CORPORATE GOVERNANCE STRUCTURES IN COMPANIES OF THE 18TH CENTURY

Angélica de Vasconcelos Silva Moreira Santos
Fucape – Fundação Instituto Capixaba de Pesquisas em Contabilidade, Economia e Finanças
Avenida Fernando Ferrari, 1358, Bairro Boa Vista – Vitória/ES – CEP: 29075-505
E-mail: angelicavms@gmail.com

Rosimeire Pimentel Gonzaga
Fucape – Fundação Instituto Capixaba de Pesquisas em Contabilidade, Economia e Finanças
Avenida Fernando Ferrari, 1358, Bairro Boa Vista – Vitória/ES – CEP: 29075-505
E-mail: ropgonzaga@gmail.com

Fábio Moraes da Costa
Fucape – Fundação Instituto Capixaba de Pesquisas em Contabilidade, Economia e Finanças
Avenida Fernando Ferrari, 1358, Bairro Boa Vista – Vitória/ES – CEP: 29075-505
E-mail: fabio@fucape.com

Abstract
This article revisits historical documents in order to provide interpretations regarding the evolution of corporate governance structures of the first two Luso-Brazilian navigation, trade, and slave-trafficking companies that were founded in the northern and northeastern regions of Brazil – the Companhia Geral do Grão-Pará e Maranhão and the Companhia Geral de Pernambuco e Paraíba – during the mid 18th century. Historical facts allow for a better understanding of the establishment and refinement of corporate governance practices, which can be attributed to the changes in the company’s socio-economic arena and to internal factors such as the broadening of the rights of minority shareholders.

Keywords: Corporate governance. Grão Pará and Maranhão general trading company. Pernambuco and Paraíba general trading company.

1 INTRODUCTION
Corporate governance structures are a major topic of research interest in order to identify best practices to better align different economic incentives between individuals within the firm (JENSEN; MECKLING, 1976).

With the objective of contributing to this area of study, this article aims to provide an historical comparative analysis of corporate governance regulations and practices in two companies of the 18th century: the Companhia Geral do Grão-Pará and the Companhia Geral de Pernambuco e Paraíba.

Both companies were founded during the same time period and developed several activities, such as navigation, trade and slave-trafficking. The analysis is based on approved statutes of the companies, available in Carreira (1983) and other manuscripts.

Corporate Governance (hereafter, CG) refers to the monitoring and control systems put in place to ensure that decisions by managers and owners regarding allocation of resources are aligned for the purpose of sound entity management (JENSEN; MECKLING, 1976; FAMA; JENSEN, 1983; SLEIFER; VISHNY, 1997). The dissociation between property and effective capital control permeates the corporate governance debate on various economic fronts.

The manner in which the companies were managed is a result of a set of habits, procedures, and techniques that were developed at the time, being linked to a nation’s culture and society. According to Zubiri (1963), what we are today is the grouping of possibilities
that we possess because of what we were yesterday. Consequently, the historical analysis of entities can provide information for a contemporary debate on this subject (LLOYD-JONES et al., 2005; MACLEAN, 1999).

The separation of property and control and its subsequent effects were also a reality experienced by the first incorporated Brazilian companies as early as the mid 18th century. The administration of the Marquis of Pombal saw the creation of two companies active in the Brazilian north and northeast: the Companhia Geral do Grão Pará e Maranhão (hereafter, CGPM) and the Companhia Geral de Pernambuco e Paraíba (hereafter, CGPP). An analysis of these companies’ documents allows for an identification of traces of what is known now in literature as CG practices.

2. FRAMEWORK

The assessment of governance practices in a historical framework – the research purpose of this work – is still a nascent topic (TOMS; WILSON, 2003). Among the studies focusing on colonial Brazil, two are worth mentioning: the pioneering initiative of Rodrigues et al. (2007), who analyzed the statutory minutes of the CGPM; and the comparative analysis of Santos et al. (2008) of the statutory minutes and the final, approved version of the statute of that company. Based on that first evidence, this study aims to broaden the scope of the analysis by including other CGPM documents as well as CGPP ones, making it possible to observe “standard” CG practices adopted by privileged Portuguese trade companies active in Brazil and how those practices evolved.

