giovanni de' Bardi, while the capital was largely supplied by Piero di Cosimo de' Medici and Tommaso Portinari, the manager of the Medici branch in Bruges. (Holmes (1996)) The company traded under the name of Canigiani, suggesting that it was legally an *accomandita*.

The *accomandita* came into its own in the late sixteenth and seventeenth centuries when it was used to finance the growing Florentine silk industry. A switch from imported silk purchased on trade credit to domestic silk purchased for cash greatly increased the need for borrowing. Since raw silk accounted for some 80% of the value of the cloth, debt financing would have involved impossible leverage. The *accomandita* provided a form of equity financing. Goodman (1981)

The commission relationship

The role of commission agent might be played by an individual (household), a company, or a branch of a company. The commission agent carried out commercial and financial transactions for a merchant principal in return for a fee. Under a commission to sell, the agent received goods on consignment to sell as best he could. Under a commission to purchase, he received instructions to purchase certain goods locally and then ship them to a specified destination. Under a banking commission, he received instructions to accept or to pay money, or to borrow or lend, on behalf of his principal.[181] For undertaking all of these transactions for his principal the agent received a fee or commission, usually calculated as a percentage of the value of the transaction. Typical rates were 2-3% for sales and purchases and 0.5-1% for banking commissions.[182]

One well-documented and well-studied example of a commission agent is that of the Van der Molen partnership of mid-sixteenth century Antwerp.[183] Van der Molen was a regular trading company, with branches in Venice and Ancona, that traded on its own account. However, it also acted as a commission agent in Antwerp for a number of Italian firms, and over time this part of its business came to predominate. Van der Molen received from its clients in Rome, Mantua, Brescia, and Ferrara goods under commission to sell. It sold these goods on credit, both to foreign merchants at the fairs of Antwerp and Bergen-op-Zoom and to local retailers in Antwerp. Van der Molen also received commissions to purchase for its Italian clients, mainly for cloth, and it sent its own agents to the centers of productions in Hondschoote, Haarlem, and Leyden and to the fairs to fulfill these commissions. Van der Molen generally paid cash for these purchases, either from the proceeds of selling clients' goods or out of funds received from their clients by bills of exchange. For some clients Van der Molen both purchased and sold, for others it only purchased. On all transactions, Van der Molen charged a commission of 3%, the customary rate in Antwerp at that time.

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[181] Braudel (1984) p 241

[182] Boyer-Xambeu, Deleplace et al. (1994); Lane (1944); Edler (1938). Westerfield (1915) reports that in a later period commission rates increased with distance, greater risk, less desirable living conditions for the agent, and lower trading volume.

[183] Edler (1938)

The advantages of commission

A commission agent operated under very different rules from an employee branch manager.[184] While an employee was retained for a period of time and was paid a regular salary, a commission agent was retained by the venture and paid a commission on it.[185] While an employee served only one principal, a commission agent typically served many. An employee traded in his master's name: his credit was merged with his master's. In contrast, a commission agent traded for his principals under his own name; counterparties did not necessarily know for whom he was acting. Consequently, a commission agent was personally responsible for the goods placed in his charge and for any related credit transactions. An employee was not personally responsible: if the employee caused a loss, he merely 'incurred his master's displeasure'.

A commission agent clearly operated under a more powerful set of incentives than an employee. While a commission agent did not bear business risk—this was borne by his principal—he did bear the casualty risk for goods in his care and the default risk for credit that he extended (unless it was under explicit instruction from his principal). More generally, if a commission agent went beyond his instructions in any way, the responsibility was his.[186] And since the instructions were often vague, he had no choice but to go beyond his instructions if he was to do anything like a satisfactory job. While a commission agent's compensation was not strongly linked to his performance for a particular venture, it did depend on the volume of his business. And volume, both repeat business and referral by satisfied customers, depended on how well he carried out his commissions.

A second major advantage of using a commission agent was that it was far less dangerous for the principal than relying on an employee branch manager. Commission was a much more arm's-length relationship. Since a commission agent acted in his own name, the potential loss to the principal was limited to the total value of the goods or money he had committed: that is, there was *de facto* limited liability. Since an employee

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[184] Westerfield (1915); Price (1991); Willan (1959)

[185] In a sense, therefore, commission was a form of venture organization. However, unlike the forms that we encountered earlier it did not involve a *joint* venture.

