Fordham Corporate Law Center
Fordham Workshop on Business Organizations in History
Friday, April 13, 2018 | 2:00 - 6:00 p.m.
Fordham School of Law | Hill Faculty Conference Room (7-119)

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Director, Fordham Competition Law Institute

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CHAPTER FIVE

BUSINESS ORGANIZATIONS: FAMILIES, PARTNERSHIPS AND COMPANIES

Businesses in pre-industrial societies ranged from crafts-based artisans and shopkeepers to merchants and manufacturers.¹ Although the vast majority of businesses were small in scale, some businesses achieved considerable size even in ancient societies. A third millennium Ur III textile mill in Mesopotamia had almost 800 workers.² Davies suggests that a Greek household business or ergasterion could attain significant size, with workshops staffed by 20 to 30 slaves (and exceptionally over 100 slaves).³ And businesses of the great Roman families dwarfed those of well-to-do Athenians.⁴

And although most businesses engaged in only one activity, some diversification can be found. For example, there are Athenian and Roman landowners with a wide diversification of businesses. Diversification of assets was not always a deliberate strategy but could result from inheritance and creditor foreclosures. In Athens business assets received as security on defaulted loans contributed to the diversity of wealthy households’ range of economic activities.⁵ The Athenian ergasterion often was divided into discrete business sub-units that could be transferred by sale, gift, dowry or inheritance.⁶ As a general rule, diversification engendered more complex business organization. For example, the broad product and geographic diversification of medieval Italian firms were structured as corporate-like compagnie and not simpler partnerships.

⁵ See ibid., 39.
⁶ See ibid., 42, 44-45.
When a person contemplates starting a business, she is faced with two different but related decisions: who should participate (business composition, section I below) and what business structure should be created (legal business organization, section II below).

The first decision is whether to do everything herself, retain agents or employees, and/or join with other persons as partners or investors. Separation of risk bearing from employment is a form of division of labor. Individuals with capital can employ it productively even if they are not good managers. Management can be organized as a tight pyramidal hierarchy or a loose multidivisional collective. Employees and agents can be monitored or given “bonds” like incentive payments. The business can grow internally or by merger; it can shrink by selling assets or spinning off operations. In theory, the firm will grow until the costs of organizing production and distribution internally exceed the costs of organizing through market transactions. As we will see in section I, business composition in pre-industrial societies is frequently characterized by personal relationships among the participants, notably family members who generally owned, managed and worked in the business. This contrasts with the more impersonal relationships among owners, managers and employees in modern businesses, particularly in large publicly traded corporations.

The second decision is whether to operate without any legal structure or to choose from a menu of legal business organizations like incorporation or partnership. Business composition and legal organization do not necessarily correlate. A family only business can operate without a formal legal structure or it might form a longer-term business organization with legal personality like a modern corporation or a medieval Italian compagnia. Conversely, a partnership can be formed only among family members or include outsiders. Section II discusses legal business organizations developed in pre-industrial societies where there was a far narrower range of options compared with today’s world.

I. BUSINESS COMPOSITION

A. Personal Relationships and Family Business

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8 See ibid., 2.
Personal relationships were critically important in pre-industrial businesses. Owners, managers, agents and investors enjoyed family or personal relations among themselves to an extent far greater than the impersonal relationships among managers and shareholders in modern public corporations. Indeed, the shift from personal relations to impersonal relations perhaps more accurately characterizes the transition from pre-industrial societies to modern societies than speaking in terms of a shift from family to non-family businesses or from family to individuals, as discussed below. The increased flow of information in the post-industrial world has facilitated this shift from personal relations to impersonal relations by making face to face contacts and family relations less critical than was the case in pre-industrial business. Recent innovations if not revolutions in information gathering and circulation can be expected to increase further the distance between pre-industrial and modern societies. Information now flows at a speed and global scale not seen before in world history. New methods of capital pooling like cloud funding are in place which will increase the impersonality of many modern transactions concerning capital pooling and risk sharing. However, personal connections will never be made irrelevant. They will survive the internet.

Family connections are the most common and strongest form of personal relations that can support business. This is reflected in the fact that the importance of family business\(^9\) continues today both in lesser developed economies and in developed economies.\(^{10}\) The economic and legal literature emphasizes that there are important advantages of keeping operations within the family, including trust or symmetric altruism, mitigation of agency

\(^{9}\) Definitions of “family business” differ. Many definitions emphasize modern corporate law concepts of ownership and control like stock capital, shareholding voting rights and representation on boards of directors. These concepts are less appropriate for defining family business in pre-industrial societies where the modern business organization forms and corporate law infrastructure did not exist. Colli’s definition is more appropriate: kin (as further defined within a particular cultural framework), property (the ownership of a significant fraction of the enterprise’s capital), and control (authority over the strategic management of the company). Colli (2003), 20.

\(^{10}\) See, e.g., Drake, Business Planning: Closely Held Enterprises, 2\(^{nd}\) ed. (St. Paul: Thomson/West, 2008), 274. One estimate is that in the United States 17 million family businesses generate about 64 percent of gross national product and account for 85 percent of private employment. See Phan & Butler (2008), 4.
concerns, long-range planning as opposed to short-term profits and protection of proprietary information. Trust or symmetric altruism can limit moral hazard between parent and child, reduce monitoring costs and induce higher effort from the child/employee. Academic recognition of the economic advantages of family businesses is a relatively recent phenomenon. That recognition contrasts with negative academic attitudes toward family business which focus on the harm to efficiency and longevity arising from altruism, nepotism and weak risk-sharing. The reality is that family business decisions frequently are made for both business reasons and non-business reasons such as protecting the family name, securing career opportunities for future generations and resolving sibling disputes. A successful family business must reconcile the sometimes conflicting interests of family and business.

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12 For example, in Mesopotamia family provided better protection of proprietary information like formulae for colored glass and perfume.

For an argument that “individuals, across cultures and historical eras, have tended to structure their households, even ones sustained by love and affection, with a close eye to reducing the transaction costs of their domestic interactions,” see Ellickson (2006), 233, 248-249.


14 See Carney, “Corporate Governance and Competitive Advantage in Family-Controlled Firms,” Entrepreneurship Theory and Practice 29, no. 3 (2005): 249. For example, some academics claim that Chinese family firms inhibited firm growth by limiting the field of potential investors, promoting business “irrationality” (vide non-economic motives), nepotism and corrupt practices, and focusing on short-term projects which could be cashed out quickly. See generally Pomeranz (1997), 3-4. See also Pomeranz (2000, pp. 170-171) who critically summarizes these claims. Pomeranz cites to the contrary examples of merchant dynasties that thrived from the 17th and 18th centuries into the 20th century, with some family dynasties surviving a thousand years or more. See ibid., 168. Like many family firms today, Qing family firms managed to avoid these weaknesses, as seen with the Yutong company in which directors served several decades, managers were recruited through an informal apprenticeship system open to outsiders and family investors were patient about longer-term returns on investment. See Pomeranz (1997), 20-21 and 24-25.

15 Phan & Butler (2008), 9.

16 Cf. Means (2013), 1231-1232 who argues that these conflicting interests call into question the prevailing view of the modern business corporation as essentially a nexus of contracts, at least as
Relations among family and household members were paramount in pre-industrial business.\(^{17}\) As seen below and in Chapter Six, family and kin were used to meet agency concerns and to provide trust which in turn affected business organization attributes like limited liability and entity shielding (protection of a firm’s assets from the personal creditors of the owners or shareholders). Non-family members of a household included slaves and social dependents in many pre-industrial societies. Households engaged in both business and non-commercial activities. For example, the Greeks had different terms for *oikos* (household) and *ergasterion* (business enterprise), although they did not always make a clear distinction between them.\(^{18}\) Conversely, non-resident family members could participate in a business while not being members of the same household. One example is the Chinese *tang* or lineage trust.\(^{19}\)

Personal and family relationships remained important even when non-family participants like passive investors were included in the business. For example, the medieval Italian *compagnia* originally reflected small family relationships between father and son or among several brothers – men who lived in the same house, who broke the same bread (as applied to family firms, see Means, “The Contractual Foundation of Family-Business Law,” Ohio State Law Journal 75, no. 4 (2014): 279 (“family businesses have distinctive characteristics, both because family values influence business choices, and because the laws governing divorce, inheritance, and trusts can produce results at odds with what business organization laws would otherwise dictate”).

\(^{17}\) A family is not necessarily coextensive with a household, but this book generally uses the terms “family” and “household” interchangeably; any distinction should be apparent in the context. Ellickson defines family as a “kinship relationship by blood, adoption, or marriage, but not necessarily a household relationship.” Ellickson (2006), 230. Household is defined as a “set of institutional arrangements, formal or informal, that governs relations among the owners and occupants of a dwelling space where occupants usually sleep and share meals.” Ibid. [Footnote omitted.]

\(^{18}\) Davies (2007), 347.

\(^{19}\) The Chinese concept of family may have been broader than the Greek *oikos* or the Roman *familia*. Family in China emphasized inclusion of ancestors, i.e. an entire lineage as distinguished from a nuclear or three-generation household. The Confucian kinship hierarchy may have had the advantage of enhancing economic equality within the group. See Zhang, “Social Hierarchies and the Formation of Customary Property Law in Pre-Industrial China and England,” American Journal of Comparative Law 62, no. 1 (Winter 2014): 171-220.
the word *compagno* implies), and who found it natural to accept unlimited liability for each other’s actions. The *compagnia* transposed the personal relationships of family to non-kin partners, as reflected in a letter of Francesco Datini to one of his business partners: “What comfort and gladness and satisfaction there is between two good brothers and good *compagni*, bound to each other . . . .” Similar transposition can be seen in the case of Assyrians merchants who relied primarily on extended families to raise capital, share risks, run their long-distance trading businesses, gather information and address agency concerns: the word to designate an employee of a firm was “son,” the head of the firm was called “father” or *abum* and correspondents in the colonies “brothers.”

Given the many advantages of doing business with family members, it is not surprising that the family was the principal business unit in pre-industrial societies. Those advantages also were reflected in a cultural preference (perhaps expressing biological imperatives) to keep business within the family or household. This cultural preference is evidenced in most of our pre-industrial societies including classical Athens, Rome, the Arabic community in the early Islamic world, medieval Italian cities and Qing China. At the same time there were economic explanations why most pre-industrial businesses were family only: there was no economic need to raise capital or share risk that required participation of outsiders. In a sense, family was the default structure for both cultural/biological reasons and economic reasons. Both economics and culture/biology were important. Cultural (biological) preferences could trump economics by limiting business to family even where outside capital was needed for certain activities. Classical Athens and Rome offer interesting situations to test this last proposition.

According to Davies and others, there was no need in Athens before the 4th century for private investment in productive assets; capital was used mostly for non-productive purposes (like monuments). Foxhall asserts that the scale of economic activity was limited

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20 See Origo (1957), 109.
21 Quoted in ibid., 110.
given the size of each polis. These economic conditions arguably explain the absence of large non-family Athenian businesses without resort to cultural explanations. However, one important and highly lucrative economic sector --- silver mining --- raises some doubt. Silver mining appears of significant scale to have generated capital needs and risk sharing beyond the capacity of even wealthy Greek households. There appears to be disagreement in the literature about the existence and importance of non-family firms in the silver mining sector. On the one hand, silver mining operations are said to generally have been fragmented into smaller units of varying sizes and configurations belonging to separate households. Athenians were aware of the economic advantages of larger non-family business organization in the silver mining sector but rejected them. Xenophon urged the Athenian polis to buy a large number of slaves to work the mines directly more or less like a corporation. The polis rejected the advice and Athenian silver mining remained a fragmented sector of family businesses. On the other hand, there is evidence of capital pooling beyond family members in the silver mining sector. For example, one large mining concession was operated by Epicrates who headed a syndicate “of just about the richest men in the city.” This suggests that Epicrates and his syndicate overcame any Athenian cultural preference for family business.

Several explanations have been offered by scholars for this Athenian or more broadly Greek preference to keep business within the family. Greeks are said to have prized independence and preferred self-employment over regular and repetitive service for a single employer. This preference is said to have been strengthened by an elite male idealization of leisurely dedication of cultural activities and a tendency to view work as a mechanism of self-definition rather than as an economic function. As a result, businesses were dependent

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24 See Foxhall (2007), 47.
27 Hyperides, 4.35. See Casson (1984), 43.
on the work and skills of household members and slaves as opposed to outside employees.\(^{29}\) But neither preference for self-employment nor idealization of non-manual activity explains why outsiders would not extend capital to family business or why the family would not seek outside capital when needed. Finley argues that there was no need to pool resources because the Greek mentality was “acquisitive not productive.”\(^{30}\) Yet the fact of extensive commerce and trade in classical Athens suggests caution about generalizations concerning Greek mentalities and their effect on commerce and trade. Any Athenian “acquisitive” mentality did not preclude commercial partnerships outside the family, particularly in the maritime trade. Moreover, all these explanations place considerable weight on the uniqueness of the Greeks and Athenians in human history. Were Athenians so much more committed to “non-productive” activity or enamored of the intellectual life (to the exclusion of commerce) than the Assyrians, Romans, early Islamic merchants, medieval Italians, medieval southern Indians and Qing Chinese?

Turning to Rome, economics provides powerful explanations for Roman business composition. The *familia* (and its nested *peculia*) was adequate for Roman businesses whose capital requirements could be met through internal financing and debt financing. Partners or investors outside the *familia* generally were not necessary.\(^{31}\) Retail trade and most manufacturing were not capital intensive. Capital requirements could be met through cash sales, trade credits\(^{32}\) and friendly loans.\(^{33}\) Larger industries like brick making and glass

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\(^{29}\) See also Frier & Kehoe (2007).


\(^{32}\) See Roberts (2011), 201-202. There is considerable evidence of trade credits for elite purchases. For example, Cicero asked a friend to buy Greek statues for him from a dealer in Campania. See Temin (2013), 171. The dealer told Cicero he would defer entry of the debt in his accounts (and thus delay payment) until Cicero received him in Rome.

\(^{33}\) Credit was available from friends and family. The younger Pliny is commonly cited as an example. Thinking about buying some adjacent farmland, he wrote to a friend: “I can borrow without difficulty. I have always a sure resource in the purse of my wife’s mother, which I can use with the same freedom as my own.” Pliny the Younger, Letters, Vol. 1, trans. Melmoth (London: Heinemann, 1915), 3.19. Romans also used their social networks to obtain cash in an emergency.
blowing were capital intensive but they were located primarily on the estates of landowning families who had accumulated large amounts of capital through agriculture and diversification. Wealthy landowners had sufficient resources to finance their extensive agricultural and non-agricultural businesses without adding partners or investors from outside the *familia*. But as in Athens, contractual partnerships (the *societas*) among non-family members were common for sea voyages, although wealthy Roman landowners participated in the maritime trade primarily as lenders and not as equity partners.

