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Governance in the East Indian Company

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Introduction

What can business history teach us about the future of businesses? Our case study is the VOC (Vereenigde Oostindische Compagnie, the Dutch East India Company), one of the world's major players in the international food market of the 17th and 18th centuries. Can the experiences of the VOC teach lessons that today's food production networks may take to heart?

There are three domains in which changes might have occurred since the times of the VOC that could be relevant to this question. These are the people themselves, the rules of the game that can be captured by the term governance, and context factors. The article will investigate all three. As far as the people are concerned it will look at factors such as worker conditions, attitudes, and culture in general. In the area of governance the paper will consider contract enforcement and coercion constraining. Context factors to consider are costs of transport and availability of capital.

The method used in this article is desk research using a number of historical sources. The theories used are from NIE (New Institutional Economics) and from cultural psychology.

A bit of history

Before 1400

International trade had been conducted by China, India, the Middle East, African kingdoms and European powers since many centuries, e.g. by the Chinese, Indians, Greeks, Arabs, and Vikings. But seafaring was still rather hazardous and limited to smaller seas or occasional expeditions. The Portuguese changed this state of affairs.

15th century

Since 1430 the Portuguese acquired shipbuilding and navigation technology that enabled them to start exploring the Atlantic and to rediscover parts of the world that until then had only been known to Europeans from myths. Soon the Spanish were also sailing the World's oceans. In 1494, Spain and Portugal signed the Treaty of Tordesillas by which they divided the world's seas among them. Spain got the West, Portugal the East. The conquest of the New World from 1492 on caused 90% of the indigenous population of that continent to die of Old World diseases. This effect did not occur in the East, with which contacts over land had existed.

16th century

From 1502 on, the Portuguese were masters of the Indian Ocean. The blockbuster here was the spice trade. Pepper, cinnamon and nutmeg were important. These products were valuable in relation to their weight, could not be grown elsewhere and were not very perishable, all of which made them fit for trade at a time when transport was slow, risky and costly. However, the inela-

stic demand combined with fluctuating supply made for hugely fluctuating prices.

During the 16th century, England and Holland gradually gained in force. The Hanseatic league with its trade across the Baltic area was important for North-West Europe. An uprising against the Spanish king Philip II (known as the 80 years' war, 1568-1648) gave rise to the foundation of the Republic of Seven United Netherlands in 1581. William of Orange, a nobleman who led the uprising, was killed by a mercenary in 1584. This did not prevent the Dutch from gaining the upper hand against Spain. Maurits van Nassau innovated warfare so that the Spanish could be beaten on land. On sea the Dutch also gained momentum. With Baltic wood and using licensed English technology (Hugill 1993, p. 115) the Netherlands were able to improve their ship-building skills considerably during this period.

During the 16th century, many Dutch traders were operating on an individual basis in the lucrative spice trade. When Philips II of Spain sacked Antwerp in 1585 the financial centre moved to Amsterdam, helping finance this trade.

1600-1650

The existence of a prominent common enemy at sea drove the Dutch traders into collaboration. In 1602 the VOC was founded as a way to not only improve price stability and profit, but above all to gain military superiority at sea over the Spanish and Portuguese, who were united at the time. This worked perfectly. Overwhelmingly, it turns out that the VOC have become powerful in the East Indies because of their use of force.

Here it becomes necessary to introduce some theoretical concepts that pertain to types of enforcement. The work of Greif (in Ménard & Shirley 2005) can help here. Greif posits that two types of institutions are needed to support markets. The first are *contract enforcement institutions*. They support the buyer in ensuring faithful delivery. They include policing, checking, and quality control. The second are *coercion constraining institutions*. These support both parties against the powers that be. They involve systems of checks and balances between political powers such as states, and economical powers such as companies. Greif (Ménard & Shirley 2005, p. 728): "The ability to effectively supply designed – private- or public-order – contract-enforcement institutions, depends on the prevailing coercion-constraining institutions, which are those that influence decisions regarding the acquisition and use of coercive power".