[186] Willan (1959)

acted in the name of his employer, the potential loss was unlimited. And, as we have seen, employee malfeasance or incompetence were among the greatest dangers facing a merchant company. In addition, as a local firm in the market in question, the commission agent enjoyed better credit, other things equal, than a branch of a foreign firm. His credit was better known and there was easier recourse in the local courts.

A final advantage of using a commission agent over maintaining a branch was that it was often cheaper. To a significant extent, the cost of a branch was fixed: its cost of operation depended little on the volume of business that it handled. Consequently, a branch was expensive unless volume was high. In contrast, a commission agent was paid by the venture and did not therefore represent an overhead. Because the use of commission agents was relatively inexpensive, it enabled merchants to trade with a larger number of distant markets and so improve their diversification. It also offered much greater flexibility: it was easy to recruit or discard commission agents as needed, while opening or closing a branch was a much more serious affair.[187]

As an illustration of the flexibility of commission, Andrea Barbarigo of Venice in 1437 sent a consignment of cotton to a merchant in Trani (Apulia) with whom he had never done business before. Barbarigo gave this agent full power to sell the cotton for cash, credit, or barter and to reinvest the proceeds in goods or remit the money back to Venice. Barbarigo's faith in the agent was based on a good report from another merchant who had used him. However, the risk was small, since he was anyhow overstocked with cotton, and Barbarigo had heard that cotton was fetching a good price at Trani.[188]

A commission agent also offered advantages over having a partner as an agent. A partner, like an employee, could commit in the name of the company. Consequently, if he was dishonest or stupid, he posed the same threat of ruin to his principal. In contrast, as we have seen, a commission agent provided the principal with *de facto* limited liability.[189]

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[187]Luzzatto (1953); Price (1991); Origo (1986); Alonso (2001)

[188]Lane (1944) Ch. 3

[189]As we saw earlier when discussing the 'holding company', a partner had stronger incentives for good behavior than an employee, since he himself would share in any loss for which he was responsible. But this was not much of a defense against incompetence.

A commission agent also had an advantage over a partner in terms of the necessary accounting.[190] So long as agents traveled, accounting was a relatively simple matter, since the partnership was wound up on the return of the *tractator* once the return goods had been sold. However, when the partner resided abroad and carried out a series of transactions, keeping track of revenue and costs and calculating profits became considerably more difficult. Accounting for commission was much simpler. While the profit of a venture depended on both the purchase price and the sales price, commission was calculated only on the 'half-trade'—either the purchase or the sale. Moreover, it was calculated on that half-trade that was under the control of the agent.

The ease of monitoring commission agents, and so the attraction of using them, was enhanced considerably when their principals had good independent information on the prices at which they traded. For example, the state-organized trading system of the Venetians, which provided just such information, may have contributed to the emergence of commission agency in the fourteenth century.[191] Principals also needed to be able to send goods, instructions, and funds to their agents. So the development of common carriers, of mail services, and of remittance through bills of exchange were important facilitating factors.

Commission offered advantages to the agent as well as to the principal. Compared to being an employee, being a commission agent offered the benefits, and of course the risks, of being a self-employed entrepreneur. However, the risks were much less than those faced by a partner. Because the business risk was borne by the principal, a commission agent could handle a large volume of transactions with only modest capital. A young man with little capital might set out for a distant market to serve there as a commission agent until he accumulated enough capital to become a merchant himself.[192] A 3% commission does not sound like much. However, it is equivalent to one quarter of the profits if the rate of profit is 12%. The latter is roughly what a *tractator* might expect

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[190]Lane (1944) Ch. 3

[191][De Lara, 2000 #2762] and Williamson (1999; Williamson (2001) argue that the availability of such information was important for the use of the commenda rather than the sea loan. However it was just as important for the use of commission agents.

