

THE EUROPEAN ORIGINS AND THE SPREAD OF THE CORPORATE BOARD OF DIRECTORS

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I. INTRODUCTION

Much of the study of comparative corporate governance focuses on differences between the approaches of different nations—e.g., two-tier versus single-tier boards,¹ codetermination versus election of directors solely by the shareholders,² shareholder primacy norm versus stakeholder models,³ and especially in the last few years, wide dispersal of stock holdings versus dominance by large block holders.⁴ This Article, however, focuses on a similarity: Around the world, the legal norm is that corporations are managed by, or under the direction of, a board of directors.⁵

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1. *E.g.* Thomas J. Andre, Jr., *Some Reflections on German Corporate Governance: A Glimpse at German Supervisory Boards*, 70 Tul. L. Rev. 1819 (1996).

2. *E.g.* Klaus J. Hopt, *European Community: New Ways in Corporate Governance: European Experiments with Labor Representation on Corporate Boards*, 82 Mich. L. Rev. 1338 (1984).

3. *E.g.* Michael Bradley, Cindy A. Schipani, Anant K. Sundaram & James P. Walsh, *Challenges to Corporate Governance: The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads*, 62 L. & Contemp. Probs. 9 (1999).

4. *E.g.* Brian R. Cheffins, *Corporate Governance Convergence: Lessons from Australia*, 16 Transnatl. Law. 13 (2002); Mark J. Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 Stan. L. Rev. 539 (2000).

5. *E.g.* Del. Code Ann. tit. 8, § 141(a) (2001); Rev. Model Bus. Corp. Act § 8.01 (ABA 1984); Richard M. Buxbaum & Klaus J. Hopt, *Integration through Law: Legal Harmonization and the Business Enterprise: Corporate and Capital Market Law Harmonization Policy in Europe and the U.S.A.* (1st ed., Walter de Gruyter Inc. 1988) (discussing the use of boards in Europe); Howard Gensler, *Company Formation and Securities Listing in the People's Republic of China*, 17 Hous. J. Intl. L. 399 (1995) (discussing the use of boards in China); Christopher L. Heftel, *Survey, Corporate Governance in Japan: The Position of Shareholders in Publicly Held Corporations*, 5 U. Haw. L. Rev. 135 (1983) (discussing the use of boards in Japan). An important caveat to this statement comes from the German two-tier board model, under which there is both a supervisory board and a management board. Andre, *supra* n. 1, at 1821.

It is worth focusing on this similarity because it represents something of a paradox. Despite differences in culture, political institutions, and business traditions, nations have converged upon a common institution—albeit with variations—for the governance of larger business organizations. This has happened notwithstanding the historic and continuing litany of complaints to the effect that boards of directors do little.⁶ Instead—in fact, if not in law—managers (particularly the chief executive officer), not boards of directors, typically run corporations with widely dispersed shareholdings,⁷ while dominant shareholders, not boards

6. *E.g.* Robert A. Gordon, *Business Leadership in the Large Corporation* 143 (1st ed., U. of Cal. Press 1966) (concluding that “the board of directors in the typical large corporation does not actively exercise an important part of the leadership function”); Myles L. Mace, *Directors: Myth and Reality* 107 (1st ed., Harv. Bus. Sch. Press 1986) (discussing a study finding that directors rarely challenged or monitored CEO performance and often served as little more than “attractive ornaments on the corporate Christmas tree”); Rita Komik, *Greenmail: A Study of Board Performance in Corporate Governance*, 32 *Admin. Sci. Q.* 163, 166–167 (1987) (noting that the modern board is a “co-opted appendage institution”); Myles L. Mace, *Directors: Myth and Reality—Ten Years Later*, 32 *Rutgers L. Rev.* 293, 297 (1979) (explaining that study reaffirmed results of earlier study as to director passivity). These sorts of complaints are nothing new. *E.g.* William O. Douglas, *Directors Who Do Not Direct*, 47 *Harv. L. Rev.* 1305, 1305 (1934) (pointing out, in 1934, that a popular theme had become that “[d]irectors should assume the responsibility of directing”). Nor are such complaints limited to boards in the United States. *E.g.* Oxford Analytica Ltd., *Board Directors and Corporate Governance: Trends in G7 Countries over the Next Ten Years* 267 (2d ed., Blackwell Bus. 1992) (reprinted in Robert A.G. Monks & Nell Minow, *Corporate Governance* 275 (2d ed., Blackwell Bus. 1995) (explaining that, in Japan, “Formal authority is held by the company president and the board of directors, but meetings are infrequent and decisions are rubber stamped”—in reality, “Real authority is held by the company president and the operating committee,” composed of the president’s immediate subordinates); Monks & Minow, *supra*, at 301 (explaining that the president director-general (PDG) of French companies “wields almost unchecked control over the enterprise . . . without the counter-power of the board of directors,” whose composition and agenda the PDG controls; “[i]ndeed, it is regarded as ‘bad manners’ for the board to take a vote on a management decision”); Roe, *supra* n. 4, at 568 (explaining that German corporate supervisory boards meet infrequently and that their information has been weak). Moreover, despite claims of improvements in corporate board governance, recent scandals again have produced complaints about passive boards. *E.g.* *The Way We Govern Now*, 366 *The Economist* 59, 59 (Jan. 11–17, 2003) (discussing poor board governance in light of corporate scandals involving Enron); Jeffrey N. Gordon, *What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections*, 69 *U. Chi. L. Rev.* 1233, 1241–1242 (2002) (describing Enron’s board as “a splendid board on paper,” and explaining that its failure reveals “a certain weakness with the board as a governance mechanism”); Michael C. Jensen & Joseph Fuller, *What’s A Director to Do?* <http://papers.ssrn.com/abstract=357722> (Oct. 2002) (“The recent wave of corporate scandals provides continuing evidence that boards have failed to fulfill their role as the top-level corporate control mechanism.”).

7. *E.g.* Melvin A. Eisenberg, *The Structure of the Corporation: A Legal Analysis* 139 (1st ed., Little, Brown & Co. 1976); Mace, *supra* n. 6, at 293–294; Monks & Minow, *supra*

of directors, commonly run corporations with concentrated shareholdings.⁸ Given the worldwide adoption of an institution whose designated role seems belied by reality, it is fair to ask whose idea the corporate board of directors was and how this institution spread around the world.

This Article explores, on three levels, the origins of the worldwide norm that corporations are managed by, or under the direction of, a board of directors. The first level is descriptive: Part II of this Article seeks to trace the geographic origin of the corporate board and gives examples of how the use of corporate boards spread. The next level is analytical: Having traced, in Part II, the geographic origin of the corporate board to Europe, Part III of this Article asks why the corporate board originated in Europe and spread from there. Part III presents a short version of a thesis⁹ that the board of directors arose out of medieval European political ideas. The reason, then, that board governance did not arise outside of Europe is because political and cultural ideas were different. However, the spread of the corporate board to non-European business organizations did not occur because of the spread of European political ideas, although it may have coincided with the spread of these ideas. Rather, it reflected a questionable supposition, at a time when the origins of the corporate board had passed into the mists of history, about the purpose and the impact of corporate boards.

Finally, Part IV of this Article addresses the normative level: It asks why it matters why the board originated in Europe and spread from there. In fact, the reasons why corporate boards arose in Europe and spread from there can tell us much about the

n. 6, at 275; Oxford Analytica Ltd., *supra* n. 6, at 269.

8. E.g. F. Hodge O'Neal & Robert B. Thompson, *O'Neal's Close Corporations* § 1.08 (3d ed., Callaghan 1988) (explaining that shareholders govern the closely held corporation); Gordon Walker, *Corporate Governance in East Asia: Prospects for Reform*, in *Corporate Governance: An Asia-Pacific Critique* 582–583 (Low Chee Keong ed., Sweet & Maxwell Asia 2002) (discussing shareholder control in the closely held corporation). According to a study, done for the World Bank, of nine East Asian countries—Hong Kong, Indonesia, Japan, Malaysia, the Philippines, Singapore, South Korea, Taiwan, and Thailand—“more than two-thirds of firms are controlled by a single shareholder; . . . separation of management from ownership control is rare; . . . [and] the top management of about [sixty percent] of the firms that are not widely held is related to the family of the controlling shareholder.” *Id.* at 582.