The family-oriented nature of Roman business was supported by a political and social emphasis on the family (the *familia*) and the head of family (the *paterfamilias*). Roman preference for the *familia* and the *paterfamilias* as the basic social and economic unit was embodied in legal rules. Roman law arguably attempted to protect the stability and status of prominent Roman families from the vicissitudes of economic activity. However, development of a legal business organization --- the *societas publicanorum* --- intended to facilitate capital pooling beyond a single family demonstrates that the strong Roman emphasis on the *familia* only business was not absolute and did not prevent the *paterfamilias* from investing in the *societas publicanorum*.

Cultural values certainly influenced business composition in other pre-industrial societies. Merchant-friendly societies like Mesopotamia and medieval Italian cities were

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35 They made maritime loans (via slaves or freedmen) to shipping merchants. Morley, “Early Roman Empire: Distribution” (2007), 587. It may be that Roman landowners preferred debt investments like maritime loans over equity investments like participation in a *societas* or contractual partnership. Shipping merchants also may have preferred debt financing over equity financing. There is little evidence of “merchant financiers” both operating and financing trade. Ships were relatively affordable and most cargoes were purchased using loans. See ibid., 588. See also Temin (2013), 172.

36 The absence of entity shielding in the *peculium* and the rejection of a general agency power to delegate authority both rested on the critical importance of the individual *paterfamilias* in the Roman world.

sympathetic to inclusion of non-family members when capital needs and risk sharing required access to resources outside the family.38 Partnerships for single projects and longer-term business organizations like the Assyrian *naruqqum* frequently included investors outside the family. Indeed, partnerships and longer-term business organizations were intended to facilitate non-family membership when capital and risk needs demanded.

B. Family networks

The importance of personal relationships also is evidenced in family networks or loose business affiliations among family members. The second millennium northern Mesopotamian city of Assur and its Anatolian trading colonies provide the earliest recorded example of merchant houses --- the Assyrian *bitum*. A *bitum* headquartered in Assur would establish branches in Anatolia. The family dominated the organization. Each *bitum* had a manager in Kanesh in Anatolia, generally the firstborn of the family. Sons in affluent families usually started their career in their father’s firm and in time accumulated enough capital to start a new branch in Anatolia. Sons in less affluent families usually began their careers with the larger merchants in Assur until they accumulated sufficient capital to start on their own.39 Foreigners and individuals without family ties were left on the margin of these *bitum* networks.40

The early Islamic world offers another example of family networks. Although most evidence comes from the Geniza documents of Jewish merchants, it is probably safe to say that both Muslim and Jewish merchants used sons, grandsons and other relatives in running and investing in business and in this sense they look like “family firms.” However, Muslim merchants usually had separate accounting among family members, as reflected in the Arabic proverb “*Tahābbū wa tahāsabū*” “love each other, but make accounts with each other.” Longer-term pooling of resources seems to have been an exception rather than the

38 See generally Silver (1995), 50-54.
39 Aubet (2013), 284.
rule. 41 In other words, many Islamic businesses may have been more like family networks or loose associations than a well-defined single family business.

Jewish merchants in the early Islamic world also may have functioned more as family networks, perhaps following similar accounting practices. One Jewish merchant family were the Tāhertīs of Qayrawān with a father, four sons and eight grandsons.42 According to Gotein, their extensive correspondence conveys the impression that the second generation brothers worked together on a permanent basis,43 while the grandsons were connected only through informal cooperation strengthened by partnerships contracted for specific business ventures. It is not clear whether partnerships between brothers or between a father and a son were temporary or more permanent.44 Partnerships among third generation Tāhertīs were definitely limited to specific projects in which outsiders also participated.

C. Multigenerational business

A majority of today’s family firms do not survive into the second generation and only a small minority survive past the third generation.45 This short survival rate is often attributed to the so-called “Buddenbrooks effect:” the third-generation dearth of entrepreneurial skills resulting in the decline of the firm.46 The same effect can be seen in

42 Ibid., 181-182.
43 The brothers divided their work among themselves in such a way that one or two, but not always the same ones, stayed in Egypt for several years, while the others were active at their bases in Tunisia and Spain.
44 Partnerships came before the court usually after the death of a participant, when the heirs had to be satisfied or settlements made with third parties.
45 For example, see Phan & Butler (2008), xi and 232-233.
46 Leadership succession becomes more difficult as the number of heirs increase, too many heirs are involved in the business or the family is unable to produce adequate leaders. See Colli (2003), 14. Transition to a new owner/manager involves many decisions and considerations, including training of potential successors, selection of successors and an adequate governance structure. The decision whether to transfer ownership control to a single person or divide it equally among heirs can be influenced by strong family values
pre-industrial societies. For example, the businesses of large families in imperial China generally could be sustained for only three or four generations.\textsuperscript{47} There are counter-examples, however, of family businesses enduring for many generations. Merchant or trader dynasties are found in Mesopotamia, the medieval Italian cities and imperial China. The Japanese temple builder Kongo Gumi began operations in 578.\textsuperscript{48}

Today many laws influence succession, notably inheritance rules,\textsuperscript{49} taxes and family law.\textsuperscript{50} Modern family firms use different legal business organizations to facilitate succession. Corporations can be formed, with voting and shareholders’ agreements and corporate governance rules.\textsuperscript{51} In 19\textsuperscript{th} century Philadelphia spin-off corporate firms were created to ensure family control.\textsuperscript{52}

\footnotesize {\textsuperscript{47} Zheng, Family Lineage Organization and Social Change in Ming and Qing Fujian, trans. Szonyi (Honolulu: University of Hawaii Press, 2001), 47:}

\begin{quote}
“The individuals critical to determining the timing of division were the married brothers and cousins of the second generation. As the size of the family expanded, the consanguinal relationships between these members gradually grew more distant; different kinds of contradictions grew more serious, and the division of the household became unavoidable.”
\end{quote}


\footnotesize {\textsuperscript{49} Inheritance rules like strict primogeniture and family law (e.g., rights of spouses and children) can heavily influence succession and duration of the family business over multiple generations. Inheritance rules not only can interfere with or complicate successful transition of family business to new generations. Inheritance rules also can interfere with pre-succession operation of the business by slowing growth and investment or even lead to liquidation: the rights that inheritance norms confer on non-controlling heirs over the founder’s estate can reduce the firm’s ability to pledge future income streams to external financiers and so constrain its ability to fund investment. See generally Carney (2005), 251; Ellul, Pagano & Panunzi, “Inheritance Law and Investment in Family Firms,” American Economic Review 100, no. 5 (2010): 2414-2450.}

\footnotesize {\textsuperscript{50} See, e.g., Ellul, Pagano & Panunzi (2010); Means (2014), 702.}

\footnotesize {\textsuperscript{51} See Colli (2003), 37-38.}

\footnotesize {\textsuperscript{52} Colli (2003), 67.}
In pre-industrial societies, taxes were less of a factor. The revenue needs of the modern state dwarf the revenue needs of pre-industrial states. Probably the most important legal rules affecting succession of family businesses in pre-industrial societies were inheritance rules (like primogeniture or equal subdivision among children)\textsuperscript{53} and family law (like rights of wives and children which were more limited than today). At least three pre-industrial societies used legal business organizations to facilitate multigenerational business: Mesopotamia, medieval Italian cities and Qing China. Many Assyrian “family” businesses succeeded for many generations as a series of renewed *naruqqum*. Renewals of the Italian *compagnia* permitted durations over several generations.\textsuperscript{54} Qing China developed the *tang* or lineage trust that was used to facilitate multigenerational businesses by permitting continuation of a business despite dissolution of the *jia* or household on the death of the father/household head.\textsuperscript{55} A portion of estate assets was placed in an ancestral trust with the income to be used for burial, sacrifice and other rituals. Some ancestral trusts ultimately evolved into lineage trusts that engaged in commercial activities with the income going to the household members. Individual households via their lineage trust could themselves become members of larger groups extending over many generations.\textsuperscript{56}

\textsuperscript{53} Comparative analysis of modern inheritance laws and their effect on succession is difficult because of lack of data. See Colli (2003), 37. The effect of inheritance laws on succession in pre-industrial family business is even more difficult to assess. Perhaps the most voluminous literature concerns although there is a considerable debate in the literature about Islamic inheritance laws, multigenerational business and economic growth, as discussed below.

\textsuperscript{54} See Goldthwaite (2009), 69. The Peruzzi firm lasted for five generations via seven renewals, although family dominance lessened as time went on. See ibid., 68-69. The Bardi family affords another example. In 1263 the Bardi firm consisted only of family members. By 1310 only 10 out of 15 partners were Bardi family.

\textsuperscript{55} Household property passed from father to sons (usually equally) either through a family division agreement (*fenjia dan*) or through a will (*yizhu*). Each successor to the household property established a new household.

\textsuperscript{56} Ibid., 73.
Multigenerational business appears to have been rare in the early Islamic world.\textsuperscript{57} The most noted exception is the Kārimī merchant dynasty in Egypt which survived from the mid-12\textsuperscript{th} century to the 15\textsuperscript{th} century.\textsuperscript{58} Many Kārimī merchants passed on their businesses, contacts and reputation to their children who had been trained as apprentices.\textsuperscript{59} They enjoyed strong political support which enabled them to dominate the eastern trade to the exclusion of Jewish and Coptic merchants.\textsuperscript{60} It is unclear whether the Kārimī were structured as a group that cooperated informally or acted under a more formal organization.\textsuperscript{61}

The (relative) absence of multigenerational business in the early Islamic world has generated considerable debate in the literature about possible explanations like Islamic inheritance rules, Islamic legal doctrine and Arabic cultural preferences. The most attractive explanation is Islamic legal doctrine which rejected the notion of legal personality for impersonal entities; this rejection prevented development of business organizations useful to support multigenerational businesses.\textsuperscript{62} The Islamic \textit{waqf} or charitable trust was an inadequate tool to ensure multigenerational businesses\textsuperscript{63} because it was not suited for profit-oriented commercial activity. The principal Islamic partnerships --- the \textit{mudaraba} and the

\textsuperscript{57} See Issawi (1982), 172. See also Ashtor (1976), 149. It is not evident, however, that merchant dynasties in the early Islamic world were significantly fewer compared with contemporary medieval Europe, at least outside Italy.


\textsuperscript{59} Kuran (2011), 138.

\textsuperscript{60} Labib (1970), 66-68. The Kārimī loaned large sums to the rulers of Egypt and Yemen and acquired sufficient influence to act as emissaries and have the Mamlūk sultan arbitrate their complaints against the rulers of Yemen. See ibid.

\textsuperscript{61} See Meloy (2010), 659.

\textsuperscript{62} The Islamic rejection of legal personality for non-human entities reflected early Islamic political and cultural values. For further discussion, see Section II.

\textsuperscript{63} Kuran (2011), 80, 110-113.
inan --- also were inadequate business organizations to sustain multigenerational business. They had short durations and heirs did not automatically replace deceased partners.

Kuran blames Islamic inheritance laws for the absence of multigenerational business in the Islamic world. Islamic law rejected primogeniture and prescribed shares for male and female heirs. But various mechanisms were used in the Islamic world to avoid these inheritance rules such as living gifts, arranged marriages, side payments and denial of widow rights. Family members could legally agree to split a shared property and develop new arrangements for its exploitation. Other societies like Qing China had inheritance rules unhelpful to multigenerational business but they successfully created rules and institutions to overcome restrictive inheritance rules. Islamic inheritance rules appear too thin a reed to explain or support the absence of Islamic multigenerational business.

D. Family versus the Individual

Hansmann et al. argue that the modern market economy has required two developments: 1) creation of legal entities combining the talents and wealth of individuals from more than one family; and 2) liberation of individuals from forced economic family membership by making individuals the basic legal entity. This two-fold development is said to have begun to actualize in medieval Italian cities after the Commercial Revolution when

64 See Kuran (2011). The inheritance law’s tendency to fragment business assets was aggravated by the partnership law requirements which hindered their duration. For an interesting hypothetical of a five-person partnership in two jurisdictions: one allowing primogeniture and another not, see ibid., 85-86.


67 The absence of sovereign borrowing and its large capital requirements in the early Islamic world may also have contributed to the absence of multigenerational business. The fact that the Kārimī were significant lenders to rulers suggests some support for this explanation.

68 See Hansmann et al. (2014), 21.
the merchant’s household (including children, servants and apprentices) evolved into a household in which adult sons were treated as autonomous entities while two or more merchants working together in a trade were considered partners in a general partnership. Social and political developments are said to have blocked a comparable Roman evolution away from the familia: Roman law provided only limited alternatives to the family as well as ultimately abandoning the societas publicanorm, its corporate-like entity.

The Hansmann et al argument is reminiscent of Henry Maine’s classic assertion that “progressive societies” have moved away from defining rights and duties as immutable outgrowths of family and marital status and toward entitling individuals to define these rights and duties by contract. The key legal developments are said to be changes in property rights, namely legal conferrals of greater self-ownership rights on slaves and adult children who formerly had been under the thumbs of family heads.

This survey of pre-industrial societies suggests caution before making generalizations about a global progression from family business (and weaker economic growth) to unfettered individual investors and entrepreneurs (and stronger economic growth). Of all our pre-industrial societies, Rome does present the best example of the economic and legal predominance of the family over individual family members. Children could not own property; all property belonged to the paterfamilias who enjoyed considerable power or podestas over the children. But Roman wives enjoyed some economic independence from their spouses. Marriage contracts, wills and women’s right to

69 See ibid., 21-22.
70 See ibid., 24-25.
73 Nicholas (1962), 68. Augustus modified the rule for solders whose property (peculium castrense) was owned by the son for most purposes. Ibid.

The Chinese household head, like the Roman paterfamilias, also had considerable power to sanction filial disobedience, like execution of disobedient sons. See Fairbank (1978), 11. The father-son relationship was governed by xiao, or filial piety and was tempered by fiduciary obligations. Ruskola, “Conceptualizing Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective,” Stanford Law Review 52, no. 6 (Jul. 2000): 1625-1627.
divorce often gave wealthy married Roman women considerable power, even when their husbands nominally held most of the authority.\textsuperscript{74}

Perhaps Rome was something of an outlier among pre-industrial societies. Individuals enjoyed considerable authority and were liberated from family domination in other pre-industrial societies. Larsen goes so far as to suggest that there was a Mesopotamian preference for individual ownership over family ownership which he asserts explains the failure to develop the \textit{naruqqum} into a perpetual multigenerational vehicle.\textsuperscript{75} In Athens a son reaching maturity was recognized as owner of his own disposable estate and the senior male (\textit{kyrios}) in the \textit{oikos} had fewer powers than the Roman \textit{paterfamilias}.\textsuperscript{76} Medieval Italian sons could hold and commit family assets\textsuperscript{77} unlike their Roman ancestors, although family and personal relations continued to have strong influence over business operations and structure.