Despite being novices, authors like Lloyd-Jones et al., (2005) mention the relevance of analyzing governance practices from an historical perspective. Maclean (1999) argues that, in this context, matters such as board selection, board performance, shareholder maneuvers, and control by a family can contribute to the current debate.

Jong et al. (2006) have been developing a research project aimed at systematically analyzing the development of corporate governance during the entire 20th century by means of a sole data set from Dutch companies, whose commercial paper was negotiated on the Amsterdam stock exchange. In order to address questions of efficiency and the long-term effects of different governance rules, that data is being linked to the performance of companies currently being studied.

The debate involving the CG topic emerges from intra-firm conflicts between agents. What is known in literature as CG is formed by the group of internal and external mechanisms that assures sustainability, the increase in social value, the securing of lower cost of capital, organizational longevity, and corporate decision-making that maximizes the probability for investors (principals) to obtain the best return on their investment. CG practices enhance the credibility of firms vis-à-vis their investors in the international market, broadening the modalities of business financing. In this way, the companies avoid depending exclusively on internal financing or self-financing (JENSEN; MECKLING, 1976).

In addition, the presence of different types of shareholders (majority and minority) also sets the stage for conflict. The most common complaints from minority shareholders involve the lack of decision-making power and the reduced or non-existent participation of such shareholders in managing the company (FAMA; JENSEN, 1983).

La Porta et al. (1999) investigated the property structures of large companies in 27 countries and determined that few companies have their property scattered as described by Berle and Means (1932), except in large economies immersed in a common-law legal arrangement.

In nearly every country analyzed, the companies that prevail are controlled by a small number of shareholders, whose voting rights usually supersede cash flow rights. Thus, the dialectic of CG mechanisms would no longer reside in protecting shareholder interest with respect to managers, but rather in shielding minority shareholders against possible expropriation by controlling shareholders (LA PORTA et al., 1999).
An understanding of the control structure is critical in demonstrating the nature of a potential branch problem in the management of the firm. Different property structures become different agency problems, which in turn require particular mechanisms to insure the well-being of the weaker component. In the next session, the two Luso-Brazilian companies’ structures are described.

3. THE CASE OF THE CGPM AND CGPP COMPANIES

The reign of Joseph I of Portugal was noted for its efforts towards administrative reorganization, economic and political restoration, aiming to make Portugal’s economy closer to the then current European economic ideals. Notable among the initiatives taken was the rational exploitation of colonies, through trade carried out by companies wielding considerable capital during large part of the 18th century (CHAUNU, 1978; MAURO, 1960; MAURO, 1980).

As Prime Minister, the Marquis of Pombal established two companies in colonial Brazil: the CGPM, in 1755, and the CGPP, four years later, in 1759. The companies operated in the Brazilian north and northeast respectively. Their main objective was to reaffirm the colonial pact, discourage smuggling as well as British influence, and integrate agricultural development in the colonies with industrialization in the kingdom (CARREIRA, 1983).

The two regions in which each company operated were very different regarding economic development. Since the 16th century, Pernambuco, in the northeast, had an export-oriented economy that was important for the colony, and its main trading product was sugar. Rio de Janeiro, Bahia, and Pernambuco accounted for 83.7% of Brazilian colonial exports to Portugal. Exports from Pernambuco also included tobacco and cotton. Moreover, extensive cattle farming made for a strong activity in the region. Under the operation of the CGPP, other northeast states (Paraíba and Ceará), despite being two of the three regions of lesser importance regarding overseas trade, had more significant export movement than the African colonies (MARQUES; SERRÃO, 1986).

On the other hand, the situation in the northern states (Grão-Pará and Maranhão) was precarious. Agriculture was at a subsistence stage and labor was lacking. In that geographical area, for instance, the circulating form of currency until 1749 – in light of the shortage of numismatic metal – was cotton cloth and cocoa seeds. In 1751, the new captain-general of Grão-Pará and Maranhão, Francisco Xavier de Mendonça Furtado, began demanding immediate measures to change the underlying crisis by sending a significant number of letters to the Marquis of Pombal (DIAS, 1970; SALAZAR, 1991).