9. The Author intends to document this thesis, at length, in a forthcoming article titled, *The Historical and Political Origins of the Corporate Board of Directors*.

realism of the assumption—often underlying law-and-economics analyses of corporate governance issues—that a rational search for efficiency dictates business governance structures. These reasons also can say much about the promise and the pitfalls of the study of comparative law as a force for change.

Before beginning this exploration, it is useful to clarify essentially what a corporate board of directors is. We cannot simply rely on the label, not only because of the different languages involved in a comparative study, but also because, as one delves into the historical development of the corporate board, terminology changes. Moreover, defining the concept of a corporate board of directors presents a tricky “Goldilocks” problem. If the definition is too broad and equates any group that manages a corporation with a board, we deprive the concept of any real meaning. After all, any company of any size will have some group of people involved in its management. Conversely, if one attempts to define the concept too precisely, we lose the essential universality of the institution in variations as to details, such as two-tier boards and codetermination.

The best that we can do is to say that the essence of the corporate board of directors comes from three underlying concepts, which involve the relationship of the directors to the shareholders, the relationship of the directors to each other, and the relationship of the directors to the corporation’s executives. The first underlying concept of corporate governance by a board of directors is that shareholders, unlike partners, do not, simply by virtue of being the owners, manage the corporation.¹⁰ Instead, they (or under codetermination, they and the employees) normally elect a group of persons (the directors) to have ultimate responsibility for management.¹¹ The second concept is that a board of directors makes decisions by acting together as a group of peers,¹² as opposed to the hierarchical arrangements and divisions of responsibility common among officers of any organization. The third con-

10. Franklin A. Gevurtz, *Corporation Law* § 3.1.3(a) (1st ed., West 2000).

11. Del. Code Ann. tit. 8, § 211(b); Rev. Model Bus. Corp. Act § 8.01(b); Gevurtz, *supra* n. 10, at § 3.1.3(a); *but see* Jesse H. Choper, John C. Coffee, Jr. & Ronald J. Gilson, *Cases and Materials on Corporations* 54 (5th ed., Aspen Publishers, Inc. 2000) (discussing system in Netherlands whereby corporate board itself—not shareholders—appoints successors of some Dutch corporate boards).

12. *Baldwin v. Canfield*, 1 N.W. 261, 270 (Minn. 1879).

cept is that the corporation's senior executives are ultimately answerable to the board.¹³

II. THE GEOGRAPHIC ORIGIN AND THE SPREAD OF THE CORPORATE BOARD OF DIRECTORS

A. The Earliest Corporate Boards

As stated at the outset of this Article, most corporations formed around the world today have boards of directors. However, if we look back to the seventeenth century, large European companies had boards of directors, but fairly large businesses owned and operated by non-Europeans did not.¹⁴ This suggests that the corporate board of directors originated in Europe.

1. *Use of Boards by the Early European Trading Companies and Banks*

The use of the term “director” to describe the members of a corporation's governing board traces the 1694 charter of the Bank of England.¹⁵ Yet, the use of governing boards among European companies—albeit with different titles for their members—was already old by that time. To give a pair of nicely documented examples, the East India companies used governing boards as early as the beginning of the seventeenth century.¹⁶

On the very last day in 1599, Queen Elizabeth I granted a charter to the Earl of Cumberland and 215 knights, aldermen, and merchants to become “a body politic and corporate” by the name of the “Governor and Company of Merchants of London trading into the East Indies.”¹⁷ The result was to create what came to be known as the East India Company.¹⁸ This charter committed the direction of the voyages and the management of all

13. Eisenberg, *supra* n. 7, at 162. This, of course, is the legal theory. As stated above, reality commonly diverges from this theory.

14. *Infra* pt. II(A)(1) (discussing the use of boards by early European trading companies and banks) and pt. II(A)(2) (discussing nonboard governance in large, non-European businesses).

15. Ronald R. Formoy, *The Historical Foundations of Modern Company Law* 20, 21 (Sweet & Maxwell, Ltd. 1923).

16. George Cawston & A.H. Keane, *The Early Chartered Companies* 86–87 (Burt Franklin 1968).

17. *Id.* at 87.

18. *Id.* at 86.

other things belonging to the company to a governor¹⁹ and twenty-four persons called “committees.”²⁰ Hence, the term “committees” predated the title “director” as the label attached to the elected members of a corporation’s governing board. The charter named Sir Thomas Smith as the first governor, but provided that the members of the company annually would elect the committees,²¹ who would choose, from among themselves, a governor.²²

Two years after the formation of the English East India Company, the Dutch government chartered the Dutch (or United) East India Company.²³ The charter (*octroi*) of the Dutch East India Company provided for governance by a general council of governors, known as *Bewindhebbers*.²⁴ This council had sixty members, broken down into a certain number of representatives from each of the various “chambers” that had come together to form the Dutch East India Company.²⁵ These chambers consisted of smaller groups of merchants in Amsterdam (which had twenty representatives on the council), Rotterdam and Delft (which had fourteen representatives), Hoorn and Enkhuizen (which had fourteen representatives), and Zeeland (which had twelve representatives).²⁶ These merchant groups already had formed shipping companies for trade with the East Indies.²⁷ Evidently, a sixty-member board proved unwieldy, so the Dutch East India Company established a second, smaller board—the *Collegium*—with seventeen members.²⁸ This board also had a certain number of representatives from each of the chambers—Amsterdam received eight, Zeeland received four, and the other two chambers each

19. The chief executive officer of such early corporations commonly had the title “governor,” rather than “president” or more modernly “CEO.”

20. *Id.* at 87.

21. *Id.*

22. Cyril O’Donnell, *Origins of the Corporate Executive*, 26 Bull. of the Bus. Hist. Soc. 55, 67 (1952).

23. M. Schmitthoff, *The Origin of the Joint-Stock Company*, 3 U. Toronto L.J. 74, 75 (1939).

24. *Id.* at 94.

25. Winfried van den Muijsenbergh, *Symposium: The Globalization of Corporate and Securities Law in the Twenty-First Century: Corporate Governance: The Dutch Experience*, 16 Transnatl. L. 63, 64 (2002).

26. *E.g.* Holden Furber, *Rival Empires of Trade in the Orient 1600–1800*, at 188 (U. of Minn. Press 1976).

27. Schmitthoff, *supra* n. 23, at 93.

28. Muijsenbergh, *supra* n. 25, at 64.

received two.²⁹ The seventeenth position rotated among the chambers.³⁰

The East India companies were entirely typical in providing for governance by a board. Among other English trading companies, the 1670 charter of the Hudson's Bay Company provided for a board of seven committees,³¹ and the charters of both the Russia Company, in 1555, and the Eastland Company, in 1579, provided for boards of twenty-four "assistants" (yet an older term for directors).³² By contrast, while the first charter of the Levant Company, in 1581, did not provide for a corporate board, this was explicable by the fact that the company started with only four members.³³ As soon as the company's membership grew, the company obtained a new charter in 1593 calling for a board of twelve assistants.³⁴

2. Non-Board Governance in Large Businesses beyond European Influence: The Japanese Merchant House Example

At the time at which sixteenth- and seventeenth-century European trading and banking corporations already were using board governance, businesses owned and operated by non-Europeans did not seem to be employing such an institution. This was not because non-Europeans did not own and operate fairly large-scale businesses. Rather, it was because larger business organizations outside the ambit of European influence utilized different management structures. The Japanese merchant houses prior to the Meiji Restoration in 1868 provide a good illustration.

For almost two and one-half centuries prior to the nominal restoration of imperial control in 1868, under Emperor Meiji, hereditary regents (*shoguns*) of the Tokugawa family ruled Japan.³⁵ During this era, Japan was largely closed off from the West.³⁶ The country was organized under a sort of feudal system, in which

29. *Id.*

30. *Id.*

31. Cawston & Keane, *supra* n. 16, at 280.

32. *E.g.* O'Donnell, *supra* n. 22, at 60, 63.

33. John P. Davis, *Corporations: A Study of the Origin and Development of Great Business Combinations and of Their Relation to the Authority of the State* vol. 2, 88 (Knickerbocker Press 1905).

34. *Id.* at 90–91.