Rather than a shift from family to individuals, a shift from personal relations and few partners/investors to impersonal relations and numerous partners/investors might more accurately differentiate pre-industrial societies from modern societies. The later Dutch and English joint stock funds of the 16\textsuperscript{th} and 17\textsuperscript{th} centuries, which most scholars agree are the closest predecessors of the modern corporation, enjoyed transferability and even secondary trading of shares held by hundreds of unrelated individual investors. In this sense they were both non-family and impersonal. The transition from medieval European business organizations like the Italian \textit{compagnia} to the Dutch and English joint stock funds is discussed in the next section.

\textsuperscript{74} See Becker, \textit{A Treatise on the Family} (Cambridge: Harvard University Press, 1991), 18. Moreover, property was kept separate as husband and wife because they were in separate \textit{familias}, with women generally subject to the \textit{dominium} of their father until his death. Watson, \textit{The Spirit of Roman Law} (Athens: University of Georgia Press 2008), 11. In sum, Roman women as individuals owned factories, shipping companies, and other businesses. See Frier & McGinn, \textit{A Casebook on Roman Family Law} (New York: Oxford University Press, 2004), 461.

\textsuperscript{75} Larsen (2007), 100ff. It would be interesting to hear from Assyrologists whether they agree that these arguments adequately takes into account the highly successful merchants of Assur.

\textsuperscript{76} Cf. Maffi, \textit{“Family and Property Law,”} in Gagarin & Cohen (2005), 255.

\textsuperscript{77} Hansmann et al. (2006), 1365.
II. BUSINESS ORGANIZATIONS

A. Modern Forms of Business Organization and Corporate Law Default Rules

There are three important differences between pre-industrial and modern legal business organizations. First, there is a much wider variety of legal business organizations available today. Second, a complex infrastructure of legal rules and institutions has been created to govern this broad variety of business organizations in today’s world. Third, taxes and liability issues are more important in the modern selection of a particular form of legal business organization than they were in pre-industrial societies.78

The modern businessperson has many choices when starting a business. She can operate as a sole proprietorship without legal structure or opt to form a legal structure from a lengthy list of alternatives: closely held corporation, public corporation, limited liability company, general partnership, limited liability partnership, among others. A complex infrastructure of legal rules and institutions has been created to support this broad array of business organizations. Legal institutions have several comparative advantages over informal institutions. Modern corporate law can be viewed as providing a standard-form contract, supplying terms most parties would have chosen if they had negotiated each term. Legal default rules provide a means of accommodating developments that cannot easily be foreseen at the outset or were too unlikely to justify the costs of making provision for them in the contract. Statutory amendments, administrative rulings and judicial decisions provide for unforeseen and unlikely situations as they arise, either by adding new legal rules or by interpreting existing rules. Firms obtain the greatest advantage from judicial interpretations if they adopt standard statutory terms used by many other firms, since those standard terms are likely to be subject to repeated interpretation by the courts.79 Courts have a comparative advantage in supplying answers to questions that cannot be resolved ex ante. Accumulation

78 The effect of taxation and liability issues on the development and use of business organizations in pre-industrial societies merits further focused research.

of decisions addressing unusual problems supplies a level of detail that is costly to duplicate through private bargaining.80

The vast majority of businesses in pre-industrial societies were small shopkeepers and artisans who operated without formal legal structure. However, economic activities like long-distance trade and manufacturing frequently required financial and human resources beyond the capacity of one family or household. They also involved high risks which prompted risk sharing with outsiders. The need for capital pooling and risk sharing generated legal business organization forms. All historical pre-industrial societies developed partnership forms to pool capital and share risks for single projects among family members alone and among family and non-family members, notably but not exclusively for long-distance trade. Four societies developed business organizations that went beyond single project partnerships: the Assyrian *naruqqum*, the Roman *societas publicanorum* and *peculium*, the medieval Italian *compagnia* and *accomandita* and the Qing *tang* or lineage trust.

B. Partnerships for Single Projects

Partnerships and contractual joint ventures are commonly found in pre-industrial societies where they were developed primarily to meet a need to pool capital, share risks and diversify investments in connection with single projects, primarily long-distance trade like a maritime voyage. They generally terminated at completion of the project or were easy to terminate. There is some evidence, particularly in Rome, that a preference for short term investments on the part of wealthy landowners and asset holders may have fueled a demand for business organizations with facile termination provisions. The essentially contractual nature of pre-industrial partnerships and joint ventures cannot be exaggerated. For example, pre-industrial partnerships and joint ventures generally lacked legal personality, entity shielding and limited liability (the last with the notable exception of the medieval Italian *commenda*).

80 Easterbrook & Fischel (1991), 34-36.
Let us turn to a chronological summary of single project business organizations divided into two sets of societies with relatively more and less detailed information about partnerships and joint ventures. There is more detailed information (at least in the English language literature) for Mesopotamia, Athens, Rome, the early Islamic world and medieval Europe. There are fewer details in the literature about partnerships or joint ventures in hunter/gatherer societies, Egypt, medieval southern India and early Qing China.

1. Mesopotamia, Athens, Rome, the early Islamic world and medieval Europe

In Mesopotamia capital needs and the risks of long-distance trade like the Assyrian/Anatolian trading network generated equity and debt financing from outside the Assyrian family. Mesopotamians developed the *tapputum* which was a partnership with a maximum of four merchants and investors who shared facilities and assets and who represented each other in transactions.81 There was no limited liability. A *tapputum* dissolved on death of its manager. Athenians formed *koinonia* or partnerships for both non-commercial and commercial purposes. *Koinonia* were common in maritime trade82 where they were used to raise capital to cover the costs of acquiring cargo in a foreign port (purchase of the cargo, transportation and duties/taxes), transport to Athens and sale in the *emporion*. There was no limited liability83 or entity shielding.

Romans developed the *societas* which was one of the legal consensual contracts. The *societas* created rights between the *socii* (contracting parties) and was not a legal body in its own right.84 English translation of the *societas* as “company” is misleading in suggesting an entity separate from the *socii*. No contracting party could act for the *societas*.85 It is unsurprising, therefore, that the *societas* lacked legal personality, entity shielding and limited

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82 See Engen (2010), 84.
85 See Nicholas (1962), 186.
liability. The *societas* also was not a partnership in the modern sense.\(^{86}\) A *societas* could be formed for any joint activity (profit or non-profit) irrespective of the scale of activities or duration. The *societas* was commonly used for sharing the risks of sea trade, as illustrated by Cato’s stated risk averse preference for a one-fiftieth share in a *societas* that operated fifty ships over sole ownership of one ship. Each party in a *societas* had to contribute capital, labor or skill. All parties shared in profits; unless otherwise agreed, profits were shared equally not proportionately. A *societas* was terminated by withdrawal or death of a partner or by legal action between partners or between a partner and the *societas*. Members of many *societates* were family members,\(^{87}\) but partners could not provide for admission of future heirs into the *societas*.

The early Islamic world developed several forms of partnership, principally the *mudaraba* and *inan*.\(^{88}\) Muslim, Jewish and Christian merchants all used these two partnerships.\(^{89}\) The *mudaraba* had the higher pedigree: the prophet Muhammed himself approved this type of partnership.\(^{90}\) In the *mudaraba*, the *rab al-mal* or principal gave capital to the *mudarib* or agent who did not invest his own capital. Profits were shared according to

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\(^{86}\) See Hansmann et al. (2006), 1356-1357. There was no mutual agency, i.e. each contracting party had to endorse a contract to be bound by it. There was no joint and several liability among parties and there was no distinction between the obligations and assets of the *societas* and the parties.


\(^{88}\) Kuran (2011), 59. Some Islamic schools recognized two more partnership forms: the *mufawada* and the *wujuh* or *sharikat al-mafalis*. See Çizakça (2011), 6-8 and 33-34. Neither was useful for commercial activity. The *mufawada* had several requirements that limited its usefulness as a business organization: inclusion of all trade activities within its scope; complete equality of the partners including distribution of profits; mutual agency and surety of the partners; and contribution of all the partners’ eligible capital. The *sharikat al-mafalis* or partnership of the penniless was formed by two merchants whose only capital was their reputations (*al-wujuh*). The merchants declared that they bought goods on credit with the intent to resell for immediate cash, with profits to be shared among themselves. Ultimately the partners repaid the debt to the original seller.

\(^{89}\) But see Ackerman-Lieberman (2014).

\(^{90}\) Hassan, Sales and Contracts in Early Islamic Commercial Law (New Delhi: Kitab Bhavan, 1997), 89.
the contract and the mudarib bore no liability for losses.\textsuperscript{91} The Hanafi school permitted an unlimited agency mandate with the Arabic clause \textit{I’mal- fih biraiak} or “act with it (investment) as you see fit (at your discretion).” The medieval European commenda may have derived from the mudaraba.\textsuperscript{92} The second Islamic partnership was the inan in which both principal and agent contributed capital which could be in different amounts.\textsuperscript{93} Profits in the inan generally were shared in proportion to the capital contributions.\textsuperscript{94} The geographic and product scope of activities of both the mudaraba and the inan could be limited in the contract.\textsuperscript{95}

The mudaraba and the inan were used to create complex organizational structures which considerably increased the opportunity for pooling of capital and risk sharing: partners’ capital could be combined with capital of the agent, capital of one mudaraba could be transferred to another mudaraba or the capital of a mudaraba could be used to form a partnership with a third party;\textsuperscript{96} Mudaribs could pool the capital of several principals which resulted in multiple mudaraba; one investor could combine the capital of the partnership with his own capital to enhance greater bargaining power vis-à-vis third parties or another inan could be formed with a third party.\textsuperscript{97}

As business organizations, the mudaraba and the inan partnerships had two weaknesses. The more serious weakness was their potentially short duration. Death or withdrawal of a partner terminated partnerships with less than three members.\textsuperscript{98} Heirs did not automatically replace deceased partners. The less important weakness of the mudaraba and inan partnerships was that initially investments could be made only in currency and not

\textsuperscript{91} Çizakça (2011), 30.
\textsuperscript{92} See Çizakça (2011, p. 11) for a summary of the arguments.
\textsuperscript{93} Ibid., 7.
\textsuperscript{94} See ibid., 27; Goldberg (2012), 125.
\textsuperscript{95} Kuran (2011), 51.
\textsuperscript{96} See Çizakça (2011), 5.
\textsuperscript{97} See ibid., 37-39.
\textsuperscript{98} Kuran (2011), 64.
in goods. *Hyal* or legal fiction mitigated the second weakness. An investor could sell his goods to a trusted third party to transfer the proceeds to a merchant, thereby formally establishing a partnership; the new partner would repurchase the same goods on behalf of the partnership.

The medieval Italian cities developed the *commenda* which was a limited partnership developed for single ventures, usually long-distance sea trade.\(^9\) As Italian merchants sought to take advantage of new economic opportunities, the *commenda* served their needs.\(^10\) A passive investor (*commendator*) provided capital to a traveling partner (*tractator*) who contributed skill and labor and sometimes capital.\(^11\) At the conclusion of a specified time or voyage, the *tractator* returned home or remitted the proceeds without returning in person. Profits were distributed as agreed in the contract.\(^12\) In a unilateral *commenda*, the *commendator* received 75% of the profit while the *tractator* received 25%. A bilateral *commenda* (also known as the *societas maris*) created a more equal relationship between the investing and traveling parties. The *commendator* was considered the primary investor, but the *tractator* also contributed a certain amount of capital\(^13\) and usually received half the profits.\(^14\) Risk of loss during the contract was borne by the *commendatore*, unless otherwise agreed.

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\(^11\) Rules were developed to protect the *commendatore’s* capital. A *tractator* had to take with him not only the quantity of capital specified but also the type specified. This protected a *commendatore* who had invested capital of a particular type because he expected it to command high prices at the point of destination. *Tractores* also were prohibited from mixing capital from different *commendatores*.

\(^12\) The *tractator’s* normal share of one fourth (unilateral contract) and one half (bilateral contract) rose in the late 13\(^{th}\) and 14\(^{th}\) centuries, particularly in the eastern Mediterranean.

\(^13\) Pryor (1983), 139.

\(^14\) Harris (2008), 10.
The commenda was not limited to professional traders and merchants. People with capital to invest like tavern keepers formed commenda, as reflected in the deposition during a 13th century lawsuit involving an oral contract for a commenda between a tavern keeper and one of her customers:

“Ansaldo Vexoso, put on oath, said: ‘I was present in the house of ... Anna since I had gone there to buy bread and wine to eat. ... Villano came in and said to ... Anna— you have money; I ask you to let me have what money you do not need in unilateral commenda and I will give you a quarter of whatever profit God will grant me—and she replied—I will give you in commenda forty shillings—and ... she said to me and to Raimondo Vexoso and Bertoloto Vexoso, who were there at that time, that we should thence be witnesses.”

The commenda facilitated pooling of capital and risk sharing, as well as addressing agency and information concerns. Medieval maritime trade generated significant agency concerns due in part to the difficulty of communication as well as a lack of knowledge of market conditions. Some commenda contracts provided specific instructions to the tractator; other commenda contracts granted more discretion to the tractator who was obliged to act in the best interest of the partnership. Any action contrary to the best interests (utilitas) of the commenda and commendatore was viewed as fraud according to the Constitutum usus of Pisa.

One of the great achievements of the commenda was creating a clear regime of limited liability for the passive partner. The commendator was liable only up to her investment in the commenda contract and was the equivalent of a limited partner. Because the commenda was structured as a single-voyage enterprise, limited liability was a necessary component. Repeated transactions would have likely been necessary for an investor to be willing to take on more liability.

The commenda was not an effective business organization for continuous business activities, however. The rationale for the commenda was that a commendator invested in a

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105 Quoted in Pryor (1983), 140.
106 Hunt & Murray (1999), 55-56.
107 See Hansmann et al. (2006), 1372.
108 Weber (2003), 70.
single maritime enterprise, because “maritime trade is not a uniform activity but a series of individual undertakings, each with its individual risks.” By limiting the commenda to a single voyage, an investor was able to limit his risk. At the same time, however, this imposed additional transactional costs on parties. When a party wanted to invest in a new voyage, a new commenda had to be formed. Each time an investor sought to form a new commenda, he would either have to establish a relationship with a new tractator or find one whom he had previously engaged with. This meant that the commenda was successful at minimizing risk only for individuals seeking short-term investments.

As short single port-to-port voyages declined with the establishment of colonies and fondaci (with many local factors, agents and procurators), use of the commenda fell. Commenda themselves became merely one of a series of contracts through which the same capital passed before finally being withdrawn from circulation.

2. Egypt, medieval southern India and early Qing China

There is less discussion in the literature about partnerships or joint ventures in Egypt, medieval southern India and early Qing China. We appear to know more about Assyrian partnerships than their Hindu and Chinese counterparts three millennia later. It is true that there are references to merchants cooperating for both sea and land trade in earlier periods of India. Majumdar cites several jataka stories from the first millennium BC about 500 merchants chartering a vessel to trade in Sri Lanka. And long-distance trade in the later medieval Chola kingdom was said to have been conducted under “partnership” agreements between a nagaram (state administrative unit) and groups of itinerant merchants who traded high-order goods for locally produced commodities.

