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The emergence of the joint-stock companies in the Dutch Republic and their democratic elements in business¹

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Abstract In the present essay we analyse the emergence of joint-stock companies during the 16th and 17th centuries in business (the Dutch *partenrederij*), and the VOC East India Companies). We suggest that in the Dutch Republic (DR) characterised by relative weak central authority, market solutions were found to solve organisation problems and these solutions, the first joint-stock companies, are efficient but also democratic in their structure. The DR demonstrate that democratic elements emerge in parallel in the economy (sometimes even preceding) and in the political field, which can be mutually reinforcing.

Keywords: Joint-stock companies, Dutch Republic, Democratic elements in business

1. Introduction

There is a substantial and growing literature on the emergence of joint-stock companies (Lawson 1993; Leeson 2009; Robins 2012; Roy 2012; Vlami 2015; Kyriazis, Metaxas and Economou 2018 etc.) their operations and a discussion of specific aspects, as for example, the principal-agent problem (Carlos, 1992; Carlos and Stephen, 1996) or their influence on history, such as the expansion of European states in Asia and their transformation into empires (Rodger 1997, 2004; Gaastra 2003; Krishna 2014).

Less attention has been given to the issue of institutional politico-economic developments, the relation between democratic elements in the administration and governance of joint-stock companies and the emergence of democratic elements in politics. In fact, as we purport to show, these developed in parallel. Joint-stock

¹ This paper presented at the 4th Pan-Hellenic Conference on Applied Economics, Economy and Democracy”, in 23-24 November 2015, in Volos (Greece). A version of the paper published in 2017, in the Collective Volume with the title: *Democracy and an Open Economy World Order* (Retrieved at: <http://www.springer.com/gp/book/9783319521671>).

companies emerged and were fully developed in states with relatively weak central governments in which democracy, or at least democratic elements, also emerged.

The essay is organized as follows: First, we analyse the relationship between weak central states and the emergence of democratic elements in politics and in the economy, and, in particular, the emergence of joint-stock companies. Then, we analyse the Dutch *partenrederij* and the East India Company (Vereenigde Oost-Indische Compagnie-VOC), followed by our conclusions.

2. Weak central governance and institutional change

The Dutch Republic emerged only at the end of the 16th century, after its revolt against Spain (1568-1648). The DR was from its inception a federal state, without a king and without a strong central government (Kyriazis 2006; Davids and t' Hart 2012). Because the DR and England had relatively weak central governments, they had to find new solutions and institutions-organisations to fill the gap and face the challenge of the Spanish Empire. And since market-oriented groups, such as merchants, ship-owners, sailors and the “industries” supporting trade were relatively more influential in the DR and England than in Spain or France, market-oriented solutions had been, and were, found. These included the emergence of joint-stock companies, banking, insurance and stock exchanges, in what has been called the 17th century ‘Financial Revolution’.²

Such developments, in simpler forms, had already taken place in other, market-oriented and democratic (or with democratic elements) states, such as ancient Athens, Rome, Carthage and some Italian and German city-states such as Venice, Florence, Pisa, Genoa, Augsburg and the Hanseatic League city-states like Hamburg, and Lübeck. Organisational knowledge gained there was diffused and adopted in the DR and England. The Bank of Amsterdam, for example, had as its model the Venetian Banco de la Piazza di Rialto, while after the Glorious Revolution of 1688, William III and his advisors introduced the Dutch financial innovations to England (Ferguson, 2003: 23).

² We develop these arguments fully in Kyriazis and Economou (2015) and Kyriazis, Metaxas and Economou (2018). In this paper we focus on the case of the DR although in the papers above, we have analysed that similar organizational and institutional developments, in business and politics, to those held in the DR, took place also in England, almost in the same historical period.

We do not argue that commercial interests, or enterprises, did not exist in Spain, Portugal or France. We argue that in these countries they were subordinate to the central government and did not influence policy decisions to a substantial degree. The Spanish king and government, for example, took into account religious (the protection of the Catholic faith) and dynastic issues more than commercial ones. Thus, they did not protect their colonies and trade with the New World sufficiently, allowing them to fall prey to Dutch, English and French corsairs and pirates. They alienated their Dutch subjects thus pushing them to revolt. They persecuted their Jewish subjects, who were economically dynamic, forcing them into exile to England, the DR and North Africa.

On the other hand, in the DR, the merchant-industrialist class, the *rejenten*, was the governing class in the federal provincial *Estates General* and in the cities, and thus their policy promoted their commercial interests. In England, the crown, under Elisabeth, also allied itself with commercial interests, going as far as forming private-public enterprises.