[192]Christiensen (1941); Price (1991) (on a later period).

to earn on average, although with much greater uncertainty.[193] The Van der Molen partners were often offered a share of the profits by their clients, but they generally declined, preferring the certainty of a commission.[194]

Some of the advantages of commission, to both parties, stemmed from its separation of relationships of agency and financing. The commission agent was a pure agent: he acted as an agent of the principal in a distant market, but he was not involved in the financing of the transactions that he mediated. In contrast, both venture organization and company organization combined agency with financing in some way. In both types of organization, the agent either contributed to the financing or was a party to it. One advantage of the separation of agency and financing, as we have seen, was that it limited the liability of the principal for the actions of the agent. Another advantage was that it allowed the principal greater freedom in finding financing, especially in the developing market for bills of exchange.

The emergence of commission

Commission had been used even with traveling agents. We saw earlier that the *pignus* loan was essentially a form of commission. And merchants of the Hansa frequently sent goods with a supercargo under commission (*Sendeve*). The supercargo might be a traveling agent but was often the skipper of the vessel carrying the goods. Such a skipper would typically undertake multiple commissions for several of the merchants sending goods with him.[195]

However, it was only when traveling agents were generally replaced by resident agents that commission really came into its own. In the Venetian trade with the East, commission was increasingly common in the fourteenth century, and became the norm in the fifteenth.[196] Italian merchant banks, having established branches in distant markets principally to serve their business in bills of exchange, also utilized these branches too to

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[193] Lane (1973)

[194] Edler (1938)

[195] Samsonowicz (1994)

[196] Lane (1973) "This custom of paying agents a fixed per cent of the turnover had superseded the practice once general throughout the Mediterranean of paying agents a share of the profits." Lane (1944) p 94

offer commission agency to others.[197] Francesco Datini often relied on branches of such merchant banks to carry out his instructions under commission in places where he had no branch of his own.[198] From the fourteenth century, Hanseatic merchants used the *Sendeve* to send goods for sale to an agent, another merchant, or an innkeeper.[199] In the sixteenth century, Spanish merchants traded mainly through commission agents.[200] Spanish merchants living in the commercial centers of northern Europe, sold under commission shipments of wool sent to them by merchants in Spain.[201] The trade with the Americas, initially relied on agents traveling under *commenda* (*compañeros*). However, as this trade matured and became established it switched over to resident agents acting under commission.[202]

The sixteenth century saw the emergence of a new phenomenon—the specialized commission agent. The Van der Molen company provides a good example. A specialized commission agent offered clients a number of advantages over a non-specialist. Because a specialized commission was completely dependent on commission business, the value to him of his reputation was amplified and he had a greater interest in satisfying his clients. Because he did not trade on his own account, there was less risk of conflict of interest with his clients and less risk of his insolvency leading to the seizure of his clients' goods.[203] Also, handling a large volume of goods brought economies of scale in transactions costs and in shipping costs.

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[197] Boyer-Xambeu, Deleplace et al. (1994) Ch. 2

[198] Origo (1986)

[199] de Roover (1971)

[200] "The old medieval system based on the establishment of big companies having factors posted all around the world, to which the Italians, Germans and Castilians were greatly indebted for their success, saw a substantial decline." Alonso (2001)

[201] Phillips (1983)

[202] Pike (1966)

[203] One example of conflict of interest is 'front-running'. The principal possesses information from which he wishes to profit by trading on it. His instructions to his commission agent to some extent reveal that information. On the basis of that revealed information, the commission agent trades on his own account (say, buying a certain good) before he executes the instructions of his principal. As a result, when the agent does execute those instructions the terms are less favorable (the price is higher, in this case) and

Specialized commission emerged in Antwerp and in associated markets such as those in London and Amsterdam.[204] Specialization was the result of a growing volume of commission business. This in turn was a result of the growing reliance on local commission agents rather than on branches. And one reason for this was the falling cost of monitoring commission agents in these markets.

Monitoring costs were falling because of the changing nature of organized markets.[205] Antwerp in particular was developing into a 'Bourse market' where relatively standardized goods traded in a public exchange. One of the important implications of this type of trading is far greater price transparency: trading takes place at 'market prices' rather than at prices that are negotiated individually. Market prices are easily observed and become public knowledge. To attract trading volume, exchanges had an interest in making this price information readily available to potential traders both locally and in distant markets. They did this by publishing regular 'price currents' that reported the prices at which commodities traded. Commission agents could send these price currents to their clients overseas to enable them to monitor execution of their commissions.

