

The East India Company: The Company that ruled the waves

As state-backed firms once again become forces in global business, we ask what they can learn from the greatest of them all

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A POPULAR parlour game among historians is debating when the modern world began. Was it when Johannes Gutenberg invented the printing press, in 1440? Or when Christopher Columbus discovered America, in 1492? Or when Martin Luther published his 95 theses, in 1517? All popular choices. But there is a strong case to be made for a less conventional answer: the modern world began on a freezing New Year's Eve, in 1600, when Elizabeth I granted a company of 218 merchants a monopoly of trade to the east of the Cape of Good Hope.

The East India Company foreshadowed the modern world in all sorts of striking ways. It was one of the first companies to offer limited liability to its shareholders. It laid the foundations of the British empire. It spawned Company Man. And—particularly relevant at the moment—it was the first state-backed company to make its mark on the world.

Twenty years ago, as the state abandoned the commanding heights of the economy in the name of privatisation and deregulation, it looked as if these public-private hybrids were doomed. Today they are flourishing in the emerging world's dynamic economies and striding out onto the global stage.

State-controlled companies account for 80% of the market capitalisation of the Chinese stockmarket, more than 60% of Russia's, and 35% of Brazil's. They make up 19 of the world's 100 biggest multinational companies and 28 of the top 100 among emerging markets. World-class state companies can be found in almost every industry. China Mobile serves 600m customers. Saudi Arabia's SABIC is one of the world's most profitable chemical companies. Emirates airlines is growing at 20% a year. Thirteen of the world's biggest oil companies are state-controlled. So is the world's biggest natural-gas company, Gazprom.

State-owned companies will continue to thrive. The emerging markets that they prosper in are expected to grow at 5.5% a year compared with the rich world's 1.6%, and the model is increasingly popular. The Chinese and Russian governments are leading a fashion for using the state's power to produce national champions in a growing range of "strategic" industries.

The parallels between the East India Company and today's state-owned firms are not exact, to be sure. The East India Company controlled a standing army of some 200,000 men, more than most European states. None of today's state-owned companies has yet gone this far, though the China National Offshore Oil Corporation (CNOOC) has employed former People's Liberation Army troops to protect oil wells in Sudan. The British government did not own shares in the Company (though prominent courtiers and politicians certainly did). Today's state-capitalist governments hold huge blocks of shares in their favourite companies.

Otherwise the similarities are striking. Both the Company and its modern descendants serve two masters, keeping one eye on their share price and the other on their political patrons. Many of today's state-owned companies are monopolies or quasi-monopolies: Brazil's Petrobras, China Mobile, China State Construction Engineering Corporation and Mexico's Federal Electricity Commission, to name but a few of the mongrel giants that bestride the business world these days. Many are enthusiastic globalisers, venturing abroad partly as moneymaking organisations and partly as quasi-official agents of their home governments. Many are keen not only on getting their government to provide them with soft loans and diplomatic muscle but also on building infrastructure—roads, hospitals and schools—in return for guaranteed access to raw materials. Although the East India Company flourished a very long time ago, in a very different world, its growth, longevity and demise have lessons for those who run today's state companies and debate their future, lessons about the benefits of linking a company's interests to a nation's and the dangers of doing so.

The gifts of government

One of the benefits the Company derived from its relations with the state was limited liability. Before the rise of state-backed companies, businesses had imposed unlimited liability on their investors. If things went wrong, creditors could come after them for everything they possessed, down to their cufflinks, and have them imprisoned if they failed to pay. Some firms had already been granted limited liability, and the Company's officers persuaded Queen Elizabeth that it should be given this handy status too.



Bridgeman

A second benefit of state backing was monopoly. In the 17th century, round-the-world voyages were rather like space missions today. They involved huge upfront costs and huge risks. Monopoly provided at least a modicum of security. The third benefit was military might. The Company's Dutch and Portuguese competitors could all call on the power of their respective navies. The English needed to do likewise in order to unlock investors' purses.