Thus, our main thesis is that a state may be strong due to its market-oriented economy or, as an even stronger argument, because it has a relatively weak central government. Relatively weaker governments leave greater opportunity for market-oriented solutions and this promotes economic strength and growth. In contrast, states with a strong central power, as in Spain, Portugal, France and the Great Asian Empires, the Ottoman, Indian Mughal as well as Ming and Tsing China, the central power decides, coordinates and retains most of the revenue, in the form of taxes, rents, custom duties, etc.

3. The democratic structure of joint-stock companies

The preconditions for the emergence and operation of joint-stock companies, apart from weak central government, as stated above, were the existence and protection of property rights. In authoritarian regimes, like the Asian empires, where property rights were not clearly defined, and where they could be abolished at the whim of the absolute ruler, there was no prospect for the emergence of joint-stock companies.³

Property rights and relative impartial courts for their protection emerged, on the other hand, in states with relatively weak central authorities and where the ruling

³ For example, during the 17th century the Ottoman sultan arrested and executed the richest Ottoman (Greek) trader, Katakouzenos, and expropriated his fortune. This was not an isolated occurrence.

elites themselves had a stake in trade, like the Italian and German states, the DR and England. In these states, property rights emerged although they were not yet (and some never became) democracies.⁴

The DR developed a highly flexible “proto-joint-stock company” form of enterprise, the *partenrederij*, by which a group of people joined together to buy, build, own, charter or freight a ship and its cargo. The individual *reeders* (ship-owners) would contribute capital in varying proportions, ranging from wealthy merchants, to the ship’s captain with sometimes substantial quotas to deck-hands. The company was directed by an elected body, voting rights being according to share-capital, a case of democratic procedure, although linked to property criteria, as in modern companies, and as was the case in the political set up of the DR and England. Voters in England had to satisfy property criteria and voting rights were far from universal (including all citizens). In the DR, voting rights in the city, provincial and federal Estates General were also linked to property, being limited to the *rejenten* class.

The *partenrederij* was used as an organisation form for the first voyages (end of the 16th century of the Dutch to discover the origins of the spices, and break the Spanish-Portuguese monopoly in this trade). In this they were successful and the individual companies, established for just one voyage, culminated in 1602 with the establishment of one permanent company, which was granted a charter by the Federal *Estates General*, thus establishing a monopoly of trade in Asia.

The VOC was governed by a body of 17 members, the so-called *17 Gentlemen* (*Heeren XVII*) and was organised in a manner that was similar to the Dutch state and its navy (admiralties), in a federalist way, reflecting again parallel economic and political developments. Six chambers were established in the place of earlier companies, in the towns where early companies were created, Amsterdam, Rotterdam, Middelburg, Delft, Hoorn and Enkhuizen (Gaastra 2003). In this respect, the VOC was more encompassing and democratic than the Levant Company⁵, which initially included only Londoners.

The actual representation of the cities was precisely stated in the charter which established the VOC. In 1602 the total number of directors in all six chambers was 62,

⁴ For a detailed analysis of the DR’s political and economic system see Kyriazis (2006), t’ Hart (2012), Economou and Kyriazis (2015).

⁵ A detailed analysis concerning the Levant company is offered by Vlami (2015).

distributed as follows among the chambers: Amsterdam 20, Zeeland 12, and the smaller chambers with 7 each. Two or three times a year the chambers chose representatives from among themselves who then attended meetings for several weeks at a time in Amsterdam (6 years in succession) or Middelburg (2 years in succession) in order to determine the company's central policy. Eight of the 20 Amsterdam directors, together with the four from Zeeland and one from the four smaller chambers sat in this meeting of the *17 Gentlemen*, the 17 members being appointed in rotation by Zeeland or none of the smaller chambers.

Thus, in theory at least, Amsterdam, the richest city and chamber did not have a majority in the governing body, and could be outvoted by a coalition of the members of all the other chambers, which thus had a kind of veto right. This can be seen also as an early form of checks and balances which reflected the political federal set up in the election of the federal Estates General by the provinces and cities. Reflecting the interrelation of economy and politics, the new directors of the chambers were to be appointed by the Estates of Holland and Zeeland (not voted by the shareholders) but in the province of Holland this authority was handed over to the mayors of the towns concerned (mainly Amsterdam) already in 1602.

