Transition to a permanent capital: EIC stockholding and stock trading, 1660-1679

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The English East India Company (EIC) is widely considered a progenitor of the modern business corporation, in part because in the middle-17th century it acquired 'permanent capital', or property rights over its share capital, allowing it to continue in perpetuity.[1] But it was not obvious in 1657 that the EIC would acquire permanent capital. Before 1657 the EIC operated by share capitals with pre-determined expiry dates – 'terminable stocks' – to be liquidated at the end of their run and followed by a fresh capital. This arrangement mitigated shareholders' exposure to directorial malfeasance and the risks inherent in the long-distance trade. This short paper is derived from a monograph seeking to explain this transition.

It was important that the shareholders most committed to the EIC as a going concern – typically the wealthy City of London merchant elite, also typically directors – consolidate power in the General Court. In the General Court all shareholders could participate in company governance. In the General Court, the shareholders elected the leadership and decided on such crucial matters as whether to liquidate the stock. A controlling interest by those most committed to a permanent capital insulated the EIC from a liquidation vote. It also allowed the Court of Committees – the board of directors ('Committees from hereon) – to relax protocols for approving share transfers. Doing so lowered the transaction costs of share trading, thereby making selling, rather than withdrawal or liquidating, a more attractive means of exiting the EIC.

It will be helpful first to review the current understanding of the transition. 'Permanent capital' is part of a bundle of corporate institutions that make up 'strong entity shielding'.[2] Strong entity shielding is the inverse of limited liability, protecting the firm's assets from its owners' liabilities. For weak entity shielding, it is only necessary that the firm's creditors a have a claim to the firm's assets ahead of its owners. The firm's owners, however, can still make claims on the firm's assets. For strong entity shielding, a firm must also have capital lock-in, which prevents investors from withdrawing Company assets,

[1] Ron Harris, *Going the Distance: Eurasian Trade and the Rise of the Business Corporation, 1400-1700*, The Princeton Economic History of the Western World (Princeton: Princeton University Press, 2020)

[2] Henry Hansmann and Reinier Kraakman, 'The Essential Role of Organizational Law', *The Yale Law Journal* 110, no. 3 (2000): 387–440, https://doi.org/10.2307/797521.

including their invested capital, at any point.[3] Capital lock-in is a necessary condition for permanent capital. With entity status and capital lock-in, the firm has property rights over its share capital and can keep its capital in perpetuity. In other words, it has permanent capital.

Historians and corporate theorists study the first corporations – the 17th-century EIC and Dutch East India Company (VOC) – to discern to what extent the modern business corporation is a creature of law versus private coordination. Corporate theory provides two deductive arguments to this question. One I call the 'legalistic' argument, from Hansmann and Kraakman (2000). The legalistic argument asserts that 'special rules' in organisational law, rather than innovative contracting, are necessary for capital lock-in and permanent capital.[4] Special rules are necessary because of the high cost of monitoring every owner's contracts with their personal creditors. The firm might prevent its owners from withdrawing assets from the firm, but that owner would have to include a waiver to liquidate firm assets with his or her personal creditor. It would be infeasible for the firm to monitor those contracts.

The other I call the 'governance-focused' argument, from Blair (2003).[5] This argument contends that once a firm is incorporated, capital lock-in and permanent capital can be coordinated within the corporate government. In addition to a corporate government, incorporation provides entity status, to which owners can concede their rights on the firm's assets, whilst keeping rights to the residuals from those assets. The 'legalistic' argument allows only for *de jure* permanent capital; the 'governance-focused' argument allows for *de facto* permanent capital.

The latest work on the EIC's transition uses the deductive reasoning of the 'legalistic' argument to form its hypotheses.[6] It asserts that the EIC 'was granted permanent capital' by Oliver Cromwell's charter in 1657.[7] The VOC had its capital locked in by the Estates General in 1612.[8] It is therefore not unreasonable to think the EIC had its capital locked in in

[3] Giuseppe Dari-Mattiacci, 'Capital Lock-in, Liquidity, and the Separation of Ownership and Control', SSRN Scholarly Paper (Rochester, NY, 28 August 2019), https://doi.org/10.2139/ssrn.3452250.
[4] Henry Hansmann, Reinier Kraakman, and Richard Squire, 'Law and the Rise of the Firm', *Harvard Law Review* 119, no. 5 (2006): 1333–1403.
[5] Margaret M. Blair, 'Locking in Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century', *UCLA Law Review* 51, no. 2 (2004 2003): 387–456.
[6] Dari-Mattiacci et al., 'The Emergence of the Corporate Form'
[7] Dari-Mattiacci et al., 'The Emergence of the Corporate Form', 219.
[8] Oscar Gelderblom, Abe de Jong, and Joost Jonker, 'The Formative Years of the Modern Corporation: The Dutch East India Company VOC, 1602-1623', *The Journal of Economic History* 73, no. 4 (2013): 1050–76.