The CGPM was responsible for fomenting local production and trade, and centered its activities on ship building, cattle raising, cultivation of rice, cotton, coffee, cocoa, vanilla, and other commodities, rice processing, exploration of salt deposits, slave traffic, and trade of products imported from Europe and Asia. CGPM
3.1 An Analysis of the CGPM

The company operations were divided in three areas: trade and navigation at the state of Grão-Pará and Maranhão (§ 22) and slave traffic from Africa to Brazil (§ 30). The company received monopoly privileges for 20 years, subject to an additional 10-year extension (§ 51).

Company capital totaled 1,200,000 cruzados\(^1\), divided in 1,200 stocks of 400,000\(^2\) thousand réis each. The amount needed to purchase one share of stock was equivalent to the annual salary of a Latin grammar professor in the captaincy of Pernambuco, one of the highest-paid positions in the school system (AHU_ACL_CU_015, Cx. 219, D. 14849).

The underwriting model was similar to the one adopted by English companies by favoring the participation of elites, specifically the merchants and the nobles (Marcos, 1997). In an attempt to protect the company in the long-run, the statute included a special clause: the partners could not withdrawal the amounts that they had invested while the company was in operation (§ 51). The statute, however, did guarantee shareholders the right to sell their stocks (§§ 50 and 51).

The issuance of capital at the CGPM was public, and only cash was accepted in exchange for the right to purchase shares. Moreover, in order to attract more shareholders, several privileges were granted to those who had invested more than 10,000 cruzados (§ 39). These individuals would have, among other benefits, the possibility of acquiring a noble title, a status that would have exempted them from paying taxes.

---

1 One cruzado is equivalent to 400 réis.
2 The monetary unit was the real (plural réis, and abbreviated to rs.). To indicate one thousand réis a “$” sign was written, followed by three zeros. Thus, 2,000 réis was written as 2$000.
There were three shareholder categories. The holders of ten or more shares were in the most privileged class. They were the only people eligible for membership on the Board, and their names had to remain concealed "in the secrecy of Company books" (§ 48): at that time, the amount of shares owned by each individual had to be secret.

The second category was formed by holders between five and nine shares, that had the privilege to vote (§ 3). In the third category were the holders of less than five shares, who could gather their resources to attain the total number of shares required to cast one vote (§ 3).

Once again, the requirement of a minimum number of shares to be eligible to the “committee of management” was similar to the system applied at British companies (SCOTT, 1912). However, in England each partner had the right to vote, regardless his or her number of shares.

Foreign capital was not excluded for the purposes of company capital formation (§ 50). Foreigners were not eligible for the right to hold managerial posts (§ 2), although it was their prerogative as stakeholders to receive dividends (§ 54). Nevertheless, the analysis cited by Dias (1970, p.230-234) of the list of the company's founding shareholders shows that of the 145 signatories, only a few were foreigners.

Company management was structured as a Board and consisted of a superintendent (president), eight deputies, a secretary, and three counselors (§ 1). Apart from these, the remaining board members were to be native or naturalized Portuguese, tradesmen, and reside in Portugal (§ 3), in addition to the need to have ownership of the minimum number of shares. Except for the first board, the statute also defined a one year term for administrative positions that could be renewed. The objective was to guarantee a proper rotation of company leadership (§§ 3 and 5).

The type of employee compensation and the employment contracts are critical in order to reduce opportunism and to encourage managers to work in the best interests of the firm (CARLOS; NICHOLAS, 1988, 1990).

The compensation system of company management positions was based completely on variable remuneration contingent on fleet expeditions, as a way of aligning the interests of the parties (§ 25). However, in 1760, the company replaced variable-based payment to managers in the Bissau and Cacheu (African trade communities) by a fixed yearly stipend of 1:200$000 reis.