109 Ibid., 64.
110 An investor could be involved in a number of commenda, which would further spread his risk. Harris (2008), 14.
112 Majumdar (1922), 80-81. Jakata stories relate incidents in the prior lives of the Bhudda.
References to “partnerships” lack detail, however, about their legal forms and attributes. Hindu jurisprudential texts provide only general information about legal business organizations. According to title 18 concerning “Partnership,” 114 parties contributed capital, human or other resources. Profits and losses generally were allocated according to the contribution. 115 According to Mathur, the medieval texts works refer to many principles of profit sharing such as: (i) samaya (convention) (ii) samvit (agreement) (iii) dravya samavaya (initial investment) (iv) vacana (injunction of the veda or smrti) (v) pradhana-guna-bhava (relative importance) (vi) karmanurupa bhaga (share according to work) and (vii) equal share.

Information on partnerships in China before the 19th century also is limited, although archives and records continue to be unearthed. 116 Most of our evidence for partnerships, however, falls in the latter half of the Qing period which was post-industrial and outside the bounds of our survey. Suffice it to say that the partnerships of the 19th century Zigong salt merchants would be familiar to modern corporate lawyers and business executives. Partnership agreements identified the parties, their shares and initial financial contribution. They described the business and its assets. 117 Governance and management rules were defined. Fiscal transparency was ensured in various ways: designation of a specific individual with bookkeeping responsibilities, periodic clearing of accounts and periodic reporting. It would be interesting to know the extent to which these were 19th century western adaptations as distinguished from continuations and modifications of prior Qing practices.

3. Maghribi Jewish subha

Another short-term pre-industrial business organization in the early Islamic world was the Jewish subha or reciprocal agency of. Maghribi merchants had a strong preference for

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115 See Majumdar (1922), 74.
116 Zelin (2009), 624.
the *subha* over the two common Islamic partnerships, the *mudaraba* and the *inan*.\(^{118}\) Each merchant retained more rights over the *subha* goods than was the case with the *mudaraba* and the *inan*. In the *subha* arrangement, two merchants agreed to act as each other’s agent for certain specified goods and services. One party could request multiple services concerning many different goods. The *subha* reduced costs in several ways, including reduced accounting and search costs.

C. Business Organizations to Pool Capital and Share Risk Beyond Single Project

Four societies developed business organizations with legal personality to pool capital and share risk that went beyond single projects like a sea voyage: the Assyrian *naruqqum*, the Roman *societas publicanorum*, the medieval Italian *compagnia* and *accomandita* and the Qing *tang* or lineage trust. Hunter/gatherers, ancient Egypt, classical Athens and the early Islamic world apparently did not develop similar business organizations. The surviving evidentiary picture for medieval southern India is less clear. Another business organization that could operate beyond single projects but which lacked legal personality is the Roman *peculium*. The *peculium* was used to manage business assets held by the head of the family or *paterfamilias*.

These longer-term business organizations (excepting the *peculium*) share some but not all of the attributes of the modern corporation. Scholars differ on the core elements of the modern corporation but the following are the most commonly cited:\(^{119}\)

1. Legal personality/formal creation by law/entity shielding
2. Perpetuity or indefinite duration
3. Transferable shares
4. Limited liability
5. Separation of management and ownership

Histories of the modern corporation typically begin in the 16\(^{th}\) and 17\(^{th}\) centuries when chartered joint stock companies were formed in the United Provinces (later the Netherlands).

\(^{118}\) Goldberg (2012), 143-154.

and England to meet the demand for capital to build and operate fleets of deep water ships
and overseas ports.\textsuperscript{120} By the mid-17\textsuperscript{th} century, English and Dutch business organizations
largely enjoyed the core elements of the modern corporation: legal personality, strong entity
shielding, indefinite duration, limited liability, transferable shares and separation of
ownership and management. The evolution toward modern unlimited plasticity of strongly
shielded entities began in the United States in 1811 when the state of New York first
permitted general purpose incorporation.

The most important distinction between pre-industrial business organizations and the
modern publicly traded corporation is the relatively few number of investors in the former
which meant that they were more like (personal) partners than (impersonal) shareholders.
The \textit{naruqqum} could have as many as 10 to 20 partners and the largest medieval Italian
\textit{compagnia} had 37 partners around 1300.\textsuperscript{121} The number of partners or shareholders in the
\textit{societas publicanorum} and the Chinese \textit{tang} may have been larger but they certainly
numbered less than the thousands of shareholders in a modern publicly traded corporation.
The smaller number of parties and the importance of personal relations among them are also
evidenced by the contemporary practice of referring to parties as “partners” in at least two
of the longer-term business organizations --- the \textit{naruqqum} and the \textit{compagnia}. The fewer
number of shareholders and the personal relations meant that one attribute of the modern
(publicly traded) corporation --- entity shielding --- was not as critical in the pre-industrial
world, as discussed below.

Today there are public corporations with shares traded on market exchanges. There
also are closely held or close corporations with one or few shareholders. The pre-industrial
longer-term business organizations more closely resemble modern close corporations which
tend to have relatively few shareholders with less separation between management and
ownership. Unlimited liability is more acceptable in close corporations because several
benefits of limited liability are absent. For example, limited liability’s reduction of

\textsuperscript{120} The place of the Italian \textit{commenda} and \textit{compagnia} in the transition from medieval business
organizations to the Dutch and English joint stock companies is discussed below.

\textsuperscript{121} See Goldthwaite (2009), 68.
monitoring costs is not important because less monitoring of managers is needed in a close corporation where suppliers of capital typically participate in decision making. Close corporations may have a comparative advantage where managers owning a large percentage of the firm work harder and engage in less self-dealing than managers who own a smaller interest in the business. The fewer number of residual claimants in close corporations facilitates contracting and monitoring to reduce agency problems.\textsuperscript{122} Pre-industrial longer-term business organizations shared these advantages.

4. Mesopotamia, Rome, medieval Europe and Qing China

Mesopotamia, Rome, medieval Europe and Qing China developed business organizations with legal personality that went beyond single projects. Each is discussed in chronological order.

a. Assyrian \textit{naruqqum}

Almost four millennia before the modern corporation, the Assyrians developed the \textit{naruqqum} (“sack” or “money bag”) to pool capital and share risks, primarily in connection with long-distance trade. Our best evidence of the \textit{naruqqum} comes from the archives in Kanesh, the chief Anatolian trading colony of the northern Mesopotamian city Assur. The \textit{naruqqum} was formed by a written contract drawn up under the supervision of the authorities in Assur, signed and sealed before witnesses and kept in the archives in Assur with copies to the Anatolian archives.\textsuperscript{123} \textit{Ummeanum} or passive investors normally contributed a considerable sum of gold or other assets. Each interest or share in the \textit{naruqqum} was held by individuals or other \textit{naruqqum}.\textsuperscript{124} The active investor or manager of the \textit{naruqqum} was required to segregate its funds from other funds or assets that he held. Many merchants had shares in several \textit{naruqqum}.

\textsuperscript{122} See Easterbrook & Fischel (1991), 55-56 and 228-230.

\textsuperscript{123} Naruqqum partnership contracts constitute the most common written document in the Kanesh archives.

\textsuperscript{124} See Larsen (2007), 95-98; Veenhof (2001), 58.
The contract creating the *naruqqum* provided for distribution of profits which generally were forfeited on withdrawal. Participants could transfer, sell or inherit their interests. If an investor withdrew before the agreed term, he could be penalized by being denied his share in the profits or being paid in silver instead of gold.\textsuperscript{125} The *naruqqum* had a duration of at least 10 years with as many as 10 to 20 parties. It frequently terminated after death of an influential head of family, but many Assyrian businesses survived for several generations. Surviving sons started anew as independent traders or in cooperation with other traders.\textsuperscript{126} Each son may have created his own new *naruqqum* or inherited part of his father’s share of an existing *naruqqum*.\textsuperscript{127}

The *naruqqum* enjoyed at least three elements of the modern corporation: legal personality, transferable shares (through sale or inheritance) and separation of ownership from management. The *naruqqum* differed from the modern corporation in two respects: it was not created by state charter law but by contract and formally it lacked perpetual or indefinite duration, although it was easily renewable. Whether the *naruqqum* had entity shielding and limited liability is not clear from the literature.

In contrast to modern publicly traded corporations, family and personal relationships predominated in the structure and operations of the *naruoqum*. Although each interest in a *naruoqum* was treated separately, many *naruoqum* were run like a family firm where the individual shareholders were members of the same family. In many families, every adult managed a *naruoqum* as his private business and some adults had interests in multiple *naruoqum*. This vibrant family dimension can be seen in the archives of the merchant Šalim-Assur.\textsuperscript{128} A younger brother in Assur (Iddin-abum) sought commitment funds and loans

\textsuperscript{125} Aubet (2013), 340.
\textsuperscript{126} Larsen (2007), 102-104. See also, Aubet (2013), 286: “[T]hat merchants were interred with their own personal seals, which meant that a mark of ownership and personal guarantee with a view to subsequent business and commercial transactions was destroyed and ceased to be used.”
\textsuperscript{127} See Veenhof (2001), 58.
\textsuperscript{128} See Larsen (2007), 99.
from friends and his older brother in Kanesh. These funds enabled Iddin-abum to persuade other financiers in Assur to participate in a *naruqqum*.

b. Roman *societas publicanorum*

The Roman Republic created a business organization --- the *societas publicanorum* --- to meet the need for “outsourced” public projects such as provision of the legions, construction of aqueducts and sewage systems and collection of taxes. The Roman Republic. The state-funded feeding of the white geese on the Capitol to commemorate their honking in warning of the Gallic attack in 390 BC is a well-known example. Polybius wrote that “almost every citizen” invested in government leases by the second century BC. A century later, according to Cicero ownership of shares in the *societates publicanorum* was widespread in the Roman population. However, one modern scholar, Fleckner, challenges the commonly held view that the *societates publicanorum* had many shareholders. Political changes killed the *societas publicanorum* which fell out of use in the early Empire. Public administration largely replaced outsourcing and these private firms for a mix of related reasons, notably creation of the imperial bureaucracy and a desire to reform the state procurement system through elimination of corrupt and inefficient *publicani*.

The *societas publicanorum* enjoyed all the attributes of the modern corporation: legal personality, entity shielding and limited liability, transferable shares, indefinite duration

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129 The *societas publicanorum* can be compared with post-industrial public companies like the 19th century French limited partnerships which also met a need for improved access to external financing (via traded shares) for large-scale state projects.

130 See Malmendier (2009), 1089.

131 See Fleckner (2014).

132 See Malmendier (2009), 1090-1092. Malmendier compares with this with dissolution of the English East India Company in 19th century for political reasons. Ibid., 1093.

133 Cf. ibid., 1090-1092. The wealth and influence of the *publicani* drew jealous attention of the emperors who ordered the state to take over much of the public works. The *publicani* survived for a time as tax collectors.

134 The *societas publicanorum* enjoyed strong entity shielding at least with respect to limited shareholders. Investors in the *societas publicanorum* enjoyed limited liability.
and separation of management and control. It had rights and duties in its own name. Neither death nor withdrawal of a shareholder nor legal disputes among shareholders triggered termination. Unlike the contractual societas, partes or shares were transferable.

The societas publicanorum was probably the closest counterpart to the modern corporation before the 17th century. The fact that it preceded the modern corporation by two millennia supports our general conclusion that legal institutions in pre-industrial societies are better understood as responses to conditions in a particular society rather than as linear stages of a Hegelian progression from primitive toward modern institutions.

The societas publicanorum was limited, however, to public contracting. The Romans never developed a general purpose “corporate” organization with legal personality, transferable shares, indefinite duration, entity shielding and limited liability. They could have done so by broadening the business scope of the societas publicanorum. Hansmann et al suggest that unlike the Roman state, few private parties may have needed services that only heavily capitalized firms could provide and that creating publicly traded firms not confined to public contracting might have required costly institutions for protecting investors.135 Another possible explanation is that the political reasons for the demise of the societas publicanorum eliminated any prospect of creation of a similar business organization that could engage in broader economic activities. This explanation has its own flaws. Corruption of the publicani and imperial in-sourcing of major (“public”) capital projects does not explain the Roman failure to adopt a longer term business organization for private investors to pool capital in manufacturing activities.

c. Roman peculium

The Romans developed a second business organization that could engage in more than single projects but which lacked legal personality: the peculium. Specific business assets of the head of the family or paterfamilias could be entrusted in a peculium to a slave or child who managed the business. The principal advantages of the peculium over the contractual partnership or societas were indirect limited liability, indirect de facto entity shielding,

135 Hansmann et al. (2006), 1399-1400.
mechanisms to facilitate duration of the business and better agency controls.\textsuperscript{136} Tiers could be created of hierarchical slaves insulating the \textit{paterfamilias} even further.\textsuperscript{137}

d. Medieval Italian \textit{compagnia} and \textit{accomandita}

The third pre-industrial longer-term business organizations with legal personality is the medieval Italian \textit{compagnia} which gradually replaced the short-term \textit{commenda} partnership as the principal business organization for medieval European long-distance trade. The traveling merchant, for whom the \textit{commenda} was an ideal form of business, became less important as long-distance trade shifted towards resident merchants trading through agents.\textsuperscript{138} The \textit{compagnia}, as originally conceived, was closely connected with family members. As \textit{compagnie} grew larger and more diversified, capital needs grew as well and outsiders were brought in to help provide the additional needed capital.\textsuperscript{139}

The \textit{compagnia} raised capital initially from equity investors (\textit{il corpo della compagnia}). Debt financing at fixed interest rates could be added (\textit{il sopra corpo}). Fixed costs were low and the \textit{corpo} was used primarily as start-up capital to buy raw materials and pay workers until sales revenues were sufficient to meet variable costs.\textsuperscript{140} Raw materials like wool could constitute a major part of total expenses.\textsuperscript{141} The \textit{compagnia} usually rented offices,

\textsuperscript{136} Agency problems could not be completely removed and agency costs generated relevant diseconomies of scale, which limited the capital invested and people involved. See Abatino & Mattiacci, “Agency Problems and Organizational Costs in Slave-run Businesses,” in Dari-Mattiacci (forthcoming) (also available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1942802).

\textsuperscript{137} The \textit{peculium} is discussed further below in connection with asset partitioning (entity shielding and limited liability).


\textsuperscript{139} Ibid., 2.

\textsuperscript{140} Goldthwaite (2009), 65-66.

\textsuperscript{141} For wool the percentage was 40 percent. Ibid., 302.
shops, warehouses and means of transport. Purchase of tools and equipment was outsourced
to workers who contracted for the various stages of production.\footnote{Ibid., 300; Hunt & Murray (1999), 111.}

The \textit{compagnia} looked very much like a modern corporation in several respects. It enjoyed legal personality and was formed by a contract which contained its articles of association. The articles set forth the name, location and general business activity, the managers, each partner’s contribution to the capital, distribution of profits on basis of capital contributions (plus a small percentage to charity, \textit{i poveri di Deo}), no competes (partners agreed not to compete with the \textit{compagnia}) and a prohibition or penalties on withdrawal of capital before dissolution. Although each \textit{compagnia} had an express duration (generally two to five years), it could be renewed and many well-known \textit{compagnie} lasted decades. At each renewal, a partner could withdraw his share or reinvest in the renewed entity. The \textit{compagnia} did not terminate on the death of a partner.