Still, getting into bed with the government was risky for the Company. It meant getting close to courtiers who wanted to extract revenue from it and exposing itself to politicians who wanted to rewrite its charter. The Whig revolutionaries who deposed James II in 1688 briefly promoted a competing outfit that the Company first fought and eventually absorbed. Rival merchants lobbied courtiers to undermine its monopoly. But for the most part it dealt with these political problems brilliantly. Indeed its most valuable skill—its “core competence” in the phrase beloved of management theorists—was less its ability to arrange long-distance voyages to India and beyond than its ability to manage the politicians back home.

The Company created a powerful East India lobby in Parliament, a caucus of MPs who had either directly or indirectly profited from its business and who constituted, in Edmund Burke's opinion, one of the most united and formidable forces in British politics. It also made regular gifts to the Court: “All who could help or hurt at Court,” wrote Lord Macaulay, “ministers, mistresses, priests, were kept in good humour by presents of shawls and silks, birds' nests and attar of roses, bibles of diamonds and bags of guineas.” It also made timely gifts to the Treasury whenever the state faced bankruptcy. In short, it acted as what George Dempster, a stockholder, called a “great money engine of state”.



The Company was just as adept at playing politics abroad. It distributed bribes liberally: the merchants offered to provide an English virgin for the Sultan of Achin's harem, for example, before James I intervened. And where it could not bribe it bullied, using soldiers paid for by Indian taxes to duff up recalcitrant rulers. Yet it recognised that its most powerful bargaining chip, both home and abroad, was its ability to provide temporarily embarrassed rulers with the money they needed to pay their bills. In an era when governments lacked the resources of the modern tax-and-spend state, the state-backed company was a backstop against bankruptcy. State-backed monopolies are apt to run to fat and lose their animal spirits. The Company was a model of economy and austerity that modern managers would do well to emulate. For the first 20 years of its life it operated out of the home of its governor, Sir Thomas Smythe. Even when it had become the world's greatest commercial operation it remained remarkably lean. It ruled millions of people from a tiny headquarters, staffed by 159 in 1785 and 241 in 1813. Its managers reiterated the importance of frugality, economy and simplicity with a metronomic frequency, and imposed periodic bouts of austerity: in 1816, for example, they turned Saturday from a half to a full working day and abolished the staff's annual turtle feast.

The Company's success in preserving its animal spirits owed more to necessity than to cunning. In a world in which letters could take two years to travel to and fro and in which the minions knew infinitely more about what was going on than did their masters, efforts at micromanagement were largely futile.

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The Company improvised a version of what Tom Peters, a management guru, has dubbed "tight-loose management". It forced its employees to post a large bond in case they went off the rails, and bombarded them with detailed instructions about things like the precise stiffness of packaging. But it also leavened control with freedom. Employees were allowed not only to choose how to fulfil their orders, but also to trade on their own account. This ensured that the Company was not one but two organisations: a hierarchy with its centre of gravity in London and a franchise of independent entrepreneurs with innumerable centres of gravity scattered across the east. Many Company men did extremely well out of this "tight-loose" arrangement, turning themselves into nabobs, as the new rich of the era were called, and scattering McMansions across rural England.

Money and meritocracy

The Company repaid the state not just in taxes and tariffs, but also in ideas. It was one of the 18th and 19th centuries' great innovators in the art of governing—more innovative by some way than the British government, not to mention its continental rivals, and outgunned only by the former colonies of America. The Company pioneered the art of government by writing and government by record, to paraphrase Burke. Its dispatches to and from India for the 15 years after 1814 fill 12,414 leather-bound volumes. It created Britain's largest cadre of civil servants, a term it invented. State-backed enterprises risk getting stuffed with powerful politicians' half-witted nephews. The Company not only avoided this but also, in an age when power and money were both largely inherited, it pioneered appointment by merit. It offered positions to all-comers on the basis of exam performance. It recruited some of the country's leading intellectuals, such as Edward Strachey, Thomas Love Peacock and both James and John Stuart Mill—the latter starting, at the age of 17, in the department that corresponded with the central administration in India, and rising, as his father had, to head it, on the eve of the Company's extinction.

The Company also established a feeder college—Haileybury—so that it could recruit bright schoolboys and train them to flourish in, and run, India. These high-minded civil servants both prolonged the Company's life when Victorian opinion was turning ever more strongly against it and also provided a model for the Indian and domestic civil service.