35. Rodney Clark, *The Japanese Company* 13 (Yale U. Press 1979).

36. *Id.*

local lords (*daimyo*), who owed allegiance to the *shogun*, ruled over the domains (*han*), into which the country was divided.³⁷ Four main orders comprised Japanese society at this time: (1) the warriors (*samurai*), (2) the peasants (farmers), (3) the artisans, and (4) the merchants, who, under Confucian theory, represented the most inferior class insofar as the merchants simply distributed goods that others produced.³⁸ Yet, despite this picture of a feudal, agrarian society in which merchants stood at the lowest rung, it would not be true that Japan, during the era of Tokugawa rule, lacked fairly large-scale business organizations. These business organizations took the form of merchant houses. Not only did the merchant houses engage in distributing and selling commodities in Japan's populous cities—including wood, oils, cotton, and huge quantities of rice—but the merchant houses also used the wealth from trade for money lending and investments.³⁹

The merchant house was a subset of the broader organization of all four orders of Japanese society at this time into houses (*ie*) which, at their simplest, consisted of the head of the household and his wife, his eldest son, the son's wife, and the househead's younger, unmarried children.⁴⁰ It was the house, rather than the individuals, that owned property or had other rights, so that the hereditary offices of some *samurai* were the rights of certain *samurai* houses, and peasant houses had the right to farm certain pieces of land.⁴¹ In the case of merchants, the house owned the business assets.⁴² The current head of the household managed

37. *Id.*

38. *Id.* Unlike European feudalism, which tied status to ownership of property, neither the *daimyo* nor the *samurai* owned estates. Johannes Hirschmeier & Tsunehiko Yui, *The Development of Japanese Business 1600–1973*, at 14 (Harv. U. Press 1975). The *daimyo* were, to some extent, the equivalent of administrators, whom the *shogun* could move to different domains. *Id.* Because of a lack of war at this time, the *samurai* did not have much to do and so existed off of stipends provided by their *daimyo*. *Id.*

39. Clark, *supra* n. 35, at 14. The principal borrowers were the *daimyo* and the central government. Hirschmeier & Yui, *supra* n. 38, at 34–35. Reclamation of land constituted one of the major investment opportunities. *Id.* at 34. For a variety of reasons—such as a lack of workers because of the labor-intensive nature of Japanese agriculture, and the separation of artisans and merchants into different social orders excluded from each others' economic spheres—the merchant houses did not move into industrial activities as had European merchants. *Id.* at 33–34. A number of merchant houses, however, became, in effect, banking houses. *Id.* at 34–35.

40. Clark, *supra* n. 35, at 14.

41. *Id.* at 14–15.

42. *Id.* at 14.

these assets for the sake of the house, which encompassed his ancestors, the current generation, and his posterity.⁴³ In this sense, the house functioned something like a corporation.⁴⁴

Successful merchant houses grew beyond the simple structure of a head of the house, his eldest son, their wives, and unmarried children. In many instances, younger sons received some of the property to set up branch houses (*bunke*) that operated under the overall house name.⁴⁵ A few large houses, such as the Mitsui house, did not divide property between the sons, but gave shares in ownership in the house to all of the sons.⁴⁶ To bring further talent into the house, the head of the household might adopt the men who married his daughters and have them join the business.⁴⁷ The merchants brought young nonfamily members into the house as apprentices (*detchi*).⁴⁸ At age seventeen or eighteen, the house would promote the *detchi* to *tedai* (a journeyman).⁴⁹ At age thirty or over, a *tedai* could become a manager (*banto*).⁵⁰ In a large house, there could be more than one *banto*, one or more of whom then became the chief manager (*shihainin*).⁵¹

The merchant house did not have a board, elected by the owners, to make decisions as a group of peers with ultimate responsibility to select and to supervise the senior management of the business. Instead, ultimate authority rested with the head of the house, to whom all employees and house members owed a duty of total obedience.⁵² In lieu of supervision by a board, the head of the house faced several constraints. The first constraint was the internal sense of obligation felt toward the house and its members, including not just the current, living members, but also ancestors and future generations.⁵³ In addition, many houses had

43. *Id.*

44. *Id.* For an analysis along somewhat similar lines dealing with Chinese households, see Teemu Ruskola, *Conceptualizing Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective*, 52 *Stan. L. Rev.* 1599, 1622–1633 (2000).

45. Hirschmeier & Yui, *supra* n. 38, at 39.

46. *Id.* at 38–39.

47. *Id.* at 38.

48. *Id.* at 39.

49. *Id.*

50. *Id.*

51. *Id.*

52. *Id.* at 38–39.

53. *Id.* at 41; see also Ruskola, *supra* n. 44, at 1628 (discussing obligations of the head of the household to other generations in the Chinese-clan businesses).

house rules, adopted by earlier heads, that set out principles and practices under which the business was to operate.⁵⁴ These included requirements for honest dealings with outsiders, recitals of general business precepts and virtues, and bylaws for governing the business.⁵⁵

Finally, many merchant houses made decisions on the basis of a discussion system.⁵⁶ This discussion system, while entailing collaborative decision-making, differed from a corporate board of directors in fundamental ways. Essentially, the discussion system involved general meetings in which the journeymen employees (*tedai*) participated in making business decisions, such as the price to charge for goods.⁵⁷ Also, some houses had advisory councils of retired *banto*, together with the current *shihainin*, that considered issues such as opening new operations.⁵⁸ Still, this sort of collaborative decision-making, with employee input or the advice of retired managers, is not the same as an elected board with the ultimate power to select and supervise managers, and to make decisions for the corporation.

Not only did the merchant house provide functional substitutes for the role of a board in supervising the head of the house, but the system of primogeniture, under which the eldest son inherited control as the head of the house, also removed what could have been a role for a board in selecting the chief executive officer.⁵⁹ Admittedly, the continuity of merchant houses over many generations suggests that circumvention of primogeniture occurred in situations in which the eldest son lacked the capability to successfully lead the house.⁶⁰ However, rather than involving any board, this entailed the existing head of the house adopting a son-in-law, or even a capable *banto* or *shihainin*, who could take over as successor.⁶¹

54. Hirschmeier & Yui, *supra* n. 38, at 40.

55. *Id.* at 40–41, 63–64.

56. Matao Miyamoto, *The Management Systems of Edo Period Merchant Houses*, 13 *Japanese Y.B. on Bus. History* 97, 129 (1996).

57. *Id.*

58. *Id.*

59. See Hirschmeier & Yui, *supra* n. 38, at 38 (discussing the system of primogeniture).

60. See *id.* (explaining that “[t]he value-priority assigned to the House as an economic unit, over family and blood considerations, led many . . . merchants to put blood considerations aside”).

61. *Id.* In an article on businesses operated by Chinese clans, Professor Teemu Rus-

B. The Spread of Corporate Boards

1. European Colonies

The spread of corporate boards to European colonies is unremarkable, especially since one of the roles of the European trading companies governed by boards was to establish colonies.⁶² In addition to the East India companies and the Hudson's Bay Company, which were involved in colonization and had governing boards, the London Company, which founded the Virginia colony, and the Massachusetts Bay Company also had governing boards.⁶³

The Bank of the United States, chartered in 1791⁶⁴ (often called the First Bank of the United States), illustrates the tendency of former colonies to copy board governance from European institutions. It seems evident that the United States' bank's twenty-five-person board was modeled on the twenty-four-person board of the Bank of England.⁶⁵ One demonstration of the English bank's influence is that both the Bank of England and the First Bank of the United States imposed term limits on directors: The Bank of England's charter prevented one-third of the directors of the Bank of England from seeking re-election,⁶⁶ while the charter of the First Bank of the United States prevented one-quarter of the directors from seeking re-election.⁶⁷ In any event, given the

kola suggests that elders in the clan formed a council analogous to a board of directors. Ruskola, *supra* n. 44, at 1650. While one can always analogize any group to a corporate board of directors, there appear to be critical differences between the clan council of elders and a corporate board of directors. There is no suggestion that members of the clan elected the elders, as would the shareholders of a corporation. Moreover, the sources cited by Professor Ruskola indicate that the elders lacked the real power to select the managers of the clan's business and largely had an honorary role. *Id.* at 1650 n. 200. Other sources make it clear that the concept of a board of directors with ultimate power over management and responsibility to the shareholders was unfamiliar to Chinese merchants in the nineteenth century. *E.g.* Wellington K. K. Chan, *Merchants, Mandarins, and Modern Enterprise in Late Ch'ing China* 70 (Harv. U. Press 1977). Instead, in the traditional Chinese company, the owners gave the manager unchallenged control, reviewed the books once a year, and replaced the manager if results were unsatisfactory. *Id.* at 71.