In contrast to a modern publicly traded corporation, interests in a \textit{compagnia} were not transferable, unlike the Assyrian \textit{narruqqum} or Roman \textit{societas publicanorum}. And as discussed below, investors in a \textit{compagnia} did not enjoy limited liability. Moreover, there was less separation of management and ownership in the \textit{compagnia} with little “vertical specialization” in the form of management structure composed of specialists. This did not exclude outside managers but they were probably more the exception than the rule. Perhaps as important as formal organizational structure was the close supervision and bonding between the top and lower levels, like the close monitoring of his various \textit{compagnie} by the Tuscan merchant Francesco Datini.

The \textit{compagnia}, like the Assyrian \textit{naruqqum} and the Chinese \textit{tang} or lineage trust, was used as one element in larger organizational complexes with “holding” companies, tiered entities and widely diversified activities. For example, two or three partners in a Florence \textit{compagnia} might create a separate Pisa \textit{compagnia} with its own name, articles of association and set of books.\footnote{Goldthwaite (2009), 70.} The Florence \textit{compagnia} then became a partner in the Pisa \textit{compagnia}. Another example is the Capponi agglomeration in which the Florentine parent \textit{compagnia}
was not merely an investment mechanism but an active commercial or banking firm on its own. In 1485 five sons of Gino di Neri Capponi invested in a parent company that ran an alum mine, engaged in banking and invested in two separate companies (Sub A and Sub B) with a non-family member. Sub A, along with two other partners, did business in Lyons and also invested in three companies with other partners—a silk company, a Parisian firm and a firm in Avignon. Sub B in Florence invested in a wool company, as well as firms in Pisa and Rome. In all, the Capponis had interests in eight firms doing business in at least six locations.

In the 13th century so-called “super-companies” were formed to meet the very large capital demands generated by a combination of textile manufacturing, trade in grain and sovereign lending. Each super-company was composed of a single compagnia, centrally managed with wholly owned branches in different locations, many partners and hundreds of employees (all Italian, mostly Florentines). Renewals of the compagnia permitted durations over several generations. The Peruzzi firm lasted for five generations via seven renewals. Family members at first predominated but less so as time went on.

Super-companies first appeared in inland towns in northern Italy and were primarily large-scale merchant houses that also engaged in international banking activities. Rather than gradually developing into larger enterprises, these super-companies “were created as large enterprises to meet their objectives.” The size, geographic range and product diversification of three Florentine firms (Bardi, Peruzzi and Acciaiuoli) justify the term “super-company.” They engaged in general trading, commodity

144 Ibid., 72.
146 The Scali Compagnia had 25 partners at the time of its failure in 1326. The Spini Compagnia was the largest with 37 partners around 1300. See Goldthwaite (2009), 68.
147 See ibid., 69.
148 See ibid., 68-69.
149 Hunt & Murray (1999), 99.
150 Ibid., 105.
trading, banking and textile manufacturing over a wide geographical area for an extended period of time. Florentine firms acquired a virtual monopoly of grain exports from southern Italy and Sicily in exchange for large loans to the local Norman rulers and elites. Enormous loans to English kings like Edward I cemented Florentine participation in the English wool trade. By the late 13th century, only heavily capitalized companies could participate in the highly profitable grain and wool commodity trade. In the mid-14th century, super-companies disappeared within a 30 month period following the sovereign defaults of Edward III. The Black Death of 1347-50, a collapse in the grain trade and political changes in England which loosened the Italian hold on the wool trade prevented resurrection of the super-companies. The super-companies were replaced with smaller compagnie with a very different management structure of a hub-and-spoke system.

The transition from super-companies to the hub-and-spoke system signals the importance of the lack of unlimited liability in the compagnia. In contrast to the commenda, the compagnia did not provide limited liability for its partners. Limited liability would have generally been unworkable for a compagnia, because “[t]he fluid and fungible nature of these firms’ assets made those assets a weak basis for firm credit.” While partners could commit additional capital on specific terms, time deposits from outsiders were common. Personal liability in a compagnia made this a much riskier venture than the commenda. The lack of unlimited liability also aggravated agency and information concerns.

The difficulties of operating a single company with unlimited liability appear to have become unacceptable by the mid-14th century when the centralized single structure was replaced with the decentralized hub and spoke system. Firms now had fewer partners, less product diversification and narrower geographic reach. Each compagnia now generally had only two to four partners. Merchants expanded operations by establishing different companies.

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151 Ibid., 102.
152 See ibid., 101-102.
153 The English crown became more adroit in handling the king’s affairs, obviating the need for continuous financing by private companies. Hunt & Murray (1999), 120.
154 Hansmann et al. (2006), 1374.
155 Goldthwaite (2009), 66.
156 Ibid., 70.
partnerships or *compagnie* rather than including all activities under one broad organization. Headquarters remained in the home city like Florence, but local branches became separate *compagnie* each with its own name, articles of association and set of books.\(^{157}\) The post-1350 hub and spoke system moderated the risks of unlimited liability and generally facilitated asset partitioning (and weak entity shielding) better than the centralized system of the super-companies.\(^{158}\) After the Italian bankruptcies of the mid-14\(^{th}\) century, investors became more risk averse. Separate *compagnie* under the hub-and-spoke system were used to protect secondary investors interested only in specific activities or locations.\(^{159}\) Unlimited liability also affected how a *compagnia* raised capital. The *compagnia* was not conducive to raising funds from longer-term outside investors.\(^{160}\) Passive investors were reluctant to provide long-term capital because they faced the risk of personal liability without sufficient control or governance rights.

The Florentine commune in 1408 created the *accomandita* which did provide limited liability to investors.\(^{161}\) The Medicis used the *accomandita*\(^{162}\) when creating new branches

\(^{157}\) Ibid.

\(^{158}\) Hansmann et al. (2006, p. 1369) argue that location-based entity shielding was an adaptation to the highly fragmented political jurisdictions and the resulting obstacles to effective administration of bankruptcy law. A speedier procedure whereby all of a bankrupt firm’s creditors with claims arising locally could immediately seek satisfaction out of the firm’s local assets was preferable to establishing a bankruptcy process that sought to assemble all of a firm’s business assets wherever held, and all debts wherever owed, and then divide the assets ratably among the creditors.

\(^{159}\) Goldthwaite (2009), 77.

\(^{160}\) Goldthwaite (2009), 67.

\(^{161}\) Ibid.

\(^{162}\) See Ibid.
in foreign cities. The Bank protected itself from the conduct of inexperienced local managers by creating an accomandita in which the Bank enjoyed limited liability as a passive investor. If the local manager was successful after two years, the Bank would convert the local business into a normal compagnia in which the Bank had unlimited liability.

The accomandita was innovative and could have been an important step in the evolution of the compagnia toward a more modern entity like the joint stock fund or even modern corporation given the accomandita’s ability to raise capital while maintaining limited liability for some investors. However, the accomandita never became widely accepted. Other than by the Medici Bank, it appears that it was infrequently used. From the late 15th century to the 1530s, fewer than six accomandita contracts, on the average, were registered annually. Thus the the accomandita “never realized its potential for evolving into something like a joint-stock company.”

Rather the Italian leadership in developing business organizations passed to the Dutch and English who created the joint stock company in the 16th and 17th century. This passing correlated with the relative decline of Italian merchants who remained largely limited to the Mediterranean compared with the expansion of the Dutch and English into the new global trading world.

The joint stock company was developed to meet the needs of the new global sea trade. Joint stock companies did not suddenly replace earlier partnerships. Two variations on the traditional partnership were first used in long distance trade by the English and Dutch, but were ultimately discarded in favor of the joint stock company. One

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163 Hansmann et al. (2006), 1373-1374.
164 See Goldthwaite (2009), 67.
165 The Florentine accomandita may have descendants in modern Italian law. The term is still used in a model of partnership contracts (societa’ in accomandita semplice) and a corporate form (accomandita per azioni). I thank Marco Corradi for bringing this to my attention.
166 Goldthwaite (2009), 67.
type of partnership, the “pre-companies” included two classes of partners, active and passive.\textsuperscript{169} The passive partners, other than financing the venture, had no actual involvement in the undertaking. The second Dutch partnership, initially used in the spice trade, was the \textit{partenrederij}. The \textit{partenrederij} was an early type of joint stock company that provided merchants with fractional ownership of a ship.\textsuperscript{170} The \textit{partenrederij} operated much like the \textit{commenda} and was dissolved following one round trip. In England the predecessor to the joint stock company was the regulated corporation developed as a partial substitute for a limited partnership which was not yet legally accepted.\textsuperscript{171} The regulated corporation was used for owning joint infrastructure. The regulated corporation, in contrast to the partnership, was able to coordinate large numbers of members, and “could potentially address the fixed capital needs of long-distance trading by providing a common infrastructure.”\textsuperscript{172}

Eventually, the joint stock companies of England and the United Provinces came to closely mirror a modern corporation. They were created via a company charter along with a set of bylaws establishing governance rules and providing the rights and duties of managers and shareholders.\textsuperscript{173} Initially, sale of par value shares raised capital, and if more capital was needed, new shares could be issued.\textsuperscript{174} As early as 1615, voting shares were issued to the Dutch public and could be purchased at an auction. A group of directors, elected by shareholders each year, managed the company. Two of the most important innovations of the joint stock company were limited liability and tradability (not simply transferability) of shares. Of course, transferability of shares was not unique in history. Shares in the Assyrian \textit{naruqqu}m and the Roman \textit{societas publicanorum} were transferable but they lacked the wide tradability of the Dutch or English joint stock company shares.

\textsuperscript{169} Harris (2008), 18.
\textsuperscript{170} Kyriazis & Metaxas (2011), 365.
\textsuperscript{171} Harris, “The Formation of the East India Company as a Cooperation-Enhancing Institution,” SSRN eLibrary Draft (Dec. 2005), 22.
\textsuperscript{172} Ibid., 23.
\textsuperscript{173} Ibid., 5.
\textsuperscript{174} Walker (1931), 102.
Tradability of shares reduced transaction costs incurred in bringing in new investors. Tradability also increased the value of the joint stock company.\textsuperscript{175} In addition to providing a greater pool of potential capital, tradable shares allowed a broader section of the population to become investors in a joint stock company. An external market for shares created an additional check on managers.\textsuperscript{176} 

Although the joint stock company was fully developed in England and the Netherlands, an earlier version was created in Genoa in the 14\textsuperscript{th} century. The Genoese government sold shares in state-backed monopolies, but all owners had to consent to the sale of any shares, limiting the practicality of this use of the joint stock company.\textsuperscript{177} Why was the joint stock company with its wide tradability of shares and limited liability developed for the first time in 16\textsuperscript{th} and 17\textsuperscript{th} century Netherlands and England?\textsuperscript{178} Were prior business organizations forms sufficient for the capital needs and risk sharing for the economic conditions in earlier periods? Conversely, were the capital needs and risk sharing of the new global maritime trade significantly greater than those in earlier periods and thus triggered development of a new business organization, i.e. the joint stock company with its wide tradability of shares and limited liability? These questions raise issues similar to those seen below with respect to the failure of some pre-industrial societies to develop longer-term business organizations. Let us briefly look at possible explanations, notably risk, capital needs and non-economic factors.

As to the capital needs and risks of the post-1492 maritime world compared with earlier sea and land trade, there is no doubt that the long-distance sea trade between

\textsuperscript{175} Kyriazis & Metaxas (2011), 369.

\textsuperscript{176} Ekelund & Tollison, Mercantilist Origins of the Corporation, The Bell Journal of Economics 11, no. 2 (Autumn 1980): 718 n.5. Tradability represented “a mechanism external to the firm through which the behavior of the cartel owner-managers could be disciplined and monitored.” Ibid.

\textsuperscript{177} Hansmann et al, (2006), 1376.

\textsuperscript{178} Numerous explanations are offered by scholars, notably increased risk of long distance trade, risk diversification, and greater capital needs.

western Europe and Asia created very high capital demands, specifically because of the need for deep water ships, permanent trading posts and a long turn-around time for voyages.¹⁷⁹ In absolute terms, these capital demands certainly exceeded those of the Assyrian land merchants who developed the *naruqqum* and perhaps also the capital needs that led to the creation of the medieval Italian super-companies. Merchants engaged in the almost global trade of the early Islamic world probably also had significant capital demands but not on the same scale as the Dutch and English traders in the post-Columbus maritime world.

The joint stock company enjoyed an additional advantage over prior business organizations, including the *compagnia*, the *accomandita* and its immediate Dutch and English predecessors. Early promoters of the joint stock companies desired a business organization to raise capital from a larger group of passive investors no longer having to rely on individuals within their own networks. Previous business organizations were efficient at raising a fixed amount of capital from a small number of related investors that would cover a known set of costs, but they were not well suited to sustain a high amount of working capital for long periods of time. The longer and riskier sea voyages of the post-Columbus world significantly increased investment uncertainties. The joint stock company permitted managers to quickly raise additional capital in a time of need through the sale of additional shares.¹⁸⁰ Debt financing was not a viable option to equity financing.¹⁸¹ The joint stock company developed in part out of a need to develop a business form that would better minimize the risk of investing in sea trade while not limiting the business to one journey. Outsiders could invest in a joint stock company without concern that their personal assets would be targeted in the case of a bankruptcy.

Success of the joint stock company also may be attributed to the political decision to permit shareholders to obtain monopoly rents. The joint stock company allowed investors

¹⁷⁹ See, e.g., Harris (2005), 21-22.

¹⁸⁰ Harris (2009), 31.

¹⁸¹ Harris (2005), 4 and Harris (2009), 18.
to enjoy the potentially large profits of a company involved in a monopolized trade. A vertically integrated joint stock company was better positioned to exercise market power and sustain monopoly prices. Tradable shares allowed investors to participate in a highly profitable monopoly while not necessarily requiring them to commit to a long-term investment. Providing joint stock companies and their shareholders with monopoly rights was likely more politically acceptable if a larger number of people could benefit from the monopoly. Indeed, some scholars suggest that capital needs, risk and agency and information concerns (discussed in the next paragraph) do not sufficiently explain why merchants would want to include passive investors and provide them with tradable shares while those investors contributed no human capital. Their explanation is that the joint stock company satisfied the wealth-maximizing goals of both merchants and those seeking to gain from the enormous profit potential of the charter companies.