In VOC times, the Dutch state and the VOC were effectively the same institution and there was no higher-order legal authority. Internally in the Netherlands, the State's power had been balanced by the representative body called the States General, founded in 1463 by Philip the Good. The States General enacted laws and voted on taxation. This system gave traders a lot of power and the means to prevent rulers from excessively appropriating gains. So internally there was a good coercion-constraining mechanism. The same was by no means true of the international environment. The Dutch were at war with their main rivals, i.e. other European powers. In consequence the VOC felt legitimized to use coercive force. They forced all competitors into submission as well as their main trade partners. So their dealings with competitors and suppliers were based on hierarchy backed by naked force.

At the personal level too, there was a great readiness to engage in adventure and in violence. Life expectancy for lower classes was short in those days. Life was a gamble to begin with, and so the considerable risk of a trip to the East Indies did not loom large in potential sailors' minds. The possibilities of deadly illness or lethal acts of war were facts of life. The religious rhetoric of the time made war and adventure easier by promising afterlife and by justifying fighting against those of a different denomination, e.g. the Spaniards. It would seem that part of the secret lay in choosing which set of values to apply to which set of people: e.g. the Spanish and Portuguese were enemies who tried to occupy the low countries, so they were allowable military targets.

1650-1700

In its first decades the VOC had achieved military superiority over the Spanish and Portuguese. This, however, raised the hostile interest of the English. In the second half of the 17th century, three successive wars weakened the Dutch in relation to the English. Although militarily the first of these wars (1652-1654) was inconclusive, the English took 1000 merchant ships from the Dutch. At this time the English also passed a series of Navigation Acts that prohibited non-English ships from delivering goods to English ports. These two facts together tilted the economic balance in favour of England. To make matters worse for the Dutch, they were involved in a war with France from 1672-1678, during which event the European banking centre moved from Amsterdam to London. After this the power of the Netherlands was much diminished.

18th century

While France and England continued to dispute European hegemony until 1815, the Netherlands stuck to trade, but without the advantages of the 17th century. The VOC operated with diminishing success until 1799 when it went bankrupt and the state took it over.

New Institutional Economics and trade

Institutions

New Institutional Economics (NIE) are an attempt to expand from neoclassical economics with its unrealistic postulates of perfect markets and *Homo economicus* to a rhetoric that takes into account the facts that markets do have to be regulated by internal institutions and that human beings are not just driven by utility optimization in an economic sense. NIE has been taking shape over the last decades since the pioneering work of Ronald Coase (1937) and later by authors such as Oliver Williamson (1985) and Douglass North (1991).

Ménard and Shirley (2005) point to a current frontier of NIE (p.10): “A gap in the literature emerges from the failure of many empirical studies of transaction costs and the firm adequately to account for the effects of the broader institutional environments, even though regulation or norms may be as important determinants of the choice of governance structure as asset specificity or uncertainty.” This remark invites to explicitly include social norms into our frame of reference.

Douglass C. North (1991) addresses the issue of international trade. The remainder of this section follows his train of thought. Countries, he says, are differentially endowed with land, physical and human capital. So the costs of production and transaction will vary across the world, and provided there is also a demand, trade becomes advantageous.

According to North, the big problem of trade is always: how to enforce deals? Insecurity leads to high transaction costs for protection or enforcement. One could use state, law, police, agency or force. Here we see that issues of trust come to the fore. The same issues that are central to NIE present themselves to traders as trust-related issues. For instance, in North's words historically a problem with authorities has been that many have behaved more like the Mafia than like impartial facilitators of trade.

If the security of transactions cannot be guaranteed then a trader incurs costs, e.g. for military protection, unpredictable taxes, or bribery. For the development of international trade to become possible, innovations were required to lower these transaction costs. The means were threefold: economies of scale, technology, and institutional innovation. The aims, or cost margins at which these innovations occurred, were also threefold: increasing mobility of capital, lowering costs of informing, and spreading risk on investment.