62. James D. Cox & Thomas Lee Hazen, *Cox & Hazen on Corporations* vol. 1, § 2.02, 83 (2d ed., Aspen 2003).

63. William C. Morey, *The Genesis of a Written Constitution*, 1 Ann. of the Amer. Acad. of Poli. & Soc. Sci. 529, 539–541, 549 (1891).

64. Pub. L. No. 1-10, § 1, 1 Stat. 191, 191 (1791) (expired 1811).

65. Compare *id.* at § 4, 192 (discussing the number and time of electing directors) with The Bank of England Act, 1696, 8 & 9 Will. 3, c. 20, § 51 (Eng.) (discussing the election of a governor and twenty-four directors).

66. The Bank of England Act, 1696, 8 & 9 Will. 3, c. 20, § 52 (Eng.)

67. 1 Stat. at 193.

general adoption of the mother countries' institutions by European colonies, the ex-colonies' failure to utilize, rather than the utilization of, corporate board governance would have required some explanation.

2. *Outside of European Colonies: The Japanese Example*

More interesting than the use of corporate boards in European colonies is the spread of corporate board governance to nations with other traditions. Once again, Japan provides a nice illustration. The development of corporate board governance in Japan came about with the introduction of the joint-stock company as a form of doing business in that nation.⁶⁸ The importation of this business form, in turn, was just one component of an effort to introduce Western technology and ideas into Japan following the Meiji Restoration in 1868.⁶⁹

As discussed earlier, before 1868 Japan was a largely isolated feudal society under the rule of the Tokugawa *shoguns*.⁷⁰ Dissatisfaction with this situation arose from a variety of sources, including economic dislocations, the growing realization of Japan's military vulnerability due to the West's superior technology, and the influence of Western ideas and institutions on the intelligentsia.⁷¹ Among the institutions that had impressed the few Japanese who traveled to the West before 1868 was the joint-stock company.⁷² While we currently tend to refer to this form of business as a "corporation"⁷³ (especially in the United States), the term "joint-stock company" not only tracks international and historical usage,⁷⁴ but also focuses attention on the feature of this form of business that was most attractive to the Japanese observers.

The joint-stock company, or business corporation, raises capital by selling fungible interests in the business to investors, who

68. See Clark, *supra* n. 35, at 33 (discussing the rise of the joint-stock company in Japan).

69. *Id.* at 18.

70. *Id.* at 13.

71. Hirschmeier & Yui, *supra* n. 38, at 20, 70-71.

72. Clark, *supra* n. 35, at 29.

73. Or, more precisely, a business corporation, as opposed to a nonprofit corporation or a municipal corporation.

74. See Alfred F. Conard, *Corporations in Perspective* §§ 66-69, 129-138 (The Found. Press 1976) (tracing the etymology and usage of the term "corporation").

thereby become stockholders.⁷⁵ During the 1860s, Japanese observers recognized the advantage of the Western joint-stock company as a mechanism for amassing large amounts of capital to undertake projects, such as building and operating railroads, that were otherwise beyond the means of the private sector in Japan.⁷⁶ Indeed, the advantage of the joint-stock company was not lost on the Tokugawa government, which, shortly before its fall, tried to pressure merchants in the ports that Japan had been forced to open to Westerners to form trading companies to improve their ability to compete.⁷⁷

At the start of 1868, disaffected young *samurai* from several *han* forced the removal of the last *shogun* and formed a new government that spoke in the name of the Emperor.⁷⁸ The new government embarked upon a wide range of initiatives to end the feudal regime,⁷⁹ to modernize the economy,⁸⁰ and generally to introduce Western technology and institutions to Japanese culture.⁸¹

The joint-stock company was among the Western institutions promoted by the new government. This started in the same manner attempted by the prior regime—pressuring merchants into forming such firms.⁸² However, these early joint-stock companies failed in just a few years.⁸³ A more successful effort at inducing joint-stock companies occurred in the banking sector. In 1872, the Japanese government issued a national banking ordinance, modeled on the United States' Banking Act of 1863.⁸⁴ While the 1872 ordinance led only to the formation of four joint-stock companies

75. Gevurtz, *supra* n. 10, at § 1.1.1(d).

76. Clark, *supra* n. 35, at 29 (quoting the 1866 writings of the Japanese educator Fukuzawa Yukichi).

77. *Id.* at 29–30.

78. Hirschmeier & Yui, *supra* n. 38, at 73. “[T]he Emperor was barely fifteen years old” at the time. *Id.*

79. *Id.* at 74, 81–82. Initiatives to end the feudal regime included initiatives abolishing the *han*, terminating the status of *daimyo*, and absorbing the *samurai* into the economy. *Id.*

80. *Id.* at 74, 79, 83–84. Initiatives to modernize the economy included initiatives introducing a national currency, reforming taxation, and ending the division of society into four orders. *Id.*

81. *Id.* at 75–76. This included the introduction of Western-style clothes. *Id.*

82. Clark, *supra* n. 35, at 30.

83. *Id.* Government interference and management inexperience with foreign trade were two reasons for the failure. *Id.*

84. Hirschmeier & Yui, *supra* n. 38, at 89.

to operate banks, the government made revisions to the banking ordinance in 1876.⁸⁵ Among other things, the 1876 revisions allowed the *samurai* to invest, as capital in the new banks, the bonds that the *samurai* had received from the government in lieu of their former stipends from the *daimyo*.⁸⁶ The 1876 revisions led to the formation of over 150 joint-stock banking companies.⁸⁷

A major turning point in increasing the use of joint-stock companies outside of the banking sector occurred in 1878, when the government amended the system for chartering new companies and empowered local governments to grant permission for joint-stock companies.⁸⁸ As a result, a wide variety of associations and businesses could, and did, obtain the designation of a company.⁸⁹ At the same time, the government conducted an extensive propaganda campaign to encourage the formation of, and investment in, joint-stock companies.⁹⁰ Along the same lines, as part of the program to integrate the *samurai* into the economy, the government made business loans available to the *samurai*.⁹¹ However, the government insisted that the *samurai* use these loans only for joint-stock undertakings involving at least several *samurai*.⁹²

Beyond governmental encouragement, the pressure of foreign competition and high capital needs in industries, such as cotton-spinning and the railroads, led to the formation of joint-stock companies, usually with between 100 and 500 shareholders.⁹³ Not atypical by any country's standards, the creation of an overall corporation law significantly lagged behind these developments on the ground. It was not until 1893 that sections of a proposed commercial code dealing with company law, based upon a draft by the German advisor Hermann Roesler, came into force.⁹⁴ These

85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.* at 112.

89. *Id.*

90. *Id.*

91. *Id.* at 82.

92. *Id.*

93. *Id.* at 112.

94. Masao Fukushima, *The Significance of the Enforcement of the Company Law Chapters of the Old Commercial Code in 1893*, 24 L. in Japan 171, 173, 183 (1991) (William Horton, trans.); Kenzo Takayanagi, *A Century of Innovation: The Development of Japanese Law, 1868–1961*, in *Law in Japan: The Legal Order in A Changing Society* 31

were then superseded by the enactment of the new commercial code in 1899.⁹⁵

The adoption of the board of directors as a governing institution for the joint-stock company arrived, albeit awkwardly, with this form of business. As previously stated, the trading companies formed as a result of government pressure at the beginning of the Meiji era soon failed. Government interference, as well as management inexperience with foreign trade, hampered these companies, while confusion in efforts to adopt corporate board governance did not help.⁹⁶ Because these companies required cooperation between houses, the company organizers modeled the role of the directors on the practices of the only previously existing organization that involved economic cooperation between merchant houses—the merchant guild.⁹⁷ Copying from the system of rotating control employed in the pre-Meiji-era Japanese merchant guilds, the early trading companies had three general directors who took turns presiding over the company.⁹⁸ The directors were assisted by thirty stewards, six of whom were on duty in any month as the supervisors of the business departments.⁹⁹ Needless to say, this proved to be an awkward way to run a business.