The joint stock company also better addressed agency and information concerns than the commenda or compagnia. The compagnia (at least initially) generally included only family members and the commenda was limited to one passive investor and one active traveling partner. But when trying to involve a large number of unrelated investors who were not knowledgeable about long distance sea trade, new rules and institutions were necessary to facilitate information flow and minimize agency concerns. Shareholders were given voting rights and information flow between managers and helped mitigate information asymmetries.

e. Qing tang (lineage trust)

Our last longer-term business organization with legal personality is the Chinese tang or lineage trust. Lineage trusts served a wide variety of objectives: pool capital, share risk, facilitate intergenerational transfer of business assets, distribute income among family

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183 Ibid., 911.
184 See ibid., 909-910.
185 Harris (2005), 30.
members\textsuperscript{186} and enable gentry and mandarins to screen their participation in commerce and trade.\textsuperscript{187}

The roots of the lineage trust go back more than a millennium. At least as early as the Sung dynasty in the 10\textsuperscript{th} century, Chinese families were encouraged to ensure performance of ancestral rites by sequestering a portion of the patrimony of each generation in the form of an endowment.\textsuperscript{188} The most common asset of a lineage trust was land but lineage trusts also engaged in commercial activities. For example, the Guan lineage trust document in 1632 explicitly stated that capital (\textit{ben}) was to be used to seek a profit (\textit{li}) with participation limited to lineage members and distributions in proportion to contributions. The indivisibility and intergenerational transfer of trust interests was not formally recognized, however, until the 18\textsuperscript{th} century.

Many lineage trusts lasted several generations which compares favorably to the duration of many modern corporations. There is evidence of lineage trusts surviving for hundreds of years. The “Record of Hekou Market” in the Ninth Compilation of the Genealogy of the Zhang Surname of Qinghe from Shunchang records a lineage trust purchasing land in 1175 and constructing an ancestral hall in 1830.\textsuperscript{189} But even if ritual continuation of the lineage trust was potentially perpetual, sale of lineage property could lead to dissolution of the trust or creation of new trusts with different assets.\textsuperscript{190}

Lineage trusts shared some but not all of the elements of the modern corporation, although they appear less “corporate” in form than the \textit{naruqqum} or the \textit{societas publicanorum}. Lineage trusts could contract in their own name, including purchase, sale and rental of property.\textsuperscript{191} They could sue and be sued and had such a reputation for litigation that in 1736 an imperial memorial rewarded lineage trusts who stayed out of litigation for

\textsuperscript{186} Zelin (2005), 114.

\textsuperscript{187} See Pomeranz (1997), 3.

\textsuperscript{188} Zelin (2009), 626-627.

\textsuperscript{189} See Zheng (2001), 94.

\textsuperscript{190} See ibid., 88-89 and 102.

\textsuperscript{191} See Ruskola (2000), 1636-1637.
three years. Lineage trusts, like the naruqqu and the compagnia, were used as elements in larger business agglomerations, for example, investing in or combining with contractual partnerships.

In contrast to modern corporations, lineage trusts almost certainly had no entity shielding (creditors of the members could claim against the trust assets) and probably no limited liability for members. Transferability of interests in lineage trusts is not entirely clear. In theory, lineage trusts were limited to lineage members but there is some evidence of transfers to outsiders. Use of fictional lineages and uniting members under a long-deceased ancestor were used to avoid the lineage requirement. Genealogy was not an insurmountable obstacle. For example, Li Pang combined five unrelated families into a single unit with a new surname – Bao. This prompted a group of rival clans to consolidate into their own new entity – the Qi. Another example comes from the 18th century when five different lineages established a market, shops and warehouse. Creative combinations were sufficiently prevalent by the 18th century that provincial governors complained to the emperor about lineage trusts where the only qualification for participation was a monetary contribution. Printed copies of lineage genealogies may have functioned as transferable certificates. Official bans on sales of genealogies suggest that there may have been a market for interests at least in larger lineage trusts. But there appears to be little evidence of wide

192 See ibid., 1662.
193 See ibid., 1654.
194 See ibid., 1636.
195 See ibid., 1638-1639.
197 See Zheng (2001), 124-126. After industrialization began in China in the 19th century, lineage trusts attracted sufficient outside capital to operate in many territories and lines of business, and to achieve a substantial degree of vertical integration. Lumber firms in early 19th century Shaanxi employed from three to five thousand workers, placing them among the largest firms in the pre-industrial world. Pomeranz (2000), 168. Lineage trusts were active participants in the complex business structures of the 19th century Zigong salt merchants.
198 See Hsiao, Rural China: Imperial Control in the Nineteenth Century (Seattle: University of Washington Press, 1960), 353. [CHECK]
tradability. Interests in lineage trusts were not part of an open financial market as was the case with the Dutch and English joint stock companies.

There was some separation of management and ownership in the tang. Governance rules were registered with local magistrates, included in genealogical records and invoked in litigation.\textsuperscript{199} Although they were never formalized before the 1904 code,\textsuperscript{200} this “legislative gap” was filled with sample governance rules in encyclopedias, trade manuals and industry codes of conduct. There also were periodic state regulations such as the 1757 disclosure requirements imposed on larger trusts.\textsuperscript{201}

\textbf{f. legal personality, duration and transferability}

The Assyrian \textit{nuqqum}, the Roman \textit{societas publicorum}, the medieval Italian \textit{compagnia} and \textit{accomandita}, and the Chinese tang to varying degrees enjoyed the attributes of the modern corporation. Legal personality, perpetuity or indefinite duration and transferability of interests (shares) are discussed below. Entity shielding and limited liability are discussed in the next section III.

\textbf{(1) Legal personality}

Traditionally, “legal personality” means that the corporation is a state-created entity or “thing.” The modern corporation is treated as though it were a legal person, having most of the rights and obligations of natural persons, and having an identity wholly apart from its constituents. Corporate law statutes in the United States typically give a corporation “the same powers as an individual to do all things necessary or convenient to carry out its business and affairs.”\textsuperscript{202} The Assyrian \textit{nuqqum}, the Roman \textit{societas publicorum}, the medieval

\begin{itemize}
  \item[\textsuperscript{199}] See Ruskola (2000), 1659.
  \item[\textsuperscript{200}] See Zelin (2005), xviii.
  \item[\textsuperscript{201}] See Ruskola (2000), 1662.
  \item[\textsuperscript{202}] See Bainbridge (2002), 7-8.
\end{itemize}

The concept of legal personality for corporations is not limited to common law jurisdictions. Civil law refers to the “separate patrimony” of the corporation, i.e. a pool of assets distinct from other assets held by the firm’s owners. The corporation’s rights of ownership over its “separate patrimony” include the rights to use the assets, sell them and secure credit. Conversely, because
Italian *compagnia* and *accomandita* and the Chinese *tang* or lineage trust all enjoyed “legal personality” in the traditional sense.

However, the traditional view of corporate legal personality has been challenged by legal scholars and economists who rest their view of the corporation on the economic theory of the firm. This view rejects reification of the corporation.\(^\text{203}\) The firm is seen as a “nexus of contracts:” the corporation is not a “thing” but a web of explicit and implicit contracts establishing rights and obligations among the various parties making up the firm.\(^\text{204}\) The corporation is viewed as an aggregate of physical and human inputs acting together to produce goods or services.\(^\text{205}\) Modern corporate law permits the firm to act as a single contracting party distinct from the individuals who own or manage it, thereby enhancing the ability of these individuals to engage together in joint projects. Legal rules governing the allocation of authority establish common expectations as to who has authority to transfer rights relating to corporate assets prior to entering into a contract for their transfer. Legal procedures for lawsuits are specified. The nexus of contracts approach has three important implications: shareholders’ rights and duties are (or should be) defined by contract; these assets are conceived as belonging to the firm rather than the firm’s owners, they are unavailable for attachment by the personal creditors of the owner. A contrasting school of European legal theory views the firm less as a contract and more as an institution with obligations beyond owners and managers.


\(^\text{204}\) Bainbridge (2002), 7-8.

\(^\text{205}\) Ibid., 28-33. The corporation has also been described as a “nexus for contracts” where the corporation serves as the common counterparty in numerous contracts with suppliers, employees and customers, coordinating the action of all these persons through exercise of its contractual rights. Corporate law permits the firm to act as a single contracting party distinct from the individuals who own or manage the firm, thereby enhancing their ability to cooperate in joint projects. See Kraakman et al. (2009), 6-9.
corporate law should be “enabling” rather than mandatory; and each firm must find the specific set of contractual obligations that best suit its shareholders.

Whether the Assyrian naruqqum, the Roman societas publicanorum, the medieval Italian compagnia and accomandita, and the Chinese tang or lineage trust also can be viewed as a “nexus of contracts” is not clear given the different legal infrastructure of corporate law statutes and regulations underlying the contractual view of a modern corporation. Without that modern legal infrastructure, the traditional view of reified legal personality may be more appropriate for pre-industrial business organizations.

(2) Perpetual or indefinite duration

Formally, only the societas publicanorum and the tang had no maximum time limit and in that sense were “perpetual.” The naruqqum had a short maximum term of five years (unless renewed) and most compagnie lasted for five years or less (unless renewed). With respect to duration, therefore, the naruqqum and the compagnia look more like partnerships than the modern corporation. The duration element of the modern corporation is subject to debate, however. Some legal scholars speak of a perpetual legal existence terminable only in rare circumstances: a vote of the shareholders to dissolve the company, an involuntary dissolution suit, or a merger or consolidation with another corporation. Other scholars reject perpetuity as an essential element of the modern corporate form.

If we focus on legal rules that extend duration rather than declarations of “perpetuity,” we see that the Assyrian naruqqum, the Roman societas publicanorum, the medieval Italian compagnia and accomandita, and the Chinese tang or lineage trust all could be indefinitely extended beyond the original term through easy renewal and inheritance rules. The principal mechanism to extend duration was a rule of non-dissolution on the death or withdrawal of a partner. For example, a decedent father’s interest in an Assyrian naruqqum could be inherited, although frequently a naruqqum terminated after the death of an influential head of family. The second mechanism to extend duration was ease of renewal.

206 See Bainbridge (2002), 11.

For example, the *compagnia* usually had an initial duration of only two to five years but many were renewed for decades.

(3) Transferability of interests/shares

As seen above in connection with the Dutch and English joint stock companies, transferability of shares helps ensure continuation of business despite withdrawals and deaths of the shareholders, thereby enhancing liquidity of shareholders’ interests and facilitating diversified investments. Fully transferable shares characterize the modern corporation. Transferable shares do not necessarily mean freely tradable shares. Transferability may be restricted. But free transferability maximizes liquidity and the potential for diversification. For these reasons, all jurisdictions in the United States provide for free transferability for at least one class of corporation.208

The Assyrian *naruqqum*, the Roman *societas publicanorum*, the medieval Italian *compagnia* and the Chinese lineage trust had varying degrees of transferability and actual tradability of interests. Interests in the Assyrian *naruqqum* and the Roman *societas publicanorum* clearly were transferable. The extent of tradability is not clear, however. Interests in the medieval Italian *compagnia* clearly were not transferable at all. Interests in Qing lineage trusts were transferable but the extent of tradability is not clear.

5. Societies without longer-term business organizations with legal personality

Hunter/gatherers, ancient Egypt, classical Athens and the early Islamic world did not develop longer-term business organizations with legal personality like the Assyrian *naruqqum*, the Roman *societas publicanorum*, the medieval Italian *compagnia* and *accomandita* and the Qing *tang* or lineage trust.209

Economic conditions explain their absence in hunter/gatherer societies and ancient Egypt, albeit different economic conditions. The literature is silent on the existence of longer-term business organizations (with or without legal personality) in hunter/gatherer societies. The most plausible explanation is a lack of demand for organizations to raise capital or share

208 Kraakman et al. (2009), 11-12.

209 The situation in medieval southern India is less clear.
risk in the relatively simpler economic world of hunter/gatherers. The absence of literacy would have made such organizations difficult to design and operate. In ancient Egypt the Pharaonic state dominated long-distance trade and food production leaving little room for private merchants outside local retail markets and perhaps domestic trade along the Nile. The Pharaonic state provided the necessary capital and took the necessary risks, particularly those incurred with long-distance trade. And as in other societies, retail commerce in ancient Egypt was too small in scale to generate a demand for longer-term business organizations to raise capital and share risk.

The absence of longer-term business organizations with legal personality beyond partnerships in classical Athens has less obvious explanations. The absence is probably best explained by economic conditions and cultural preference for small family business. Scholars debate the reasons why the Athenian failed to develop “corporations.” The debate would be better focused on the reasons why the Athenians accepted partnership forms to engage in commerce and trade but failed to develop business organizations like the naruqqum, the Roman societas publicanorum, the medieval Italian compagnia and accomandita or the Qing tang or lineage trust.

Economic conditions have been offered for the absence of large and non-family Athenian businesses which would have been candidates for structuring as longer-term business organizations. The reasoning is that longer-term business organizations beyond partnerships were not needed because the scale of Greek economic activity was limited given the size of each polis, i.e. capital requirements and risk sharing were within the capacity of a single Athenian family or household. There is one important economic sector, however, in which this does not appear to have been the case --- silver mining. Athenian silver mining was fragmented into small units owned by separate households even though economies of scale suggest a need for capital pooling and risk sharing beyond the capacity of single

211 For a fuller discussion, see Section I above.
households. As discussed in section I, a strong social or cultural preference for small family business may explain fragmentation in silver mining despite the apparent economic benefits of larger organizations that combined capital from different households. Foxhall asserts that the idea of a corporation was alien to the Greeks given the deeply rooted alternative social institution of the oikos or household; under this view the Greeks were too “inward looking” toward the household to form corporations. But the four other pre-industrial societies that developed longer-term business organizations — Assur, Rome, medieval Italy and Qing China — also had the deeply rooted alternative social institution of the family. “Inwardness” of outlook appears an unconvincing explanation for Athenian exceptionalism, at least without a further comparative analysis of these other societies.

Legal doctrine also has been offered as an explanation for the absence of longer-term business organizations in Athens, notably lack of limited liability and inadequate general state enforcement mechanisms. Legal infirmities do not strike this observer as important factors in the failure to develop longer-term business organizations with legal personality in classical Athens. Limited liability was not a necessary condition for the success of other pre-industrial business organizations like the naruqqum and compagnia. And there was sufficient state enforcement of commercial agreements in Athens, at least in specially created fora.

In contrast to Athens, legal doctrine (and underlying political and social considerations) are the best explanation for the absence of business organizations beyond partnerships in the early (and indeed later) Islamic world. There was extensive commerce and trade in the early Islamic world over a territory far larger than the Assyrian trading area, the late Roman Republic, medieval Europe and even Qing China. Why didn’t this commerce and trade generate development of longer-term business organizations to supplement the two partnerships of mudaraba and inan? By the 11th century the Islamic mudaraba and inan partnerships were comparable in sophistication to business organizations in Europe at the time, if indeed they were not more sophisticated. Islamic

212 See Foxhall (2007), 47. See also Engen (2010), 47.

213 See Chapter Four.

214 See Chapter Two.
business organizations of the 11th century remained in place until supplemented in the 19th and 20th centuries with modern forms.