These concepts from North will assist in explaining the VOC's history. But they do not say much about the role of the state. The work of Greif (2005) can help here.

Social norms

These authors still leave the *social norms* side uncovered. Fortunately incidental mention is made of social norms in historical sources. We shall now review some of these in roughly chronological order.

1600-1650

First, why did the Spanish and Portuguese lose to the Dutch in the early 17th century? It would seem that Iberian trade was more oriented towards the needs of rulers, and hence it focused on bullion (gold and silver) instead of commerce (Emmer & Gaastra 1996 p. xvi). This tended to maintain a centralized economy. In the Netherlands and England, on the other hand, entrepreneurs enjoyed considerable freedom that was facilitated by the state. This reinforced the creation of a strong, rich middle class. When this well-educated, independent class united to form the VOC, with state support and military force, the Iberians were no match. The Dutch did not just spend their money but invested it, and they did so with utmost efficiency. They outsourced fighting to state-supported trader / pirates ('kapers' such as Piet Hein, who could be traders or warriors as circumstances required. The Iberians were 'fat cats' while the Dutch were 'lean and mean' as contemporary jargon has it. Egalitarian society had beaten hierarchical society.

1650-1700

Secondly, what made the Dutch initially outperform the English so markedly in the first half of the 17th century? The English were better armed, but that was not it: the two powers were not at war with one another. The Dutch simply spent their money better. They were very creative in making money through institutional innovation in the three areas mentioned by North:

1. Economies of scale

The creation of the VOC meant that a great number of competitors had turned into allies. Together they could e.g. fund a concerted effort to fight the Spanish – Portuguese at sea, as well as paying for a settlement in Batavia (today's Jakarta) that acted as a hub with its own considerable working capital with which to secure assets. So here, collaboration beat competition.

2. Technological innovation

The Dutch developed a very efficient shipbuilding industry. By 1636, 2500 Dutch ships were in operation, while the English had only 180 ships in 1629. Moreover, the Dutch 'Fluyt' ship was easy to build, needed few crew members to operate, and could hold 20 ton of load per crew member against 7 for English ships. Why did the English, who were aware of this (Barbour 1996), not copy the Dutch? Nicolaes Witsen published a treatise on shipping in 1671 in which he remarks "It is surprising that foreigners, though they may have studied economical building in the dockyards of this country, can never practise it in their own land. (...) And this in my opinion proceeds from the fact that they are then working in an alien environment and with alien artisans. From which it follows that even if a foreigner had all the building rules in his head, they would not serve him, unless he had learned everything here in this country by experience, and still that would not help him, unless he should find a way to inculcate in his workmen the thrifty and neat disposition of the Hollander, which is impossible." Incidentally the Dutch carpenters were also better paid than their foreign counterparts. This humane attitude to worker conditions no doubt helped in making them devoted craftsmen.

3. Institutional innovation

The VOC remunerated its commercial heads of expedition ('bewindhebbers') by provision. This gave them an interest in turnover, not dividend (Steensgaard 1996). This effectively created a class of managers. Other innovations of the time included partial ownership of ships – one could even

own only 1/16 of a ship – as pseudo-insurance schemes against wreckage. This was necessary, because the average ship lived less than 10 years due to accidents, and the average sailor has a chance of 2 in 3 of not returning home.

Another innovation involved credit. The Dutch protestants had a trust-based system of cheap money lending that favoured investment. The *Bank van Lening* was specialized in low tariffs for poor customers (Schama 1987). This might seem poor business logic, but it was in accordance with the teachings of John Calvin (1509-1564) whose reformation had by that time inspired public opinion in the Netherlands. Calvinism provided, as Schama proposes, a moral defence against tooth-and-claw capitalism. At the same time it enabled a broad distribution of riches, meaning that profiting from the new opportunities became accessible to many.