CONCLUSION: LARGE FIRMS AND SMALL

Business organization evolved in response to pressures both external and internal. As we have seen, the external pressure came from the evolution of arrangements of representation from traveling merchant, to traveling agent, to resident agent. This itself was a response to in the commercial structure, in the volume and composition of trade, in transportation, communications, and finance. These changes also affected the organization of business directly.

The internal pressure came from the conflict between economies of scale in trading and diseconomies that resulted from the increasing difficulties of agency and financing. On the whole, the diseconomies rapidly outweighed the economies, and the typical business enterprise remained quite small. Large enterprises were very much the

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the profit of the principal correspondingly smaller. In short, the agent 'steals' some of the potential profit from the trade.

[204]See Bratchel (1978) on specialized commission in London and Christiensen (1941) on the same phenomenon in the Dutch trade with the Baltic.

[205]See Kohn (2003d).

exception, and even the largest of these were small by today's standards.[206] There were two types of large enterprise—large companies and large joint ventures.

The large companies were predominantly merchant banks.[207] Size made a large company a more reliable counter-party—a matter of crucial importance for a financial intermediary. The largest companies—the Italian 'supercompanies' of the fourteenth century and the great South German companies of the sixteenth—grew to an extraordinary size largely because of their involvement with governments.[208] Basically, they obtained valuable trading privileges—for grain and wool in the first case, for bullion in the second—in exchange for concessionary loans. Their size helped them to borrow the funds they needed to fund these loans.

Large enterprises in the form of large joint ventures included those Italian share ventures that were involved in public finance. They also included Dutch share ventures and English joint stock companies involved in commerce. The latter, like the very large companies, obtained trading privileges from governments in exchange for a financial *quid pro quo*. So here, too, there was an association between unusual size and dealings with governments.[209]

The structure of the large joint venture—in the form of the Dutch share venture or English joint stock company—would become increasingly important in the coming centuries. It would extend in duration to become less a venture and more a company. This structure would serve a commercial function in the form of the great trading companies of the seventeenth and eighteenth centuries—for example, the Dutch *Verenigde Oostindische Compagnie* and the English East India Company. And, in the late nineteenth century, this structure would evolve into the modern industrial corporation.

This structure would never really overcame the internal problems that were evident already, as we have seen, in the sixteenth century (although technological progress in

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[206]The Bardi, one of the largest companies of its day had about 120 employees. It had some li. 700,000 in assets (about $28 million in today's money) and li. 90,000 in capital ($3.6 million). Hunt (1994)

[207]See Kohn (1999e) on merchant banks.

[208]See Hunt (1994) on the Italian 'supercompanies' and Ehrenberg (1928) on the great South German companies. See also Braudel (1982)

[209]Steensgaard (1996); Steele (1994); de Vries (1976) p 133

management and communications would help to mitigate them). That large companies of this type proliferated nonetheless was a consequence of economies of scale of various types that were sufficiently great to outweigh the problems. In the case of the great trading companies, the economies of scale came in obtaining and managing trading monopolies.[210] For the industrial corporation, the economies of scale were technological.

In the coming centuries, the importance of the great trading companies was, however, relatively minor. Until the mid-nineteenth century, commerce was dominated by the small merchant firm—either a merchant house or a small company.[211] It was the second form of business organization that emerged in the sixteenth century—commission—that made this possible. Commission allowed small firms to reap many of the economies of scale in trading externally rather than internally and so enabled them to hold their own successfully against larger companies.[212]

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[210]Jones and Ville (1996)

[211]See for example Grassby (2001): "The seventeenth century economy was neither dominated nor led by big business or by corporate management, but by small firms whose capital financed both production and distribution." p 402-3. See also Price (1991).

[212]Lane (1944) argues that use of the commission agent and the joint venture enabled the small firm to diversify and to remain liquid and flexible: "[Andrea Barbarigo] and many merchants like him did not need to build business concerns in which a number of employees were trained to work together to make something or perform some specialized type of service. They were more like middlemen who operate on many markets without being tied down by an organization." p 85.

Price (1991) makes much the same argument for commission in the British North Atlantic trade of the eighteenth century.

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