To justify the new compensation system, the governor of the state of Grão-Pará and Maranhão, Manuel Bernardo de Melo e Castro, argued in one of his letters that managers in Africa sent ships with slaves that had no condition to work, just to earn higher salaries (AHU_ACL_CU_013, Cx. 43, D. 3958). Thus, the change in the type of remuneration was an attempt to avoid this problem (DIAS, 1970).

Dividends were distributed on an annual basis, except for the first payment, which was delayed for three years (§ 52). Moreover, there was a statutory arrangement for the “examination of accounts”, what could be compared to an internal audit conducted by two of the eight deputies (§ 6).

According to an internal regulation in the city of Belém do Pará, known as the “Economic Directorate for Company Management”, at the end of each year, managers were required to submit a full inventory of items at farms and storehouses. The bookkeeping process had to cover all merchandise. In addition, board members demanded a list of unpaid debts, recognizing them on the balance sheet (DIAS, 1970, p.271).

One item to be highlighted in the statute is the definition of a "private caretaker judge" (§ 7), who had to make decisions regarding all legal matters in which any company member was a defendant or a plaintiff – analogous to what is today known as a council of arbitration.

Despite the private nature of its activities, the CGPM enjoyed a semi-public identity, as the estate assets and the monopoly privileges were granted indirectly by the Crown. In other words, alongside the capitalist profile of satisfying partners' profit interests; there was
also an obligation to take on governmental tasks of colonial management in certain regions (MARCOS, 1997).

The above-mentioned situation is aligned to the philosophy of an absolutist state. The company was not a simple commercial enterprise; it comprised a group of managers closely tied to the influential protection of the monarchy (§ 4). This model contributed to the economic restoration of the Portuguese Empire (MAURO, 1980).

The state intervention in CGPM led to conflicts of interest, because some decisions were not the best ones for shareholders’ protection. For example, if farmers wanted to deal directly with Portugal and other markets, the CGPM had an obligation to send the goods free of charge (§ 19). Those conflicts are described by Carlos (1991, 1992), and Carlos and Nicholas (1988, 1990, 1993).

The general management principles were defined by the company’s statute, whereas other complementary documents addressed specific topics that had to be approved by the majority of all the shareholders (§ 6).

3.2 An Analysis of the CGPP

The CGPP was founded four years later that the CGPM and its statute followed the same principles of the first company. Thus, in this topic only differences between the two statutes will be addressed.

With regard to the administrative structure of the analyzed companies, the CGPP presented a different structure from that of the CGPM, with a board and two administrative bodies. Based in Lisbon, the board consisted of a superintendent, ten deputies, one secretary, and three counselors.

The administrative bodies were subordinate to the board. Each administrative body, one based in Porto (Portugal) and the other in Pernambuco (Brazil), consisted of one manager and six deputies. In terms of election for the board, CGPP applied the same criteria of CGPM. The only difference was that minority shareholders could elect one councilor (§ 3). Thus, it is possible to observe an evolution of CG practices.

![Figure 2 CGPP administrative structure](source: Adapted from Ribeiro Júnior (1976))

The total amount of the company’s capital was 3,400,000 cruzados, consisting of 3,400 shares (§ 53). One important difference from CGPM was that besides cash, properties and goods at market value could also be used to buy stocks (§ 54).

Despite the confidentiality requirement applied for both companies regarding the number of shares held by each individual, CGPP developed a different approach for the
election. The electoral process began with the formulation of an alphabetical list of members, with two, one, or no asterisks preceding the name of a given shareholder.

Individuals qualified to hold superintendent and deputy positions had two asterisks by their name. One asterisk identified isolated members who had voting rights. Shareholders without an asterisk did not hold a sufficient number of shares to vote. These individuals could make an agreement, summing up their stocks in order to have the right to vote (AHU_ACL_CU_015, Cx. 139, D. 10311).

Figure 3 provides an example of the system.

![Figure 3 Extract of the election minutes (the translation of the title means “List of Stockholders of the Companhia Geral de Pernambuco and Paraíba”)](Source: AHU_ACL_CU_015, Cx. 139, D. 10311)

The asterisk system thus identified who could vote and who could receive votes, while taking care not to display publicly the distribution of shares. This system enhanced transparency in the election process and could be seen as an evolution of CG practices in the CGPP.