similar fashion, and several other EIC historians have been vague at best about whether the charter did in fact recast the EIC as a permanent capital.[9]

Unfortunately, Cromwell's charter no longer exists. There is however considerable evidence suggesting the charter did not grant the EIC permanent capital with capital lock-in. For instance, there is no mention of capital lock-in in Charles II's 1661 charter, purportedly a close copy of Cromwell's.[10] Even more to the point, the preamble – the private contract between the EIC and its investors stipulating the terms of investment, such as investor's rights – included a withdrawal clause. At the end of the first seven years, in 1664 the investors were to receive a valuation of the stock and to have the opportunity to withdraw their capital.[11] In the lead up to the December 1664 withdrawal window, EIC directors discussed what to do in the event of a mass withdrawal.[12] Since this clause is inconsistent with *de jure* capital lock-in, the transition question should be considered differently.

Indeed, other evidence suggests the 'governance-focused' argument is more appropriate for how the EIC capital was locked in. After the 1664 withdrawal window, in March 1665 the EIC adopted a new preamble. An original copy of this preamble has now been lost, though fortunately not before the early 20th century. Sainsbury includes a summary of the new preamble's main points in a footnote. The new preamble likely removed the right of investors to withdraw, while at the same time increased the power of members in the General Court to change the structure of the EIC's government. There is no mention of withdrawal in Sainsbury's summary, though there is mention of producing valuations of the stock for the shareholders every seven years.[13] Notably, so far as the *Court Minutes* show, the Committees never again discussed the possibility of investors withdrawing, not in the lead up to the 1671 and 1678 valuations, nor at any other time.[14] Meanwhile, the 1665 preamble did include a proviso allowing for any shareholder with £500 of stock or more to bring a vote on any issue to the General Court, including, possibly, the repeal of lock in.

[9] Hunter, *A History of British India*; Lawson, *The East India Company: A History*.

[10] John Shaw, *Charters Relating to the East India Company from 1600 to 1761* (Madras: Government Press, 1887), 32–46, https://archive.org/details/dli.csl.7770/page/n49/mode/2up.

[11] Ethel Bruce Sainsbury, *A Calendar of the Court Minutes Etc. of the East India Company, 1655-1659*, vol. 5, A Calendar of Court Minutes Etc. of the East India Company, 1635-1679 (Oxford: The Clarendon Press, 1916), 173–75.

[12] Ethel Bruce Sainsbury, *A Calendar of the Court Minutes Etc. of the East India Company, 1664-1667* (Oxford: The Clarendon Press, 1925), 90.

[13] Sainsbury, 133.

[14] Ethel Bruce Sainsbury, *A Calendar of the Court Minutes Etc. of the East India Company, 1671-1673* (Oxford: The Clarendon Press, 1932); Ethel Bruce Sainsbury, *A Calendar of the Court Minutes Etc. of the East India Company, 1677-1679* (Oxford: The Clarendon Press, 1938).

If the March 1665 preamble did in fact lock in the share capital, as I believe, then it also allowed the EIC to overcome the costs of monitoring the credit contracts of its individual shareholders. The EIC did not have freely tradable shares. Rather, the directors scrutinised each proposed transfer, including the identities of those involved, and then gave or withheld approval. Share transfers between current shareholders, all of whom had signed the March 1665 preamble, were relatively easy to approve. Yet given the EIC did not have *de jure* capital lock-in, if share trading was to expand well beyond current EIC shareholders, there needed to be a way for the 1665 preamble to apply to all who came to own EIC stock. In September 1668 this was accomplished. The Committees decreed that from then on, all prospective shareholders were to swear an oath to abide by the March 1665 preamble to possess the share.[15]

The March 1665 preamble locked in the share capital, creating the conditions for the EIC to have a permanent capital in a technical sense. In a practical sense, it was nevertheless necessary for those most committed to the stock to consolidate power in the General Court, for a vote in the General Court could remove capital lock-in or force liquidation. Early in its history, each shareholder was given one vote. This changed. The New General Stock (NGS) – the stock founded in 1657 – gave one vote for every £500 of stock held by a shareholder. Thus to understand the structure of power in the General Court is to understand the distribution of stock ownership and how it changed over time.