So in this half-century, traders had beaten fighters. And very clearly, social norms were involved regarding

- placing trade above warfare
- delegation of power (e.g. by the Dutch state to the VOC, by the VOC to Batavia)
- valuing thrift (also literally by paying for good workmanship of carpenters)
- high trust (leading to large-scale collaboration and to cheap capital).
-

1650-1700

The Dutch hegemony lasted only for fifty years. How did the English gain the upper hand? This is basically straightforward: by a combination of military force and protectionism. In the history section above these elements are already outlined. So in this era, fighters beat traders.

Role of culture

The historical succession of powers begs the question whether cultural differences between Portugal / Spain, the Netherlands and England played a role. Culture embodies the history of a people and that it is very long-lived, so that relative differences between the cultures of different societies tend to remain the same (Hofstede & Hofstede 2005). European societies have not been fully destroyed and rebuilt in the last four centuries, so it is plausible that the values found now are related to the values back then. The United Kingdom is today's extension of England, which was its centre of power.

'Values' are to be understood here as largely unconscious tendencies, not as conscious opinions. Hofstede & Hofstede define five dimensions of cultural variety as 'broad tendencies to think and act in certain ways'. Thus, in a culture with a different orientation on one of these dimensions, the same event might be perceived differently and lead to a different response. Two of these dimensions can most readily inform VOC history. They clearly relate to the division of power in society ('power distance') and to the use of force as a way of achieving aims ('masculinity'). Power distance is the degree to which subordinate people accept that power is unevenly distributed in a society. In a society of large power distance, centralization of economic and social life is popular while in a society of small power distance, more people feel that they are masters of their own destinies. In the 17th century, many countries were governed by royal families. But in the North of Europe, class boundaries were more permeable, the middle classes were more numerous, and power was more contested, than in the South. This is consistent with contemporaneous differences in power distance as shown in figure 1.

Masculinity is the degree to which aggression is deemed a suitable way of solving disagreements. In a masculine society, force is seen as necessary to curb bad behaviour, while in a fe-

minine society, violence is seen as leading to unwanted retaliation. In the former, the right of the strong holds, while in the latter the weak and needy are respected. Both societal attitudes work as self-fulfilling prophecies by rewarding behaviours that are consistent with their basic values. Masculine cultures tend to be found in countries that thrive on warfare and expansion while feminine cultures are found in countries that thrive on trade. Hofstede & Hofstede come up with recent country scores on these dimensions for the countries in this article (figure 1):

| | Power distance | Masculinity |
|----------------|----------------|-------------|
| United Kingdom | 35 | 66 |
| Netherlands | 38 | 14 |
| Portugal | 63 | 31 |
| Spain | 57 | 42 |

Figure 1. country scores for Power Distance and Masculinity for some countries (from Hofstede & Hofstede, 2005). Scales are from 0 to 100. The scores are for 1970 with later confirmations.

As it turns out, these recent data are fully in line with the historical events described above. Differences in power distance explain the first shift of power: Spain – Portugal lost out to adversaries who were more decentralized, middle-class oriented, and flexible. Differences in masculinity explain the subsequent shifts: The Netherlands initially beat England by being better at cost saving and trading, but later it lost out to them by being less good at power play.

But are there no huge institutional differences between the time of the state companies and today's world where public and private sector are separate? Yes, there are. One might say that at the time there were no checks and balances between states, or in Greif's terms, no coercion constraining power. Yet the rhetoric of national leaders today is often hardly better, and naked self-interest of states often still dominates international trade negotiations, and is even thought to inspire warfare. Still, there is a difference: at the time this kind of behaviour was deemed perfectly normal. The idea of a universal moral circle that included all human beings is contested today, but it had not yet been invented at a time when the world was still bigger than people's imagination could conceive of.

So although states are there today to provide both contract-enforcing and coercion-constraining power between companies, states still suffer from coercion among themselves and this carries over into uncertainties and sometimes distrust in trade relations.