The appointment of the CGPP board and the auditing process followed the same standards set by the CGPM.

Remuneration for directors was variable: directors in Lisbon and Porto received 4% of the value of goods both sent to the colony and also brought back (§ 29). Superintendents in Pernambuco and Paraíba enjoyed a 2% markup on the value of goods sold in those markets. Because of unequal treatment, colonial directors sought to increase their commission.
However, the board warned on August 29, 1760, that – as was the case with the CGPM – the directors would be replaced unless they accepted the commission established in the statute (RIBEIRO JUNIOR, 1976, p.108).

A “caretaker judge” (§§ 7 and 8) was also appointed to CGPP, but he was granted with a lifetime term, different from CGPM practices. The same privilege was later extended to the “caretaker judge” at CGPM (§ 9).

The founders of CGPP had additional rights to CGPM shareholders. They were exempted from fighting in the war (§ 43) and had the right to “passive retirement” (§ 44) (Royal Permit of January 31, 1818). A minimum dividend of 5% of the company’s profits was distributed every two years.

In order to attract a greater number of shareholders, the CGPP statute gave more power and privileges in comparison to the CGPM shareholders. Besides that, the minority shareholders of CGPP were given a broader range of rights, being eligible to participate directly in management positions.

The decision to allow minority shareholders to participate in the company’s administrative bodies could be explained by the captaincy’s instability. The absolutist state was threatened by revolts in other similar captaincies, such as Minas Gerais and Bahia. Those movements were starting at the state Pernambuco, whose people had already fought against the Dutch invaders in the XVII century.

The letter from Governor Luis Diogo to the Marquis of Pombal better explains the linkage between the instability and the new privilege to minority shareholders. In 1757, before the foundation of CGPP, the governor announced his intention of establishing a company in Pernambuco with an identical purpose of CGPM with 75% of its shares being controlled by local merchants, thus avoiding their adverse behavior against the new Company (AHU ACL CU 015, Cx. 84, D. 6948).

The comparison between the two statutes of the Luso-Brazilian companies allows to infer that and evolution of corporate governance practices was reached by the CGPP, mainly through its broader benefits to shareholders, which can be attributed to the changes in the company’s socio-economic arena and to internal factors such as the broadening of the rights of minority shareholders.

4. CONCLUSION

This work aims to contribute and expand previous literature on corporate governance in an historical context by adding a new example of governance practices in Luso-Brazilian navigation, trade, and slave-trafficking companies of the 18th century. Their organization at the height of mercantilism presents a connection between property and control subsidized by governance practices in order to simultaneously address private and royal interests.

The analysis of historical documents provides a better understanding of how the Companies were managed and which mechanisms were employed to guarantee a better alignment of interests. Additionally, it is possible to observe an evolution in the corporate governance structures when the two companies are compared.

For a more in-depth analysis of corporate governance practices, it would be interesting for future research to detail possible internal conflicts that existed, as well as to broaden the comparative analysis with other foreign companies placed in the same context.

---

3 In colonial Brazil, citizens had to give their houses upon request of a royal guest. The passive retirement was the right given to some citizens to remain at their homes and only to be the host of a royal guest.
REFERENCES
Manuscripts from Projeto Resgate\textsuperscript{4} de Documentação Histórica Barão do Rio Branco
AHU_ACL_CU_015, Cx. 84, D. 6948
AHU_ACL_CU_015, Cx. 94, D. 7481
AHU_ACL_CU_015, Cx. 139, D. 10311
AHU_ACL_CU_013, Cx. 43, D. 3958
AHU_ACL_CU_015, Cx. 219, D. 14849

Secondary Sources


\textsuperscript{4} “Projeto Resgate” is a project that aims to rescue and preserve the documents on the history of Brazil in archival collections abroad. In practice the documentation is systematized into inventories, published and at the same time, microfilmed and digitalized on cd-rom [distributed to the federal universities in Brazil].