I have reconstructed EIC stockholding for the years 1657, 1661, 1666, 1671, 1672, 1673, and 1674 using the EIC's stock journal and general ledgers, both available in the British Library. For 1657, I recorded all payments made on subscriptions into the NGS. For the remaining years, I arrived at the structure of stockholding by calculating backwards from records of dividend payments. For example, if the EIC paid out £10 for a 10% dividend, then that shareholder was recorded as having a holding of £100. To determine how much of the total stock was recovered by this method, I divided the total stock recovered by the paid-in value of the share capital, £369,895.25. For all years but 1666, I was able to recover within 2% of the total paid-in capital. In 1666, I recovered 90% of the total paid-in capital.

[15] Ethel Bruce Sainsbury, *A Calendar of the Court Minutes Etc. of the East India Company, 1668-1670* (Oxford: The Clarendon Press, 1929), 93.

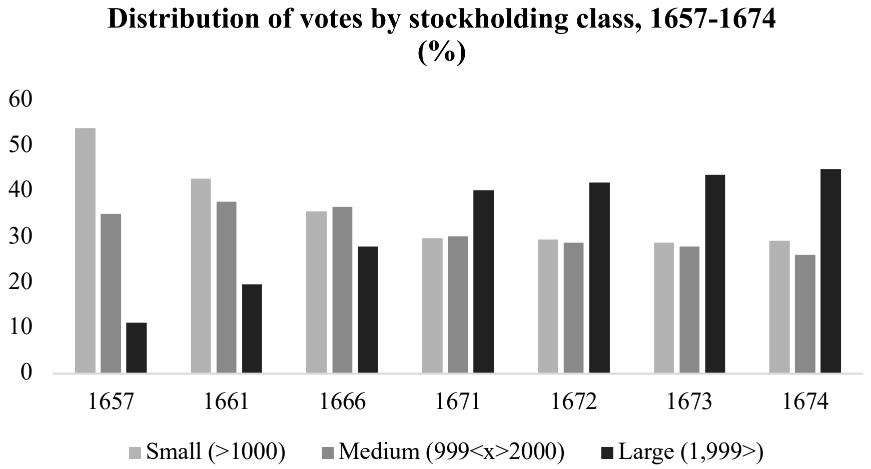


Figure 1: IOR/L/AG/1/1/1-6, 10.

Berle gives two definitions of 'corporate control', absolute and relative.[16] Under conditions of absolute control, a coterie of shareholders owns a majority of the votes in the corporate government. Under conditions of relative control, a small coterie owns a near-majority of votes while the rest are scattered amongst many. Since every £500 of stock translated to one vote, the structure of stockholding can be used to determine the structure of vote holding. In 1657 the stock was held predominantly by smallholding stockholders, evenly distributing the votes. By 1671, around 40% of votes were held by individuals with stockholdings of £1,999 or more (figure 1). That group was quite small, about thirty-eight shareholders, while the lion's share of vote holding shareholders had one or two votes (table 1). It seems quite plausible to say that relative control had been established by 1671.

[16] Adolf A. Jr. Berle, 'Control in Corporate Law', *Columbia Law Review* 58, no. 8 (1958): 1212–25.

Structure of EIC stockholding, no. of stockholders*

No. of stockholders	*1657*	*1661*	*1666*	*1671*	*1672*	*1673*	*1674*
<99	102	44	25	25	22	21	23
100–499	456	364	268	245	244	249	248
500	132	108	100	97	94	86	88
501–999	96	84	66	70	69	65	65
1,000	22	31	32	27	24	23	21
1,001–1,499	27	26	22	29	26	27	23
1,500	7	6	8	9	9	7	7
1,501-1,999	13	16	17	10	11	12	12
2,000	4	6	8	5	5	7	8
>2,001	8	14	19	33	33	32	32

Table 1: IOR/L/AG/1/1/1-6, 10.

The years between 1666 and 1671 are of some interest. In 1668 the EIC acquired its first sovereign colony, Bombay, in southwest India. Charles II had been given the colony by the Portuguese, and he gave it to the EIC. The new colony required fixed, rather than circulating, capital for civic and military infrastructure. In 1678 the EIC reported it had £60,000 worth of fixed capital in Bombay.[17] Fixed capital required a longer time horizon for the EIC's investment strategy. Maintaining the NGS as a perpetually going concern was thus increasingly important.