The one longer-term Islamic legal institution — the *waqf* or charitable trust — was poorly suited for profit-oriented activity and was never adapted to serve as a business organization. An individual created a *waqf* by contributing immovable property (perhaps after conversion from money or other wealth) to a *waqf* in perpetuity for any legitimate purpose, including construction and maintenance of public fountains, assistance to travelers and caravanserai, and support for wedding outfits to impoverished brides. The *waqf*‘s originally stated purpose was irrevocable and not even its founder could change it.\(^{215}\) The restricted use of *waqf* assets hindered pooling of capital and adaptation to changing economic conditions. *Qadis*, who supervised *waqfs* and received compensation, resisted modifications of the *waqf* to make it suitable for commercial activities, perhaps out of fear of going beyond the creator’s intent.

The two most likely explanations for the absence of longer-term business organization in the Islamic world are lack of economic demand and legal doctrine. Were there too few economic activities in the early Islamic world with the capital and risk sharing needs to generate demand for longer-term business organizations? The absence of large capital needs in Rome (outside of public contracting) arguably helps explain a lack of Roman demand for a general purpose *societas publicanorum*, although political considerations probably predominated, as suggested above. In a similar vein, some scholars question the size of capital needs in the early Islamic world. Perhaps capital needs in the early Islamic world could be met within families.

But economic conditions alone probably do not alone explain the failure of the early Islamic world to develop business organizations like the *naruqqum*, the *societas publicanorum* or the *compagnia*. A more persuasive explanation rests on Islamic legal doctrine. Islamic law limited legal personality to human individuals.\(^{216}\) This doctrinal limitation did not result

\(^{215}\) This prevented multiple *waqfs* or the pooling of resources to achieve economies of scale.

from a failure of legal imagination. Islamic jurists rejected institutional legal personality despite their knowledge of Roman law which accepted the *societas publicanorum* as a legal person. Legal personality can also be found in Persian law, with which Muslim jurists were familiar. Nor was an inherent Islamic legal inflexibility responsible. As discussed in Chapter Four, Islamic law was sufficiently flexible with the potential to adapt to changing economic and other conditions.

The narrow Islamic view of legal personality paralleled if not rested on a political or cultural reluctance to recognize institutions separate from individuals. Unlike in India and Europe, no permanent status was accorded municipalities and social groups. The *waqf* illustrates the Islamic resistance to legal personality for non-humans. The *waqf* was not viewed as a legal entity but as the withdrawal from circulation of the substance (‘*ayn*) of a property owned by the founder and the spending of the proceeds (*manfa'a*) for a charitable purpose; there was no unanimous view as to who became owner of the ‘*ayn*. The Islamic refusal to accord legal personality to non-human bodies might have resulted from an initial concern about tribal factionalism. On this reasoning, community building was critical to Islam’s rapid diffusion with a need to weaken kinship ties and reduce intertribal violence. Very interestingly, perhaps the modern economics-based view of the corporation as a “nexus of contracts” rather than as a “legal person” would have been more acceptable to early Islamic jurists.

In sum, political and social factors were important for the development (and non-development) of longer-term business organizations in pre-industrial. Societies with politically powerful merchants and traders like Assur and the medieval Italian cities developed the *naruqqum*, the *compagnia* and the *accomandita*. The politically


218 Ibid. A Zoroastrian temple could hold property and make loans as an organization.


221 Using game theory and other economics tools, Greif argues that medieval European individualistic cultural beliefs and a move towards weak kin-based organizations were the catalysts
decentralized and merchant-friendly United Provinces led the development of the joint stock company. The Roman Empire for political reasons ultimately failed to develop a full purpose longer-term business organization like the *societas publicanorum*. And as we have just seen, political or cultural considerations probably underlay Islamic law’s rejection of longer-term business organization with legal personality.

D. Forms of Organization to Partition Assets

Families and individual in pre-industrial societies, like today, partitioned their assets for several reasons. Partition can facilitate management and sale of separate businesses. Partition can facilitate intestate and testamentary dispositions. For example, the Athenian *ergasterion* often was divided into discrete business sub-units that could be transferred by sale, gift, dowry or inheritance.\(^{222}\) Another reason for asset partitioning is protection against creditors which is the main focus of our discussion. This gets us into the arcane subject of entity shielding and owner shielding or limited liability. Entity shielding protects the firm assets from personal creditors of the shareholders or partners.\(^{223}\) Limited liability insulates the shareholders or partners in the firm from firm creditors.

1. Entity shielding

Entity shielding is defined more precisely as legal rules that protect a firm’s assets from the personal creditors of the owners or shareholders.\(^{224}\) There are three types: weak entity shielding (firm creditors have priority over owner creditors re firm assets), strong entity shielding (firm creditors have priority over owner creditors re owner assets), and perfect entity shielding (firm creditors have priority over all creditors of the firm).

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\(^{222}\) See Foxhall (2007), 42, 44–45; Engen (2010), 42–48 and 52–54. This inter-generational liquidity contrasts with the asserted deficiency of later Islamic law inheritance law.

\(^{223}\) Hansmann et al. (2006) argue that entity shielding is logically prior to owner shielding. Others disagree. See generally Kraakman et al. (2009). The historical evidence is mixed in the sense that we find examples of firms with entity shielding and no limited liability, limited liability and no entity shielding, both and neither.

\(^{224}\) This summary is taken from Hansmann et al. (2006), 1337-1340, which is the seminal work on asset partitioning and entity shielding.
shielding (adds liquidation protections) and complete entity shielding (denies any claims of non-firm creditors against firm assets).

Entity shielding has many benefits, including reduced creditor monitoring, lower managerial agency costs and protection of going-concern value. The costs and risks of entity shielding include debtor opportunism, higher bankruptcy costs and exploitation by control persons. Many factors can influence the level of entity shielding, including availability of alternative structures for financing businesses, the prevalence of capital intensive enterprise, capital markets and cultural norms like landowner and aristocratic attitudes toward trade.

The concept of entity shielding is not limited to common law systems. Civil law refers to the “separate patrimony” of the corporation, i.e. a pool of assets distinct from other assets held by the firm’s owners. The corporation’s rights of ownership over its “separate patrimony” include the rights to use the assets, sell them and make them available for attachment by its creditors. Conversely, because these assets are conceived as belonging to the firm rather than the firm’s owners, they are unavailable for attachment by the personal creditors of the firm’s owners.

Firms lacking entity shielding with numerous shareholders are largely unknown in modern times. Modern publicly traded corporations with numerous shareholders require entity shielding to prevent unacceptable costs of monitoring the credit behavior of all these shareholders. Entity shielding was not as important in the pre-industrial world for two reasons: 1) there were far fewer partners or interest holders; and 2) family or kin ties provided trust and information not available in modern corporations with their multitudes of unrelated shareholders.

Pre-industrial single project partnerships and contractual joint ventures lacked entity shielding, with the exception of the medieval commenda discussed below. Neither the Mesopotamian tapputum nor the two principal Islamic partnerships — the mudaraba and the inan — had entity shielding. The Roman contractual joint venture — the societas — also lacked entity shielding and was a poor instrument for asset partitioning. The alternative of

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a narrowly defined *peculium* with indirect entity shielding may have made it less important to provide the *societas* with entity shielding.\(^{226}\) The Roman *peculium* merits further discussion. The *peculium* served several functions in addition to partitioning assets; it facilitated use of talented slaves\(^{227}\) and partially screened the *paterfamilias’s* business activities from peers and the public. The *paterfamilias* could partition his assets by placing each of various businesses in a separate *peculium*. Generally the *familia* or the *paterfamilias* was a robust debtor and recourse to the assets of a *peculium* would not have been necessary. Nonetheless, the *peculium* enjoyed no formal entity shielding. Personal creditors of the *paterfamilias* could claim against the assets of the *peculium*, probably equal in priority to claims of the *peculium* creditors. Contemporary sources apparently do not discuss the reasons why the Romans rejected formal entity shielding for the *peculium*. Entity shielding may have been rejected to guard against the risk that a wealthy Roman *paterfamilias* would stuff his personal assets into the businesses of his sons and slaves to the detriment of his creditors.\(^{228}\) Moreover, the ordinary entity shielding benefit of reducing creditor monitoring costs would not have obtained given the single owner *paterfamilias*. The prospective creditor of a *peculium* business needed to evaluate only the creditworthiness of one individual to establish appropriate credit terms.\(^{229}\) However, the *peculium* enjoyed partial de facto entity shielding: limited liability in one *peculium* business (see below) prevented the creditors of that business from levying upon assets committed to other *peculia* of the same *paterfamilias*.\(^{230}\) De facto entity shielding may have been significant given that Romans conducted a large part of their business via *peculium* arrangements.\(^{231}\)

\(^{226}\) Pryor (1983), 135.

\(^{227}\) See Hansmann at al. (2006), 1368.

\(^{228}\) With entity shielding the *paterfamilias* may have been more tempted to assign personal assets to the *peculium* and to encourage his slaves or sons to borrow further against those assets and invest in speculative ventures whose success would have benefited the *paterfamilias* and whose failure would have cost his personal creditors. Hansmann et al. (2006), 1362.

\(^{229}\) See ibid., 1360.

\(^{230}\) Ibid.

\(^{231}\) Ibid. The usefulness of de facto entity shielding enjoyed by *peculium* creditors was reinforced by Roman law’s further partitioning of a *peculium* for liability purposes if a slave used it to manage
The exception to the generalization that pre-industrial single project partnerships lacked entity shielding was the medieval *commenda* whose assets were protected from creditor claims of the passive investor (*commendator*).\(^{232}\) According to Hansmann et al., the *commenda*’s principal assets were “unusually easy to partition from those of the firms’ owners, and thus could be constructed as strong contracting entities without excessive concern for investor opportunism toward either their personal or their business creditors.”\(^{233}\) Under the *commenda* neither the partners nor their creditors had opportunity to withdraw assets from the firm to the detriment of the interests of the firm’s creditors or of the other partner.

Entity shielding in longer-term business organizations roughly correlates with the number of investors/partners and the trust relationship among them. The Assyrian *naruqqum* with relatively few partners and strong family ties probably lacked entity shielding. The Roman *societas publicanorum* with its apparently larger number of investors enjoyed strong entity shielding. The Roman *peculium* with its single owner *paterfamilias* enjoyed partial de facto entity shielding. The medieval Italian *compagnia* with investors numbering in the dozens and strong family ties had weak entity shielding (*compagnia* creditors had priority over partner creditors). The Qing *tang* or lineage trust is the exception with numerous investors but no entity shielding (creditors of the lineage members could claim against trust assets). Qing cultural reverence for family and reliance on trust may explain the lack of entity shielding.

Whether the Assyrian *naruqqum* had entity shielding is not entirely clear. There is no evidence in the Kanesh archives that the *naruqqum* had entity shielding.\(^{234}\) The number of

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\(^{232}\) Hansmann et al. (2006, pp. 1358-1359) explain this exception in terms of the special situation of the firm assets residing in the returning ship’s hull which reduced the costs of liquidation protection.

\(^{233}\) Hansmann et al. (2006), 1372-1373.

\(^{234}\) Aubet (2013), 339ff.
partners or investors ranged as high as 10 to 20. Most of these partners or investors were well known or related to each other. The *naruqum* remained largely family firms “based principally on trust and friendship.” This suggests that entity shielding was not critical and certainly its apparent absence did not raise an insuperable barrier to risk sharing and the pooling of large amounts of capital by Assyrian merchants.

The Roman *societas publicanorum* enjoyed strong entity shielding at least with respect to passive investors. Tradability of shares reinforced the need for entity shielding. Tradability is difficult to sustain without strong entity shielding, while tradability in turn provides the liquidity that strong entity shielding would otherwise deny to the firm’s shareholders. As mentioned above, however, recent scholarship challenges the conventional view of significant tradability in the shares of the *societas publicanorum*.

The medieval Italian *compagnia* had weak entity shielding (*compagnia* creditors had priority over partner creditors). As Italian businesses grew larger, the number of partners increased and extended to non-family members. By the late 13th century, many partners were “unrelated.” In the second half of the 13th century, there were *compagnie* that had as many as 20 partners and one *compagnia* had 37 partners. The choice of weak entity shielding over the strong entity shielding of the *societas publicanorum* can be explained by the fact that the *compagnia* had a more manageable number of partners than its Roman predecessor that had hundreds of unrelated investors.

237 The far less used medieval Italian *accomandita* lacked entity shielding, perhaps because of its temporary duration.
240 See Goldthwaite (2009), 68.
241 *Compagnia* membership was capped at forty partners. Goldthwaite (2009), 68.
medieval Italian compagnia had several benefits. It lowered creditor monitoring costs, lowered agency costs by reducing the risk to compagnia partners that an agent would excessively borrow and lessened administrative costs of bankruptcy. Accounting innovations improved asset valuation and partitioning. The post-1350 hub and spoke system further facilitated asset partitioning. Separate compagnie were used to protect secondary investors interested only in specific activities or locations. After the Italian bank bankruptcies of the mid-14th century, investors became more risk averse as seen earlier.

Unlike the societas publicanorum and the compagnia, the Qing tang or lineage trust almost certainly had no entity shielding, i.e. creditors of the lineage members could claim against the tang assets. The majority of tang had from six to twenty partners, but some had have as few as two partners and as many as several dozen investors, including not only individuals but partnerships and other lineage trusts. Trust among related kin and investors may help explain the lack of entity shielding. The Qing worked to forge and maintain strong personal bonds between unrelated members. Another possible reason for

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242 Hansmann et al. (2006, p. 1369) argue that location-based entity shielding was presumably an adaptation to the highly fragmented political jurisdictions and the resulting obstacles to effective administration of bankruptcy law. A speedier procedure whereby all of a bankrupt firm’s creditors with claims arising locally could immediately seek satisfaction out of the firm’s local assets was preferable to establishing a bankruptcy process that sought to assemble all of a firm’s business assets wherever held, and all debts wherever owed, and then divide the assets ratably among the creditors.

243 Goldthwaite (2009), 77. The veil of a compagnia was sometimes pierced by courts. Entity shielding was not always recognized between branches of a firm operating in different locations. See Hansmann et al. (2006), 1371 n.111. For example, an action was successfully brought against a compagnia in Naples that was 95 percent owned by a Medici compagnia in Rome and 5 percent by its Neapolitan manager. Courts treated the two compagnie as one, for purposes of a lawsuit brought by the holder of a bill of exchange drawn in Rome and payable in Naples. Ibid., 1369.


the absence of entity shielding might be the emphasis on family and lineage which may have created cultural obstacles to strong partitioning of assets.

2. Limited Liability (Owner Shielding)

Shareholders in the modern corporation enjoy limited liability which protects their personal assets from contractual (but not necessarily tort) claims of the corporation’s creditors. Unlike entity shielding, limited liability often can be achieved via contract by requiring firm agents to obtain the agreement of firm creditors who agree to waive their right to levy on owners’ personal assets. A common method puts “limited” or “inc” in the firm’s name.

a. Partnerships

Generally there was no limited liability in pre-industrial partnerships, with the medieval Italian commenda again the notable exception. There was no limited liability in the Mesopotamian tapputum, the Athenian koinonia,246 the Roman societas, the two principal Islamic partnerships (mudaraba and inan) and partnerships in early Qing China.