Culture vs social norms

One might also wonder how, if culture has not evolved that much, some of the inhumane aspects of trade in the VOC times were justified. For instance, the Dutch have been active in the slave trade, and they have suppressed local peoples in the East Indies by military means. For understanding this it makes sense to distinguish cultural values from social norms. The former are unconscious while the latter are often hotly debated. A practice such as slavery or colonial warfare belongs to the realm of social norms, not culture. Culture will influence public perception of such a practice. But historically it seems that societies have a way of finding justifications for action that follow their interests.

So the sequence can be thus summarized: cultural elements together with a host of contextual factors – such as the state of the art of naval and military technology – were prime drivers of historical development, as we have seen. In order to justify the inhumane parts of colonial trade, Europeans had to invent a rhetoric that defined the locals – i.e. non-Europeans – as backward. Such a rhetoric would then lead to social acceptance of practices that would not have been ac-

cepted without it. A blatant version of this process occurred in justifying the slave trade. Van der Horst (2006, p. 238) discusses early VOC times. He remarks “Racism did not exist at this time. It only developed later when the Europeans realized that military superiority alone did not justify the subjugation of other races and began to believe that they were also morally and intellectually superior.”

This quote shows that when existing cultural values and new practices are not in line, they can be made so by moral interpretations. Examples of how moral explanations are routinely provided to explain incidents that we would today interpret as fortuitous are provided by Schama, e.g. when he quotes Bontekoe. In 1646, at the height of Dutch prosperity, Willem Ysbrantsz Bontekoe published his ship journal. His ship, the *Nieuw Hoorn*, was controlled not by a captain but by a VOC *bewindhebber* – a commercial man. Schama (1987, p. 31-32): “When Bontekoe watches the *Nieuw Hoorn* sink from his splintered spar, his explanation is properly homiletic, dwelling on the set relationship between greed, sin and disaster: <<Oh God, how is this fine ship undone, yea, even as Sodom and Gomorrah.>>”.

Issues surrounding culture and norms are still pertinent today. International food provision networks cross boundaries of cultures and of norms, and this is a fertile ground for the invention of self-serving rhetoric by partners engaged in this trade. Both between companies and between countries, trust-related issues are omnipresent. Without first leaving a position that claims that one’s own group is morally and intellectually superior, no resolution of trade conflicts is possible.

Open questions

Several issues deserve a better, more extensive treatment that could not be granted within the confines of this paper. Here they are.

- Power has shifted downstream since the time of powerful trading companies such as the VOC. Are today’s global retailers such as AHOLD the modern equivalent of state companies such as the VOC?
- Retailers are in a privileged position because they have almost exclusive access to consumer markets. How could they gain this position? It has made a difference that none of today’s trading companies have the kind of exclusive access to products that the VOC had. Large tropical fruits companies such as Dole and Chiquita come closest.
- What was the role of public opinion? The public in the European countries was not indifferent to inhumane practices. The first time a slave ship entered the port of Vlissingen, the local population immediately set all the slaves free. But most of the slave trade happened out of sight of public opinion.
- What were the relationships with East Indian producers? Culture clash has played a role here. The Dutch and the English complained that Indonesian natives were dishonest. This is a kind of claim typically levelled by somebody from an individualistic, egalitarian society to people from group-oriented, hierarchical societies who are just trying to be courteous. A cross-cultural analysis of trade relationships in the colonies could shed more light on this issue.

Conclusion

This article has looked at changes in three areas since the times of the VOC in the 17th century. Since VOC times it seems that *people*, and their cultural differences between the various countries and world regions involved have remained remarkably similar. *Context factors* have changed dramatically, with the cost of transport being an obvious example. New transport possibilities have been the prime enabler of the VOC. *Institutions* have changed a lot too, in particular coercion constraining institutions. Antagonistic arrangements have lost out to international collaboration, though there is still a long way to go. Creating good institutional environments that make it more profitable for traders to collaborate than to fight has been the key to improvement. This lesson is still valid for today's international food trade, both at the level of worldwide trade and at the level of one particular chain.

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