The 1876 revision of the national banking ordinance not only increased the number of joint-stock companies, but also established the norm of board governance for these companies. Specifically, the revised ordinance included model articles of incorporation.¹⁰⁰ These articles provided for the selection of the bank's president (*todori*) from among the directors (*torishimariyaku*) at a meeting of the directors.¹⁰¹ Moreover, the banking ordinance empowered the president and the directors, at a meeting of the directors, to act according to the interests of the bank and to hire, fire, and set salaries for bank personnel.¹⁰² In the absence of an overall corporation law for joint-stock companies formed outside of bank-

(Arthur Taylor von Mehren ed., Harv. U. Press 1963).

95. Takayangi, *supra* n. 94, at 31–32.

96. Clark, *supra* n. 35, at 30.

97. *Id.*

98. *Id.*

99. *Id.*

100. Tsunehiko Yui, *The Development of the Organizational Structure of Top Management in Meiji Japan*, 1 Japanese Y.B. on Bus. History 1, 4 (1984).

101. *Id.*

102. *Id.* at 5.

ing during the 1870s and 1880s, governance varied with the provisions of particular articles.¹⁰³ Nevertheless, the articles of such companies commonly called for a board of directors. While provisions in the articles reflected considerable variation as to the directors' responsibilities, these article provisions, as with the banks' provisions, typically contemplated joint action with the president in making decisions for the companies and, somewhat naively, focused on decisions regarding hiring and firing employees and setting salaries.¹⁰⁴

By 1893, when the corporate law provisions of the commercial code went into effect, the concept of corporate governance under a board of directors was already well established.¹⁰⁵ In any event, the 1893 code affirmed the authority of the directors over the joint-stock company.¹⁰⁶

III. WHY DID THE CORPORATE BOARD OF DIRECTORS EVIDENTLY ORIGINATE IN EUROPE AND SPREAD FROM THERE?

A. A Traditional Story

One constant in human history is the clever invention occurring in one part of the world and then spreading throughout the globe as people in different lands copy the invention. For instance, fine porcelain arises in China and the Europeans copy the idea. The steam engine arises in Europe and spreads around the world. An obvious explanation as to why the corporate board originated in Europe and spread from there would follow along the same sort of lines: The corporate board of directors was a clever invention by the Europeans, who were looking for a mechanism to govern a business in which large numbers of individuals would make passive investments and receive shares in the venture (the joint-stock company).

The republican model of corporate governance, in which shareholders elect directors to manage the business, seems well-suited to the firm that raises money by issuing ownership inter-

103. *See id.* at 5–7 (providing examples of provisions from the articles of incorporation of various joint-stock companies).

104. *Id.*

105. *See id.* (giving examples of joint-stock companies, established in Japan in the 1870s and 1880s, which were governed by a board of directors).

106. *Id.* at 12.

ests to large numbers of investors—which interests will be attractive because they are freely transferable. “Because stockholders, as such, do not directly participate in managing the corporation,” there can be large numbers of owners who “can trade their stock without disrupting the running of the company.”¹⁰⁷ Of course, this explains only why shareholders should not directly run the widely held company with freely tradeable ownership. It does not explain why shareholders should elect a board, instead of simply making entirely passive investments, as in a limited partnership.¹⁰⁸

The predominant economics rationale states that boards elected by shareholders exist as a necessary tool to monitor corporate management. Typically, this view starts with the assumption that the corporate hierarchy exists to gain the advantage of team production, while minimizing agency costs, like shirking and disloyalty, by having higher-level agents monitor lower-level agents.¹⁰⁹ However, the problem then becomes who will monitor the highest-level monitors. The traditional economics answer is that the shareholders, as the residual claimants, have the best incentives to monitor the highest-level agents.¹¹⁰ This answer, however, faces a practical difficulty in the publicly held corporation, since there are too many scattered shareholders to allow for efficient monitoring directly by the shareholders. This, in turn, leads to the argument that the corporate board, elected by the shareholders, provides a solution to the practical difficulty of shareholders monitoring on their own behalf.¹¹¹

B. A Revisionist Story

The problem with the story outlined above is that it is simply wrong in explaining why the corporate board of directors arose in

107. Gevurtz, *supra* n. 10, at 16.

108. See Michael K. Pierce & Jill E. Fisch, *Overview of Substantive Law Governing General Partnerships, Limited Partnerships, and Limited Liability Companies* 5–6, 10–13 (ALI-ABA CLE Course of Study, 2003) (discussing and defining limited partnerships under the Revised Uniform Limited Partnership Act (RULPA) of 1985).

109. Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 Vand. L. Rev. 1, 5–7 (2002).

110. Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 Am. Econ. Rev. 777, 782–783 (1972).

111. See e.g. Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & Econ. 301, 311 (1983) (explaining that “[t]he common apex of the decision control systems of organizations . . . in which decision agents do not bear a major share of the wealth effects of their decisions is some form of board of directors”).

Europe. Moreover, while the story might have some merit insofar as non-Europeans copied the corporate board based upon the assumption that it was the most efficient way to run a joint-stock company, it is less clear whether the story is correct as to the real impact of the corporate board. In other words, a board of directors is not like a steam engine, an invention whose impact is unassailable. Specifically, if one builds a steam locomotive without a steam engine, the train will not move. The same, however, may or may not be true if one establishes a joint-stock company without a board of directors.

*1. European Corporate Board Governance Prior to the
Joint-Stock Company*

The reason we can conclude that Europeans did not develop the corporate board of directors to monitor management on behalf of passive investors in the joint-stock company is that the board, as an institution of corporate governance, predated the invention of the joint-stock company by a century or more. In fact, the English and the Dutch East India companies, with their governing boards, evolved from the so-called “regulated company”—essentially a guild whose membership consisted of merchants conducting independent operations under the company’s franchise. In the second half of the sixteenth century, the English government issued charters to companies of merchants, such as the Russia Company, the Eastland Company, and the Levant Company, granting the merchants the exclusive right (at least among English subjects) to trade in a specified territory¹¹² and providing for governance of the companies by boards.¹¹³

The charters of the East India companies followed the same pattern.¹¹⁴ The regulated companies, like the Eastland Company,

112. Davis, *supra* n. 33, at 88–89, 97–98. The charter of the Russia Company granted the merchants in that company exclusive rights, as far as English subjects, to trade in Russia, as well as in “lands of infidels” discovered by the merchants of the company. *Id.* at 97–98. The Eastland Company’s charter granted its merchants the exclusive right, among English subjects, to trade with Scandinavia and the Baltic region, but not Russia. Cawston & Keane, *supra* n. 16, at 61. The Levant Company’s charter granted its members exclusive trading rights with Turkey. Davis, *supra* n. 33, at 88.

113. Cawston & Keane, *supra* n. 16, at 61; Davis, *supra* n. 33, at 88–89, 98.

114. See Cawston & Keane, *supra* n. 16, at 87–88 (discussing the royal charter, granted on December 31, 1599). The charter generously described the English East India Company’s territory as encompassing all of Africa, Asia, and America, from the Cape of Good Hope “to the Straits of Magellan.” *Id.* at 87–88.

did not conduct operations as a corporation. Instead, members of a regulated company conducted the trading voyages, either individually or in groups, under the company's exclusive franchise.¹¹⁵ The governing board of a regulated company adopted ordinances regulating the members' activities. For example, the board of the Eastland Company adopted a regulation prohibiting members from engaging in "colouring" goods.¹¹⁶ "Colouring" referred to selling the goods of a nonmember merchant as a member's own.¹¹⁷ By operating in this fashion—as undisclosed principals—nonmembers attempted to circumvent the company's exclusive franchise.¹¹⁸ As this example illustrates, the role of a regulated company's board was not to have overall responsibility for operating a business, but to impose rules on individual merchants to preserve a monopoly.

The Russia Company may have been the first to experiment with operating as a joint-stock company—in other words, having the merchants chip into a common fund to outfit the ships for trading voyages under the company's command, rather than having the merchants conduct operations individually or in ad hoc groups.¹¹⁹ Sources differ as to the extent to which the English and Dutch East India companies operated from their inception as joint-stock companies or went through a period in which they operated as regulated companies.¹²⁰ In the case of the English company, the confusion arises from the fact that the original charter preserved the members' right to trade individually under the company's franchise, much as in a regulated company, and from the fact that not all of the members subscribed to the early voy-

115. See Davis, *supra* n. 33, at 112 (explaining that companies "first appeared as groups of adventurers actuated by their personal interests").

116. Schmitthoff, *supra* n. 23, at 82 n. 30.

117. *Id.* at 82.