VOC shares were later introduced into the Amsterdam stock exchange and all Dutch citizens had the right to buy its shares, making it thus an open and democratic company. Capital investment was initially considered to be permanent (since no provision for a specific duration of life-time for the company was made), but investors who wished to liquidate their interest in the VOC could sell their share to a buyer at the stock exchange. The VOC did not issue any share certificates. Transactions, mainly in round amounts of 3,000 guilder were written into the account books of the six constituent chambers. The amount of 3,000 guilders was a very substantial sum for the period so that, in fact, only wealthy people could afford to be shareholders, thus excluding those who were poorer, unless of course they could pool their savings together, as happened on occasion, for example, among the crewmembers of the Company's ships.

Thus, in fact, as also in the political field, participation in the VOC reflected the actual economic situation of the times: The majority of the shareholders belonged to the commercial, industrial and banking elite, the *rejenten* class, which elected the governing body of the *17 Heeren*. The VOC introduced another very important

financial innovation since it was a limited liability company: all shareholders were responsible for any debts of VOC only to the extent of their investment (Gaastra 2003; Halkos and Kyriazis 2005; Kyriazis 2006).

Thus, the Dutch model of the joint-stock company reflected the actual political set-up. It was not fully democratic since its governing bodies were not elected by the shareholders but appointed by the Estates General, which were elected political bodies, but as stated before, only by the *reijenten* elite class. On the other hand, property rights, such as dividends paid to shareholders, were implemented by a democratic principle, e.g., dividends were paid according to the capital participation of the shareholder, as in modern companies (Gaastra, 2003: 21-23).

During its life, VOC's organization underwent some changes as, for example, in 1645 when the Dutch towns of Haarlem and Leiden managed to force through the very advantageous regulation that Amsterdam should give up two of the twenty chamber seats in their favour. We know also that originally during 1602, 1,143 people were subscribed as shareholders in Amsterdam, 264 in Middelburg (Zeeland chamber) and 358 in Enkhuizen but, on average, for smaller sums. Civil servants and merchants pre-dominated, but craftsmen, clergy men, doctors and even a few labourers were to be found among the original shareholders. Shephardim, Spanish-Portuguese Jews expelled from Spain and Portugal, were important investors in Zeeland.

In 1647, the directors' term of office was restricted to three years, while some control and participation was granted to other shareholders, which involved the setting up of three committees formed with major shareholders having invested at least 6,000 guilders in the Amsterdam and Zeeland chambers, or 3,000 guilders in the smaller ones. One of the committees was to examine the amounts together with the directors, like modern auditors. The second operated as an enlarged electoral college (per chamber) and convened when a director's position became vacant. Together with the remaining directors, with whom they were equal in number, they recommended three possible candidates for the post, one of whom was chosen by the cities' Estates General. The third committee of nine major shareholders took part in the meeting of the 17 Gentlemen as an advisory but influential body (*ibid.*, pp. 34-36).

Similar developments took shape in England with the creation of the first "proto-joint-stock companies" during the second half of the 16th century, which culminated

in seven international trading companies by the end of the 16th century: the Merchant Adventurers, Eastland Company, Muscovy Company, Levant Company, East India Company (EIC), Hudson's Bay Company and African Company.

4. Conclusions

The joint-stock company as a form of organization proved successful over a long period of time as a mechanism for allowing large amounts of capital to be raised. This again necessitated a strong level of trust between outsiders (the investors) and insiders (the company directors). The means by which this trust and co-operation was fostered was largely outside the legal setting (although the law protected the enforcement of contracts and property rights) and seems to have involved endogenous constraints such as informal social sanctions, social norms and the fear of loss of reputation and future business, based on cultural beliefs and factors within the merchant community (Lipton, 2009).

Trust was fostered through the democratic setting of the joint-stock company, since investors had voting rights and thus could influence the company through the choice (election and dismissal) of its directors, but also by making them accountable, obliging them to keep meticulous accounts, which were open to scrutiny. Thus, here again, development of trust was a major characteristic of a democratic setting in the economic field, in the same way that it was essential for democracy to emerge in the political field. In more democratic states, such as in the DR. England and then, Great Britain after 1707, the existence of Parliament provided the opportunity to bring grievances against abuses, and also of the EIC directors to fight, as in the famous case of Edmund Burke and Richard Sheridan against the EIC's director Warren Hastings in the Commons, for fraud, abuses, etc. Although Burke lost his case, the influence on the EIC's directors' future behavior was important, making them more cautious (Robins, 2012, pp. 141-144).

The joint-stock company as a successful organisation form survived and was diffused to all open economies during the next centuries. Our main argument in this essay is that the form of joint-stock company could not have emerged in an absolutist political regime with strong central authority. Joint-stock companies did not emerge in the great eastern empires, such as those of the Ottoman, Mughal India or Tsing China,

but in the small, more open and democratic countries with weaker central authority, such as England and the UP.

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