The Company liked to think of itself as having the best of both private and public worlds—the excitement and rewards of commercial life, on the one hand, and the dignity and security of an arm of the state on the other. But the best of both worlds can easily turn into the worst.

The perils of imperialisation

In the end, it was not rapacious politicians who killed the Company, but the greed and power of its managers and shareholders. In 1757 Sir Robert Clive won the battle of Plassey and delivered the government of Bengal to the Company. This produced a

guaranteed income from Bengal's taxpayers, but it also dragged the Company ever deeper into the business of government. The Company continued to flourish as a commercial enterprise in China and the Far East. But its overall character was increasingly determined by its administrative obligations in India. Revenue replaced commerce as the Company's first concern. Tax rolls replaced business ledgers. Arsenals replaced warehouses. C.N. Parkinson summarised how far it had strayed, by 1800, from its commercial purpose: "How was the East India Company controlled? By the government. What was its object? To collect taxes. How was its object attained? By means of a standing army. What were its employees? Soldiers, mostly; the rest, Civil Servants."



Sir Robert Clive with wife, daughter and local help

The Company's growing involvement in politics infuriated its mighty army of critics still further. How could it justify having a monopoly of trade as well as the right to tax the citizens of India? And how could a commercial organisation justify ruling 90m Indians, controlling 70m acres (243,000 square kilometres) of land, issuing its own coins, complete with the Company crest, and supporting an army of 200,000 men, all of which the East India Company did by 1800? Adam Smith denounced the Company as a bloodstained monopoly: "burdensome", "useless" and responsible for grotesque massacres in Bengal. Anti-Company opinion hardened further in 1770 when a famine wiped out a third of the population of Bengal, reducing local productivity, depressing the Company's business and eventually forcing it to go cap in hand to the British government to avoid bankruptcy.

The government subjected the Company to ever-tighter supervision, partly because it resented bailing it out, partly because it was troubled by the argument that a company had no business in running a continent. Supervision inexorably led to regulation and regulation to nationalisation (or imperialisation). In 1784 the government established a board to direct the Company's directors. In 1813 it removed its monopoly of trade with India. In 1833 it removed its monopoly of trade with China and banned it from trading in India entirely. In 1858, the year after the Indian mutiny vindicated the Company's critics, the government took over all administrative duties in India. The Company's headquarters in London, East India House, was demolished in 1862. It

paid its last dividend in 1873 and was finally put out of its misery in 1874. Thus an organisation that had been given life by the state was eventually extinguished by it.

A dangerous connection

Ever since its ignominious collapse the Company has been treated as an historical curiosity—an “anomaly without a parallel in the history of the world”, as one commentator put it in 1858, a push-me pull-you the like of which the world would never see again. But these days similarly strange creatures are popping up everywhere. The East India Company is being transformed from an historical curiosity into a highly relevant case study.

The Company’s history shows that liberals may be far too pessimistic (if that is the right word) about the ability of state monopolies to remain healthy. The Company lasted for far longer than most private companies precisely because it had two patrons to choose from—prospering from trade in good times and turning to the government for help in bad ones. It also showed that it is quite possible to rely on the government for support while at the same time remaining relatively lean and inventive.

But the Company’s history also shows that mercantilists may be far too optimistic about state companies’ ability to avoid being corrupted by politics. The merchants who ran the East India Company repeatedly emphasised that they had no intention of ruling India. They were men of business who only dabbled in politics out of necessity. Nevertheless, as rival state companies tried to muscle in on their business and local princelings turned out to be either incompetent or recalcitrant, they ended up taking huge swathes of the emerging world under their direct control, all in the name of commerce.

The Chinese state-owned companies that are causing such a stir everywhere from the Hong Kong Stock Exchange (where they account for some of the biggest recent flotations) to the dodgiest parts of Sudan (where they are some of the few business organisations brave enough to tread) are no different from their East Indian forebears. They say that they are only in business for the sake of business. They dismiss their political connections as a mere bagatelle. The history of the East India Company suggests that it won’t work out that way.