118. As one commentator has noted, "if it was possible for a [nonmember] to avail himself of the trading monopoly of the regulated company by inducing a member to trade as his undisclosed agent, the monopoly was bound to become worthless." *Id.*

119. *Id.* at 91. Interestingly, the Russia Company may have started as a joint-stock company and then regressed into a regulated company. *Id.* at 91–92.

120. Compare Davis, *supra* n. 33, at 118–119 (explaining that the English East India Company did not conduct trading voyages as a corporation, rather than as individual merchants and merchant groups, until 1612) with William R. Scott, *The Constitution and Finance of English, Scottish and Irish Joint-Stock Companies to 1720*, at 153–155 (Peter Smith 1951) (explaining how, from its inception, the English East India Company conducted its voyages on a joint-stock basis, even though members invested on a per-voyage basis rather than into permanent capital or joint stock of the company).

ages financed on a joint-stock basis.¹²¹ In the case of the Dutch company, the failure of the charter to create, or even to mention, a company-wide joint stock has led one noted scholar to conclude that the individual chambers (companies of merchants in various Dutch cities) actually conducted the initial operations of the Dutch East India Company and that the role of the governing councils was to coordinate the activities of the separate merchant companies, much in the manner of a cartel.¹²²

In any event, it was not until the middle or toward the end of the seventeenth century (historians disagree as to when) that the English East India Company completed its evolution into a structure that we now associate with a joint-stock company (or business corporation). Voting rights in the East India Company began to depend upon the amount each member invested in the permanent joint-stock, instead of being available to all members.¹²³ In addition, the company no longer granted members the right to trade on their own under the company's franchise.¹²⁴ As a result, these two changes tied the benefits of membership in the English East India Company—both in terms of voting control and economic return—entirely to a subscription into a common fund for the company's activities, and thereby completely transformed the company from a confederation of merchants into a vehicle for passive investment by the general public.

The use of boards by the late-sixteenth-century English regulated companies appears to derive from a pattern set by two of the earliest companies of English merchants engaged in foreign trade: the Company of Merchant Adventurers and the Company of the Merchants of the Staple.¹²⁵ Despite its somewhat swashbuckling

121. Schmitthoff, *supra* n. 23, at 90–91.

122. *Id.* at 93–94.

123. See Scott, *supra* n. 120, at 465 (explaining that voting rights in the East India Company were limited, in 1650, to one vote for each £500 pounds sterling contribution); Davis, *supra* n. 33, at 129–130 (noting that the new charter of 1693 gave one vote for each £1000 pounds sterling contributed, up to a maximum of ten votes).

124. Compare Samuel Williston, *The History of the Law of Business Corporations Before 1800*, in *Select Essays in Anglo-American Legal History* vol. 3, 195, 200 (Comm. of Assoc. of Am. L. Schs. ed., Little, Brown & Co. 1909) (discussing when members lost the right to trade independently under the East India Company's franchise toward the end of the seventeenth century) with William Mitchell, *Early Forms of Partnership*, in *Select Essays in Anglo-American Legal History* vol. 3, 183, 194 (Comm. of Assoc. of Am. L. Schs. ed., Little, Brown & Co. 1909) (discussing when members lost the right to trade independently under the East India Company's franchise in 1654).

125. Percival Griffiths, *A Licence to Trade: The History of English Chartered Companies*

sound, “Merchant Adventurers” was a label used by English merchants who engaged in the export trade of manufactured goods.¹²⁶ During the fifteenth century, merchant exporters operating from England had no formal, separate organization.¹²⁷ Instead, many of them apparently were members of the Mercers Company, a London merchants’ guild.¹²⁸ By the late-fifteenth century, however, the London merchant exporters had come to view themselves as a distinct fellowship with the title “Merchant Adventurers,” and, evidently, were operating in connection with the English merchants in the low countries.¹²⁹

In 1505, Henry VII granted a charter to “The Company of Merchant Adventurers,” giving the company a monopoly on trade in the export of English manufactures, although membership in the company had to be open to any English merchant who paid a fee.¹³⁰ More significantly, for purposes of this Article, this charter placed governance of the company in a governor and an elected board of twenty-four so-called “assistants.”¹³¹ The function of the governor and the assistants was to resolve disputes among merchants and to enact ordinances for the regulation of the company’s members.¹³²

The Merchants of the Staple take their name from the fixed place (the Staple) to which, at various times, English law limited all sales of raw wool exports (as opposed to the cloth exports handled by the Merchant Adventurers).¹³³ The compulsory staple system began in 1313 and moved around for half a century, until settling in Calais, which was then under English control.¹³⁴ Significantly, for purposes of this Article, a mayor and a council of

7, 9 (Ernest Benn Ltd. 1974).

126. *Id.* at 9.

127. *Id.* at 10.

128. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*

132. Cawston & Keane, *supra* n. 16, at 249–251.

133. Griffiths, *supra* n. 125, at 6. The interest of the Merchants of the Staple in such a limitation, particularly insofar as it could reduce competition and allow control over prices, is obvious enough. The English kings saw this as a way to extract revenues from the wool merchants. Eileen Power, *The Wool Trade in English Medieval History* 87–89 (Oxford U. Press 1941).

134. *Id.* at 96–99.

twenty-four governed the Company of the Merchants of the Staple in Calais (and, for two years, also ran the city).¹³⁵

All told, two points are significant about the Company of Merchant Adventurers and the Company of the Merchants of the Staple. Both had governing boards, and neither was anything remotely like a joint-stock company. Instead, these were simply merchant guilds that had certain exclusive rights granted by the crown. Under these circumstances, the board hardly existed to monitor management on behalf of passive investors or, in any sense, to manage a business. As suggested by the charter of the Merchant Adventurers, the board existed to resolve disputes and to pass ordinances regulating members' conduct.

2. The Origins of Corporate Boards in Political and Cultural Ideas

Since the corporate board of directors in Europe did not start as a device to supervise management on behalf of passive investors in a joint-stock company, how did the idea originate? In fact, corporate governance by a representative board, working with a chief executive officer (a "governor" in the typical parlance of the early corporate charters), is a reflection of widespread political practices and ideas in Western Europe in the late Middle Ages. Specifically, while fictional literature may frequently picture medieval Europe as a place of autocratic governance by kings, European political ideology and practice in the late Middle Ages, although hardly democratic, often called for the use of collective governance by a body of representatives. Examples of such representative-governance ideas and practices are found in the assemblies or parliaments of medieval European kingdoms, in town councils, in governing councils for guilds, and in the Church. Given this prevalent practice, and the ideology that underlay this practice, it was natural for the early corporations to utilize board governance.

European kingdoms in the late-twelfth through fourteenth centuries widely undertook the development and the use of representative assemblies, which are the precursors of today's parliaments.¹³⁶ While the English Parliament, because of its survival

135. Griffiths, *supra* n. 125, at 7.

136. Thomas N. Bisson, *Medieval Representative Institutions: Their Origins and Nature*

and ultimate influence, is the most noted example,¹³⁷ Spanish kingdoms had their “Cortes,”¹³⁸ various Italian kingdoms had “assemblies,”¹³⁹ the French had their “Estates,”¹⁴⁰ and the Germans had the “Reichstag” (or *diet*), on an imperial level, and the “Landtage” on the level of the principalities.¹⁴¹ Town councils appeared in Italy by the end of the eleventh century¹⁴² and sprouted up throughout France,¹⁴³ the low countries,¹⁴⁴ England,¹⁴⁵ and Germany¹⁴⁶ throughout the twelfth and thirteenth centuries. The end result was that town councils, commonly numbering twelve or some multiple thereof, became a prevalent feature of medieval European municipal government.¹⁴⁷

The use of governing boards by medieval European guilds, for the most part, occurred later than the development of medieval European parliaments and town councils. In Italy, fourteenth-century Florentine guilds provide examples of the use of complex systems of councils that mirrored the complexity of Florentine city government.¹⁴⁸ Guilds in some German cities had six- or

1 (The Dryden Press 1973).

137. See H.G. Richardson & G.O. Sayles, *Parliaments and Great Councils in Medieval England* 1 (Stevens & Sons 1961) (reprinted in Bisson, *supra* n. 136, at 32–39) (discussing the English parliament and describing it as “an easily recogni[z]able institution”).