Likewise, as the time horizon of the EIC's investment strategy pushed further into the future, share trading became even more important. Fixed capital investment required the EIC to forgo giving dividends but added to the value of EIC shares.[18] Share trading also provided an important means of exiting the stock. But because the EIC's longevity was vulnerable to insurgent votes in the General Court, the laxity of share transfer approvals depended on the degree of control over the General Court. Only a few instances in which the Committees blocked a transfer were recorded, though it is notable that the Committees did block some transfers. Perhaps the most impactful way the Committees exerted control over share trading was by requiring their approval of share transfers at all. Once control was consolidated, approval protocols could be relaxed.

[17] Sainsbury, *A Calendar of the Court Minutes Etc. of the East India Company, 1677-1679*, 339.

[18] Chaudhuri, K.N., *The Trading World of Asia and the English East India Company, 1660-1760* (London: Cambridge University Press, 1978), 417.

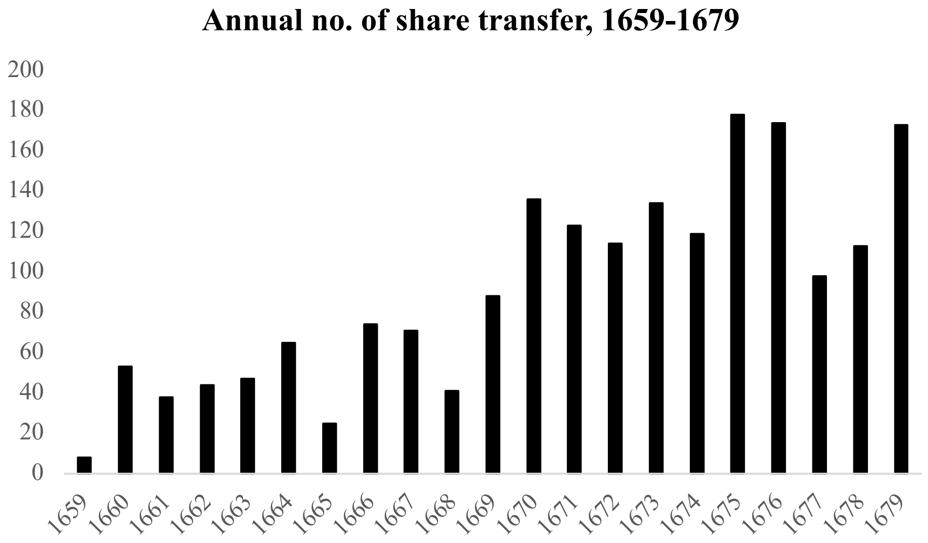


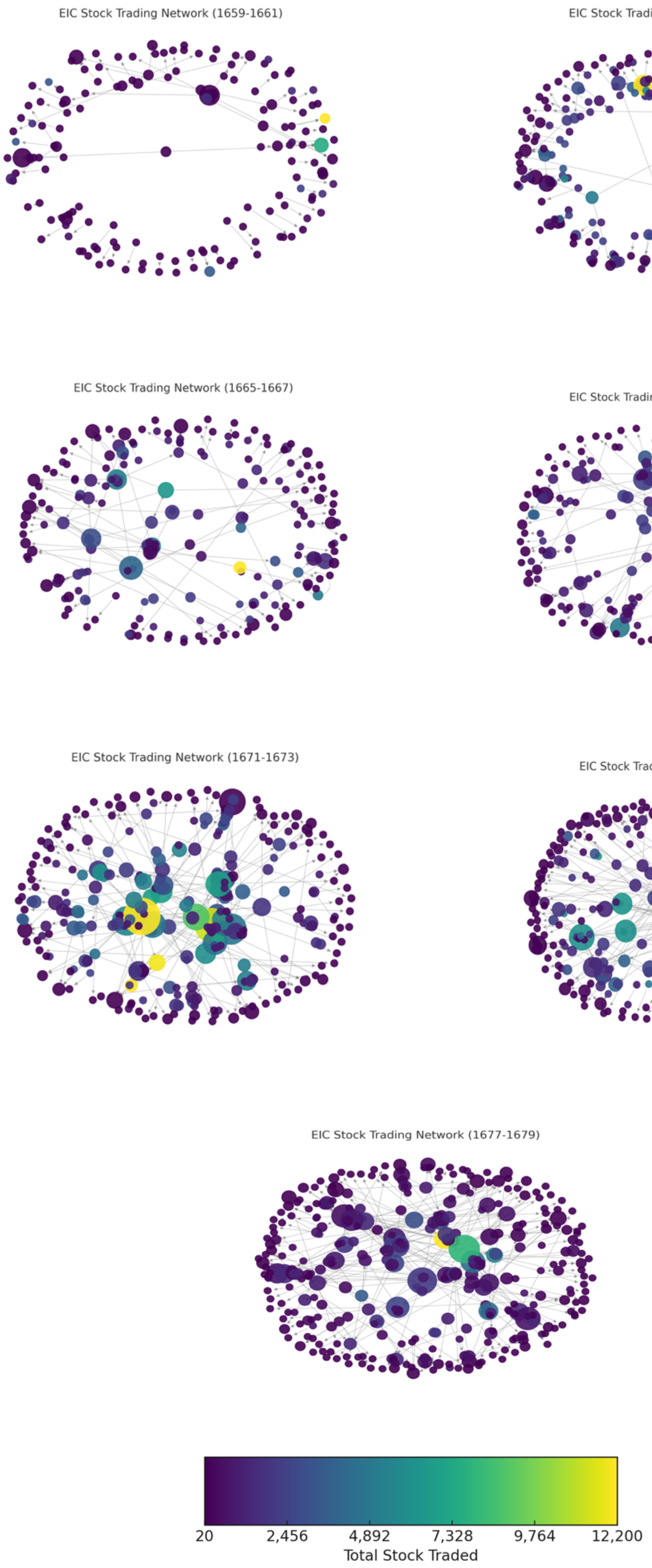
Figure 2: Sainsbury, *A Calendar of the Court Minutes etc. of the East India Company, 1635-1679*. Oxford: Clarendon Press. 1907-1938.

Sainsbury recorded share transfers in the back pages of the *Calendars of Court Minutes*. Between 1657 and 1679, 1,941 transfers were made, between 1,173 individuals, amounting to a total of £1,469,426.97 stock transferred. Figure 2 shows the annual number of share transfers per year. I do not mean to suggest causation, but it is notable that the periods of greatest increase roughly corresponded with the consolidation of power in the General Court and with changes to share transfer approval protocols. In 1668 stock ownership was made contingent on an oath to abide by the March 1665 preamble. In 1670 the annual number of transfers increased to a new steady level. In 1671, relative control had been established in the General Court, and the degree of that control persisted in the years following. In 1673, the Committees delegated share transfer approvals to the accountant.[19]