As to the medieval Italian commenda, the commendator or passive investor had only limited liability, as seen earlier in the chapter. One of the great achievements of the commenda was creating a clear regime of limited liability which protected the passive party. The single voyage nature of the commenda probably could not have operated without some type of limited liability for the investing party. Repeated transactions would have likely been necessary for an investor to be willing to take on more liability.

b. Longer-term business organizations

Pre-industrial longer-term business organizations present a mixed picture with respect to limited liability. Only the Roman societas publicanorum clearly provided limited liability where investors could provide capital and acquire shares (partes) without becoming liable for the firm’s obligations. The Roman peculium indirectly provided some limited liability. Liability of the paterfamilias for the conduct of managers of a peculium was highly

important given the widespread use of slaves and children who held little to no property of their own. The *paterfamilias* could limit his liability in several ways. If he remained at arms’ length from the operation of the *peculium* business, he generally was liable to third parties only for obligations up to the amount of the *peculium*.\textsuperscript{247} He could further reduce liability by narrowly defining the business to be conducted under a *peculium* in the terms of appointment (*praepositio*). A pyramid structure with tiers of slaves between the *paterfamilias* and the business could provide further protection from third party liability.

The question whether the Assyrian *naruqqum* had limited liability is not easily answered. Commentators seem to presume the absence of limited liability with little discussion. But limited liability may have been available through contract if the parties agreed.

As discussed above, the Italian *compagnia* lacked limited liability which would have generally been unworkable because “[t]he fluid and fungible nature of these firms’ assets made those assets a weak basis for firm credit.”\textsuperscript{248} Creditors of the *compagnia* could claim against the assets of partners, with exceptions for family real estate, certain personal possessions and dowries.\textsuperscript{249} Unlimited liability affected how a *compagnia* raised capital. The *compagnia* was not conducive to raising funds from longer-term outside investors.\textsuperscript{250} In contrast, passive investors in the *accomandita* enjoyed limited liability. As discussed earlier in the chapter, the Medici Bank protected itself from the conduct of untried local managers by creating an *accomandita* in which the Bank enjoyed limited liability as a passive investor.

Qing lineage trusts probably lacked limited liability. The Qing Code and sub-statutes failed to distinguish between personal and business debt. Zelin concludes that limited liability was not based on contract after failing to find a single provision for limited liability

\textsuperscript{247} However, the *paterfamilias* was fully liable to third parties for acts done in the course of business by a ship captain (*actio exercitoria*) and by managing agents (*actio institoria*).

\textsuperscript{248} Hansmann et al. (2006), 1374.

\textsuperscript{249} See ibid., 1366 n.92.

\textsuperscript{250} Goldthwaite (2009), 67.
among 131 contracts.\textsuperscript{251} Unlimited liability prompted Qing lineage trusts to control and monitor entry and withdrawal; for example, they required members to first offer their interests to fellow members.\textsuperscript{252} The absence of limited liability became more of a problem with industrialization and more capital intensive industries in the 19\textsuperscript{th} century.\textsuperscript{253}

### III. ACCOUNTING, CREDIT AND FINANCIAL INSTITUTIONS

Accounting, credit and financial institutions have been highly important in the history of commerce and law. In two periods --- Mesopotamia and medieval Italy --- innovations if not revolutions in bookkeeping, credit and financial institutions significantly contributed to an explosion of commerce, trade and economic growth. They merit brief mention here even though strictly speaking they are not business organizations.

The importance of credit for commerce and trade cannot be exaggerated. As Lopez declared: “Unstinting credit was the great lubricant of the [European] Commercial Revolution.”\textsuperscript{254} The same might be said of the Mesopotamian commercial revolution several millennia earlier. Availability of credit was critical at every level of the Mesopotamian economy, from peasants and artisans to the largest landowners.\textsuperscript{255} Credit sales in the Anatolian trade were not uncommon.\textsuperscript{256} Palaces, temples, merchants and landowners all

\textsuperscript{251} See Zelin (2009), 628-629.

\textsuperscript{252} Zelin (2005), 55.

\textsuperscript{253} See Zelin, “A Critique of Rights of Property in Prewar China” (2004), 32-33 (capital intensive industries which necessitated larger numbers of partners and trusts as members which in turn made it difficult to sort out liabilities of the firm, as distinct from liabilities of investors, who themselves were not individuals).

\textsuperscript{254} Lopez (1971), 72.


\textsuperscript{256} For example, goods were consigned on credit to a \textit{tamkarum} for resale in distant parts of the country. The \textit{tamkarum} signed an acknowledgment of the amount of the debt (usually expressed in silver) and the repayment terms. Generally, there was a 30 percent penalty for non-payment. See Aubet (2013), 336-338.
participated in lending and payment services. Most loans were for personal emergencies but many were business loans. Loans could be sold and transferred, thereby further increasing liquidity. Indeed, the first known financial instruments in history are Mesopotamian loan agreements, recorded at Uruk on clay balls dating from around 2800. Forms of negotiable instruments appeared in the second millennium. There even is evidence of commodity clearinghouses futures contracts, derivatives and perhaps a forward market in wine.

Substantive rules governing creditor rights and credit mechanisms were highly refined, both as a matter of customary law and contract practice. Contractual provisions commonly imposed joint liability on multiple debtors. Other credit mechanisms included guarantees, pledges and authorization of creditors to borrow the value of the loan from a third party like a banker or moneylender. This last mechanism was used by creditors to

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259 See Roberts (2011), 23.
260 Ibid. These were tokens shaped like lambs, loaves of bread, honey jars and other promised goods, encased in clay balls. Some tokens represent units of work. Marks on the balls probably represent adjustments made after the initial loan.
262 See Swan (1993), 11-12.
263 Ibid., 3.
266 Ibid., 148-149. Where the contract was silent on joint liability, it may have been implicitly found in disputes. In other cases debtors were held to a proportionate share of the debt. See Ibid., 150.
267 See Ibid., 108 and 120.
268 See Ibid., 133ff.
269 See Ibid., 152-153: the creditor would state: “if the debtor does not pay back (if his term has elapsed), I will enter a merchant’s house and I will take silver at interest (at his expense).” The creditor could indemnify himself by taking out a loan for the amount owed to him with a banker or moneylender, of course ultimately at the expense of the debtor.
collect small debts without resort to legal action when the borrower was late in paying. For example, Assyrian merchants used authorizations when the silver caravan from Anatolia was late in arriving at Assur.

An important difference remains between Mesopotamian credit institutions and modern institutions. Modern systems tend to see the debtor as an individual, isolating him from his family and heirs. The Mesopotamian debtor was typically seen in the role of household head, whose subordinate members (wife and children) were part of the debtor’s creditworthiness. The debts of Anatolian married couples regularly included the wife as co-debtor who was jointly liable with the husband.

Literacy and the subsequent revolution in recordkeeping and accounting contributed to the Mesopotamian commercial revolution. Cuneiform writing on clay tablets recorded commodity flows that allowed for the expression and communication of nuances of time, location, personnel and administrative action. This facilitated forward planning. Writing also significantly facilitated legal developments, notably with respect to contracts and dispute resolution. For example, model contracts based on actual transactions were used in scribal schools to train future scribes. This required knowledge of the elements of common contract forms and their proper phraseology.

In medieval Europe, led by the Italian cities, two related developments significantly contributed to commercial expansion: 1) innovations in accounting techniques like double entry bookkeeping that greatly facilitated asset partitioning and business operations, as seen above; and 2) negotiability of credit and financial instruments like promissory notes and bills of exchange. Payments could be made not simply to a particular individual or entity like

\[\text{\textsuperscript{270}}\text{See Westbrook, “Conclusions,” in Westbrook & Jasnow (2001), 337.}\]
\[\text{\textsuperscript{271}}\text{Veenhof (2001), 150.}\]
\[\text{\textsuperscript{272}}\text{Algaze (2008), 138.}\]
\[\text{\textsuperscript{273}}\text{See Bodine (2014), iii, 5-6 and 178-179.}\]
\[\text{\textsuperscript{274}}\text{See Goldthwaite (2009), 3-10; Hunt & Murray (1999), 2. Unlike modern accounting techniques, Italian accounting techniques were used more to record specific credit and debit relations rather than for analysis of total incomes, profits, cash flows and overall performance of investments.}\]
a seller but could be made to the “payee or his order.” Promissory notes could be made to the payee or “bearer.” Good faith purchasers of negotiable financial instruments could enforce payment. Neither the concept nor the practice of negotiability is found under Roman or early Islamic law.275

The Mesopotamians and medieval Italians, as well as the Qing Chinese, recognized the importance of writing and documentation in the enforcement of agreements and commercial dispute resolution. All deliberately created business records as potential evidence should a dispute arise. Contracts were registered with notaries or local officials. This contrasts with the early Islamic law preference for oral authentication of transactions and the absence of public notaries or registration of contracts.276

Credit and financial institutions were important in other pre-industrial societies, despite skeptical claims to the contrary, particularly about Greece and Rome. Greek banking began with money changing in the major ports to handle coins from almost 100 polities.277 Expert at keeping their own cash secure, money changers began safeguarding valuables for others, like traders away on long voyages. This evolved into demand deposits and then into loans risking both the banker’s own assets and customers’ deposits. Thirty Athenian bankers of the 4th century have been identified by name. This compares with 80 in medieval Florence.278 Scholars differ on the robustness of Greek credit and financial institutions. Some classicists like Finley see a relatively primitive financial system with little credit available and sales made without credit: no credit payments, no negotiable paper, no book clearances and no bankers;279 in such a credit-starved environment, money lending was concentrated


275 Berman (1983), 351.

276 See Lydon (2009), 649.

277 See Roberts (2011), 72.

278 Roberts (2011), 75.

279 Finley (1983), 73: “Not thirty Athenians are known from the whole of the fourth century who are specifically identified as bankers, a reflection of the rarity of the occupation, not of a defect in the available sources.”

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on small usurious loans to peasants and consumers, as well as large loans “to meet the political or other conventional expenditures of the upper classes.”\(^{280}\) Other scholars see a more robust financial system with considerable credit available: trapezitai (bankers) accepted deposits and made loans by the late fifth century;\(^{281}\) credit was important for the import and export trade, if not for retail trade at the agora.\(^{282}\)

How robust were Roman financial and credit institutions? Again, scholars differ. One view is that bankers and banks existed but they did not play an important role as a source of business capital. According to Goldsmith,\(^{283}\) the only entities resembling financial institutions were money changers (numularii), moneylenders (feneratorii), bankers (argentarii or trapezitai) and tax farmers (societates publicanorum). Deposits were small and loans were made mostly for consumption or political expenditures. There was only a narrow range of financial instruments: mortgage loans on agricultural land, consumer loans to the poor or to upper-class borrowers living beyond their means or needing funds for political expenditures, and debts of tenants to landlords. Other scholars paint a very different picture of a sophisticated Roman financial world providing a wide range of services, including money changing, deposit accounts, mandated payments, transfers between accounts, credit for auctions, loans to clients and third parties, guarantees for contracts and legal appearances and tax payments.\(^{284}\) Financial markets in different regions of the Roman Empire were linked, most likely through financial intermediaries. Wealthy Romans like Cicero both borrowed and loaned money. Roman law was developed to meet the demands of credit and other financial transactions.\(^{285}\)

IV. CONCLUSIONS

\(^{280}\) Ibid., 186. See also Casson (1984), 26-27.

\(^{281}\) See Goldsmith (1987), 27.

\(^{282}\) Ibid., 29.

\(^{283}\) See Goldsmith (1987), 42-47.

\(^{284}\) See Temin (2013), 178-189.

\(^{285}\) See Andreau, “Banking, Money-lending and Financial Life in Rome.”
Family and personal relationships among participants in pre-industrial businesses were critically important even when longer-term business organizations with “legal personality” were formed that included non-family investors. A shift from personal relations to impersonal relations better differentiates pre-industrial societies from modern societies than a shift from family to individuals.

All pre-industrial societies, including those with a cultural preference for family business or a negative attitude toward commerce and merchants, developed legal business organizations that included non-family members, notably partnerships to raise capital and share risks for short-term projects like sea voyages or long-distance land voyages. Four pre-industrial societies developed legal organizations with legal personality to pool capital and share risk that went beyond partnerships for a single project: the Assyrian naruqqum, the Roman societas publicanorum and peculium, the medieval Italian compagnia and accomandita and the Chinese tang or lineage trust. To varying degrees, these business organizations, except for the Roman peculium, had some of the attributes of the modern close corporation, notably legal personality, transferable shares and separation of management and ownership.

History is too messy for grand narratives of linear historical progression of business organization forms from their non-existence to primitive forms to the modern corporation. Business organizations are better understood as responses to economic and social/cultural conditions in a particular society. Early second millennium Assur in northern Mesopotamia developed the naruqqum which enjoyed many attributes of the modern corporation because it met a demand for business organization in the lucrative long-distance trade; moreover, no political or social considerations prevented development of the naruqqum in the merchant oligarchy of Assur.

Culture and politics count. Economics alone does not explain historical developments. The political and cultural dimensions to the development of legal business organizations were highly important. Societies with politically powerful merchants like Assur, the medieval Italian cities and the politically decentralized and merchant-friendly United Provinces (later the Netherlands) developed longer-term business organizations with legal personality when economic conditions demanded. Politics and culture may have
had the contrary effect on development of business organizations in the early Islamic world. Political or cultural considerations probably underlay Islamic law’s rejection of longer-term business organization with legal personality. The reasons why the Roman Empire failed to develop a general purpose longer-term business organization are unclear. Lack of an economic demand may be the explanation, as Hansmann et al suggest. But politics may also have played a part.

The development of business organization forms in pre-industrial societies confirms that generally law responds to commerce. It will come as no surprise to lawyers that there is a two-way relationship between legal business organizations on the one hand and commerce and trade on the other hand. But commerce generally comes first in the mutual relationship. Demand for legally recognized business organization forms to pool capital and share risks generally preceded the legal rules and institutions. The historical evidence of demand preceding business organization is seen most clearly in Rome and the medieval Italian cities. The historical evidence is less robust in other societies where apparently there are either fewer surviving documents that shed light on demands for business organization or the primary sources have not been examined by scholars with this focus in mind. The conclusion that business organization laws generally followed commerce is based more on inference and correlation than direct historical evidence of the chronology. Where there was a demand for non-family investors, it was met by the creation of legal business organization like the Assyrian *naruqqum*, the Roman *societas publicanorum*, and the medieval Italian *compagnia*. Where the state dominated commerce and trade as in ancient Egypt, and the Pharaoh and temples provided the needed capital and took the risks, there was no demand for those kinds of business organizations which in turns the absence of surviving evidence of such organizations.

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286 This differs from the situation respecting commercial dispute resolution and contract enforcement where the direct evidence of merchant or trading community demand for speedy and impartial commercial dispute resolution is considerable. See Chapter Four.
Chapter Five: Business Organizations: Families, Partnerships and Companies


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