138. E.g. Michael A.R. Graves, *The Parliaments of Early Modern Europe* 14 (Pearson Educ. Ltd. 2001) (referring to the first recorded “Cortes” (parliament) in Spain).

139. E.g. Bryce Lyon, *Medieval Constitutionalism: A Balance of Power*, in *Studies of West European Medieval Institutions* 168–169 (Variorum Reprints 1978) (describing provincial assemblies in parts of Italy).

140. E.g. C. H. McIlwain, *Medieval Estates*, in *The Cambridge Medieval History* vol. 7, 683–687 (listing the history and development of early Estates in France).

141. E.g. Graves, *supra* n. 138, at 23–24 (describing various assemblies in different parts of Germany).

142. E.g. John H. Mundy & Peter Riesenber, *The Medieval Town* 54 (D. Van Nostrand Co. 1958) (listing the beginning of Milanese self-government as sometime between 1084 and 1097).

143. E.g. Carl Stephenson, *Borough and Town: A Study of Urban Origins in England* 40–41 (Medieval Acad. of Am. 1933) (listing privileges in the Norman capital of Rouen, self-government among them, and cataloging several other cities in France with consular governments).

144. E.g. *id.* at 36–37 (describing the expanding role of town councils in Flanders).

145. E.g. Colin Platt, *The English Medieval Town* 129–132 (David McKay Co., Inc. 1976) (recounting portions of the “impressively detailed account” of the establishment of a town council in Ipswich and some of its apparent parallels in other cities).

146. E.g. Susan Reynolds, *Kingdoms and Communities in Western Europe 900–1300*, at 174 (2d ed., Clarendon Press 1997) (defining *consules* as members of the ruling councils in many German towns).

147. See *id.* at 191 (describing councils consisting “of twelve or twenty-four or some other round number” as common in many towns across Europe).

148. E.g. Edgcumbe Staley, *The Guilds of Florence* 119–121 (Methuen & Co. 1906)

eight-person councils by the fourteenth century.¹⁴⁹ In England, a merchant-guild council of twenty-four members, who were virtually the same persons who served on the twenty-four-member town council, existed at Leicester in the mid-thirteenth century.¹⁵⁰ For the most part, however, the move by the guilds toward the use of boards of assistants occurred in the fifteenth and sixteenth centuries.¹⁵¹ Not only did the use of governing boards in medieval European guilds generally occur later than the parliaments and town councils, but this also represented a retrenchment of earlier governance of the guilds through meetings of the entire membership.¹⁵²

A variety of councils were involved in the governance of the medieval Church and church organizations.¹⁵³ The high point of the use of councils in Church governance occurred when the Council of Constance resolved the great schism and claimed, for future councils, primacy over Papal authority.¹⁵⁴

A detailed account of the underlying ideas behind these representative institutions, and how those ideas came to be manifested in the early corporate boards, is beyond the scope of this Article. For present purposes, suffice it to say that joint-stock companies arose out of regulated companies, which were little more than merchant guilds with an exclusive franchise.¹⁵⁵ Hence, the linkage between board governance in the merchant guilds and in the trading companies is easy enough to understand. The merchant guilds, in turn, were closely connected with medieval Euro-

(discussing the two councils in the Calimala guild).

149. *E.g.* Lujo Brentano, *On the History and Development of Guilds and the Origin of Trade-Unions* 126 (Burt Franklin 1870) (giving, as examples, the councils of the Gardners and Spinwetter guilds at Bale and the Tailors guild of Vienna).

150. Platt, *supra* n. 145, at 133.

151. *E.g.* Brentano, *supra* n. 149, at 151–152 (tracing the development and role of a Court of Assistants in the time of Queen Mary).

152. *See id.* at 194–195 (describing a meeting of a “Shoemakers’ Guild” in Arnstadt in 1628).

153. *E.g.* R.W. Carstens, *The Medieval Antecedents of Constitutionalism* 26–28 (Peter Lang Publ., Inc. 1992) (describing governance of the Dominican Order).

154. *E.g.* Antony Black, *Council and Commune: The Conciliar Movement and the Fifteenth-Century Heritage* 17 (Patmos Press 1979) (discussing the actions and declarations of the Council of Constance). Ultimately, however, Papal supremacy was to prevail after the Council of Basel. *E.g.* John N. Figgis, *Political Thought from Gerson to Grotius: 1414–1625*, at 50–51 (Harper & Bros. 1907) (discussing the end of the Council of Basel in 1449).

155. *Supra* n. 112 and accompanying text (describing the evolution of early companies from merchants working independently but under one franchise).

pean municipal governments,¹⁵⁶ which, in part, explains the link between company boards, boards in merchant guilds, and town councils. Moreover, to medieval European jurists, both guilds and towns were a *universitates* (essentially, a corporation) and, as such, were subject to common norms of governance with other corporations.¹⁵⁷ The medieval European guilds and town councils themselves reflected political ideas and practices also manifested in the medieval European parliaments and in the Church councils.¹⁵⁸

The two functions of the board of the Merchant Adventurers suggest some of the underlying ideas behind the European use of representative councils. One function was the adjudication of disputes involving the merchants in the company.¹⁵⁹ The desire to have a board of twenty-four (which, not coincidentally, is a multiple of twelve) hear disputes reflects the medieval European preference for group decision-making in adjudication¹⁶⁰—a preference still reflected in the twelve-person jury.¹⁶¹ The other function of the Merchant Adventurers' board—adopting ordinances to regulate the membership¹⁶²—reflects the medieval European preference for consensus when making decisions impacting all members of the community.¹⁶³

One manifestation of this preference for consensus occurred when Canon Law jurists turned a Roman Law doctrine of *quod omnes tangit ab omnibus approbetur* (“what touches all is to be approved by all”) from a technical rule involving co-tutorship into

156. H.W.C. Davis, *Mediaeval England* 310 (Oxford U. Press 1924).

157. Antony Black, *Guilds and Civil Society in European Political Thought from the Twelfth Century to the Present* 24–25 (Cornell U. Press 1984).

158. *Id.* at 44.

159. Griffiths, *supra* n. 125, at 11–12.

160. Reynolds, *supra* n. 146, at 23–34. The reintroduction of Roman law in the twelfth century led to the increasing use of single presiding judges in lieu of adjudication by collective groups, as had been characteristic of earlier medieval Europe. *Id.* at 51–52. Resistance to this trend occurred in the preservation of trial by jury in England, and—significantly for purposes of this Article—in mercantile matters where assemblies or groups of merchants continued to try disputes. *Id.* at 53–58.

161. Significantly, one of the main functions of medieval European parliaments and town councils was the adjudication of disputes. *E.g.* Richardson & Sayles, *supra* n. 137, at 34–35 (arguing that the primary function of thirteenth-century English parliaments was judicial); Fritz Rorig, *The Medieval Town* 161 (U. of Cal. Press 1967) (explaining that a primary function of early town councils was adjudicating disputes—particularly mercantile disputes).

162. Griffiths, *supra* n. 125, at 11.

163. Reynolds, *supra* n. 146, at 302–305.

a broad principle of governance.¹⁶⁴ This principle applied not only to the Church, but to other “corporations”¹⁶⁵—using the term in the broader sense of a collective group, including guilds and towns—and was invoked in the summonses sent by kings demanding that representatives appear at a parliament.¹⁶⁶ The role, then, of a board, council, or parliament was to have representatives with full power (*plena potestas*) grant the consent required on behalf of the broader community.¹⁶⁷

Just as medieval European political ideas were the source for the corporate board, different political and cultural ideas meant the absence of a board elsewhere. The governance structure of the Japanese merchant house provides a good illustration. As discussed earlier, the merchant house was part of the organization of all four orders of Japanese society into houses, in which the head of the house was entitled to obedience.¹⁶⁸ This family-oriented, hierarchical organization is consistent with Confucian values. For instance, Confucianism speaks of five relationships: ruler–subject, father–son, husband–wife, elder brother–younger brother, and friend–friend.¹⁶⁹ Four of the five are vertical relationships entitled to unquestioned obedience.¹⁷⁰

3. *The Transplant of Corporate Board Governance: Post Hoc Ergo Propter Hoc Reasoning and Culture Spread*

By the nineteenth century, when the Japanese and other non-Europeans were looking at adopting the joint-stock company, the history of when and why Europeans developed the corporate board was centuries old. It is unclear how many Europeans at

164. Brian Tierney, *Medieval Canon Law and Western Constitutionalism*, 52 *Catholic Historical Rev.* 1, 13 (1966).

165. Black, *supra* n. 157, at 73 (citing J. Najemy, *Guild Republicanism in Trecento Florence: The Successes and Ultimate Failure of Corporate Politics*, 84 *Am. Historical Rev.* 53, 56 (1979)).