By adding time and uncertainty to the outcome of a transaction, the share transfer approval protocols imposed transaction costs on shares trading. Once relaxed, we should expect the market to work more efficiently. Further analysis will of course be necessary to establish causality. But, again, it is notable that the evidence suggests the market for EIC shares did improve as power was consolidated and approval protocols weakened. Figure 4 shows networks of EIC share trading between individuals in three-year increments. The size of the node represents the number of transfers that individual made. The colour corresponds with the total value of the stock transferred. After 1673, we see the emergence of market makers. For example, Lord George Berkeley, conducted twenty-two trades totalling £11,200

[19] Sainsbury, *A Calendar of the Court Minutes Etc. of the East India Company, 1671-1673*, 191.

in stock between 1671 and 1673. In 1671 he had £5,050 of stock, and in 1673 he had £2,300, meaning the total volume of stock he traded far exceeded his holdings.



EIC Stock Trading Network (1659-1661)

EIC Stock Trading Network (1662-1664)

EIC Stock Trading Network (1665-1667)

EIC Stock Trading Network (1668-1670)

EIC Stock Trading Network (1671-1673)

EIC Stock Trading Network (1674-1676)

EIC Stock Trading Network (1677-1679)

Figure 3: Sainsbury, *A Calendar of the Court Minutes etc. of the East India Company, 1635-1679*. Oxford: Clarendon Press. 1907-1938.

In sum, the EIC’s transition to a permanent capital rested on the consent of its General Court. Consent was ensured by a coterie of shareholders consolidating a controlling interest in the stock. Control insulated the stock from liquidation votes and allowed the EIC to relax its share transfer approval protocols. Doing so lessened transaction costs for share trading, facilitating an exit option for investors that did not require removing capital lock in.