166. *E.g. Summonses to the Parliament of November 1295*, reprinted in Bisson, *supra* n. 136, at 147–148 (reciting the doctrine that “what touches all should be approved by all” in setting forth the purpose of the summons and commanding county, town, and ecclesial representatives to attend).

167. *Id.* (describing the requirement for bishops, clergy, barons, shires, and towns to send representatives with “full and sufficient power” to act for their constituencies).

168. *Supra* nn. 35–61 and accompanying text (describing the Japanese merchant house).

169. Hirschmeier & Yui, *supra* n. 38, at 45.

170. *Id.*

that point were aware of when and why the tradition of board governance started. However, what was visible to the Japanese and others was a form of business that had a tremendous advantage in raising capital by selling shares to large numbers of strangers and that seemed always to have a board of directors at its helm. Hence, the Japanese and other non-Europeans did what people often do: They assumed that correlation equaled causation and, in adopting the joint-stock company, also adopted the governance structure they assumed was necessary for such companies—a board of directors.

Of course, just because corporate boards came out of political theory, rather than business efficiency concerns, and long predated the joint-stock company does not necessarily mean that the joint-stock company would have arisen without corporate boards. It is often the case that an invention originally directed toward one purpose finds other uses (as in the case of gunpowder).¹⁷¹ Perhaps the existence of governing boards in the regulated trading companies facilitated the evolution of these companies into joint-stock companies. There are two possibilities along this line: one based upon investor perception, the other based upon the actual impact of boards on performance.

An investor-perception impact arose if persons would not have invested in the joint-stock companies unless they had the right to vote for representatives on a governing board. In a sense, this would be the seventeenth- through nineteenth-century equivalent of the so-called “law matters” thesis, which asserts that greater minority shareholder protections explain the presence of widely dispersed shareholdings in some countries.¹⁷² Interestingly enough, the notion that a person would not invest without the ability to vote for representatives on a governing board might, itself, reflect European cultural and political ideas, and not something shared by those from other cultures or political traditions. For example, Chinese investors in the first Chinese joint-stock companies were used to a tradition of nonintervention with the hired managers of their businesses, and, hence, did not re-

171. Historians believe the Chinese originally invented gunpowder for use in making firecrackers. Columbia Encyclopedia, *Gunpowder*, <http://www.encyclopedia.com/html/g1/gunpowder.asp> (accessed Feb. 23, 2004).

172. Brian R. Cheffins, *Does Law Matter? The Separation of Ownership and Control in the United Kingdom*, 30 *J. Leg. Stud.* 459, 461–462 (2001).

quest control but instead readily invested based upon trust in the managers.¹⁷³

Exploring the impact of corporate boards on corporate performance is well beyond the scope of this Article.¹⁷⁴ As mentioned in the introduction to this Article, observers have long been skeptical about how much impact corporate boards really have had. Yet the fact that large corporations have prospered and have contributed to modern economic prosperity suggests that there must be something right about the management structure of corporations—notwithstanding complaints arising from periodic corporate meltdowns. Still, it is difficult to read the work of economic historians without coming to the conclusion that the managerial developments that made corporations work are those—like the development of the U-form and M-form organizational structures—that occurred below the level of the board of directors.¹⁷⁵ Along the same lines, the history of corporate management in Japan suggests that professional managers acting in a hierarchical fashion, not the board of directors as an institution, made Japanese corporations successful.¹⁷⁶

173. Chan, *supra* n. 61, at 73.

174. Various recent studies attempt to assess the impact of board composition and other corporate governance practices on corporate performance. Many of the results have been inconclusive. *E.g.* Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54 *Bus. Law.* 921, 922 (1999) (reviewing over 100 studies and finding no convincing evidence that independent directors improve firm performance); Robert W. Hamilton, *Corporate Governance in America 1950–2000: Major Changes But Uncertain Benefits*, 25 *J. Corp. L.* 349, 359–373 (1999) (studies have not produced consistent positive results from changes in corporate governance, such as increased use of independent directors). Studies in less-developed economies suggest perhaps a greater impact. Mark Mobius, *Issues in Global Corporate Governance*, in *Corporate Governance: An Asia-Pacific Critique* 47–48 (Low Chee Keong ed., Sweet & Maxwell Asia 2002) (discussing recent studies in emerging markets that show better stock performance of companies with so-called “better corporate governance,” including more independent boards). Nevertheless, it is difficult to say how much of this result comes from having a board versus from other so-called “good corporate-governance practices.” It is also hard to say how much of improved market returns reflect investors’ current desire for the stock of companies with so-called “better corporate-governance practices,” and how much reflects actual improved performance by such corporations.

175. *E.g.* Richard S. Tedlow, *The Rise of the American Business Corporation* 13–24, 55–60 (Harwood Academic Publishers 1991) (illustrating structures adopted by railroads in the shift from mercantile partnerships, and later development of the U-form (unitary) and M-form (multidivisional) organizations).

176. *See* Yui, *supra* n. 100, at 11–21 (describing the development of management of joint-stock companies by a senior executive director, aided by junior executive directors, and the lack of development of the board of directors as a decision-making body in Meiji Japan).

Indeed, there is a certain irony in reading complaints from contemporary observers of the early Japanese boards of directors, who castigated the members of these boards for not doing anything.¹⁷⁷ These writings assumed that directors on the boards of Western companies were actively managing their businesses.¹⁷⁸ Yet, to read the writings of observers of the boards of Western companies is to see the same complaints about boards that did not do anything but defer to management.¹⁷⁹ It may be that the best that can be said of the board of directors as an institution is that it is mostly harmless.

IV. CONCLUDING THOUGHTS ON WHY IT MATTERS

Two broad lessons emerge from examining the reasons why the corporate board of directors originated in Europe and spread around the world. The first lesson has to do with business governance, political and cultural ideas, and assumptions about wealth-maximizing efficiencies. Law-and-economics-oriented scholarship often seems to assume that business-governance institutions exist because they serve some efficiency.¹⁸⁰ However, the origins of the corporate board of directors in medieval European political theory, and the use of other governance arrangements in societies where political and cultural ideas were different, show that human beings, even in the business context, do not divorce their notions of how to run a business from their broader political and cultural ideas.¹⁸¹ Moreover, the history of the spread of the corporate board of directors suggests

177. *Id.* at 7 (referring to Ukichi Taguchi, the publisher of the *Tokyo Keizai Zasshi*, then Japan's most influential economic journal, who wrote in 1884, "directors [of Japanese banks] might as well be retired. . . . [T]he president handles everything himself.").

178. *Id.* at 8 (referring to another article by Taguchi).

179. For such a description of an English board of directors in a work of fictional literature written not long before the complaints by Taguchi about Japanese boards, see Anthony Trollope, *The Way We Live Now* (Oxford U. Press 1982) (originally published in 1875) ("Melmotte himself [the chief executive officer of the company and perpetrator of a fraudulent promotion] would speak a few slow words . . . always indicative of triumph, and then everybody would agree to everything, somebody would sign something, and the 'Board' . . . would be over."). For later complaints about inaction by boards in the United States and elsewhere, see *supra* n. 6 and accompanying text.

180. *E.g.* Fama & Jensen, *supra* n. 111, at 301.

181. For a recent attempt to document this phenomenon statistically, see Amir N. Licht, *The Mother of All Path Dependencies: Toward A Cross-Cultural Theory of Corporate Governance Systems*, 26 Del. J. Corp. L. 147 (2001).

that the adoption of business governance institutions may occur because they *appear* to work, not necessarily because they do.

The second lesson to emerge from this discussion of the origins and the spread of the corporate board of directors is to point out the promise and the pitfalls of comparative law as a force for change. Simply put, the spread of the board of directors might show, once again, the wisdom of the precept that “a little knowledge is a dangerous thing.” In this instance, comparative study, which is merely descriptive, can be a useful starting point in suggesting other ways of doing things. Before copying other institutions, however, it is helpful to understand fully the historical and cultural forces that produced those institutions.