

Corruption, Negligence, and Mismanagement at the Dutch East India Company

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Abstract: This case study investigates the unethical practices and internal struggles of the world's first multinational company, the Dutch East India Company (DEIC). These problems contributed to its collapse in 1799 after almost two centuries of existence. The company was unable to cope with the shift in global economic powers, changing consumer preferences, rise of competition, the cost of wars it financed, and the inadequate supervision of its merchants. Moreover, internal corruption in private trading, high dividends to shareholders, and uncontrolled administrative costs compounded the company's problems.

Introduction

Internal corruption and corporate malfeasance at the Dutch East India Company were facilitated by a number of factors: a) an organizational structure that allowed conflicting officer-trader roles for employees; b) the constraint of distance for timely communications, and effective internal discipline of personnel; c) the prevalence of deception that resulted in corrupting labor hiring and in slavery; and d) the unethical trading practices rampant among the shipping companies. Officials also serving as merchants free-rode on the company's resources to trade for

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personal gains while representing their official designations from DEIC (Erikson & Bearman, 2006).

Some of the company's personnel pocketed brokerage percentage from suppliers, overloaded ships with personal cargoes for trading, diluted precious metals to produce more volume, colluded with other traders and inspectors, and bribed local government officials. Being the first publicly-traded corporation, the influence of DEIC on current business practices, securities market, bookkeeping, and the financial system are lasting. The case of DEIC is therefore, an illuminating source of strategic and ethics learning.

Case Objectives

The objective of this study is to examine the management of DEIC in relation to abuse and mishandling of human resources and unethical practices that contributed to its demise. The case explains one-sided labor contracts. It also shows failed internal control from conflicting duties of DEIC officials who acted both as company administrators and traders for personal gain. DEIC used its monopolistic position and coercion to expand its territory and increase returns. This case discusses part of the Anglo-Dutch War and dealings with local rulers to reclaim trading routes and partners. The latter created major losses for DEIC, and soon resulted in the Dutch government taking over its operations.

Background: Nutmeg and the Beginning of DEIC

In the 17th century, Europeans enjoyed consuming nutmeg because its seed and its mace offered two distinct flavors for their food (Adams, 1996). However, the Portuguese controlled nutmeg supply and price. Dutch brothers Cornelis and Fredirek de Houtman bravely traced the nutmeg seeds back to a plantation in the Banda Islands of Indonesia (Glickman, 2018; Rei, 2012). This knowledge of the nutmeg source completed the Dutch plan to invest in the East and generate funds for independence from Spain from 1568 to 1648 (Weebers & Ahman, 2014; Andeweg & Irwin, 2002).



Photo Source: "Nutmeg" by jamesapfairlie, CC BY-NC 2.0

The Dutch lawyer-statesman Johan van Oldenbarnevelt had strong support for a business consolidation of twelve existing trading companies (Rei, 2012). This led to the creation of the Verenigde Oost-Indische Compagnie or the Dutch East India Company (DEIC) as a chartered private company on March 20, 1602. The DEIC was granted a 21-year trade monopoly in the waters to and from the East for both diplomacy and conquest (Rei, 2012; Adams, 1996) with additional capitalization of DEIC drawn from the merchants through the provincial states (Adams, 1996).

A Governor General oversaw the trading in the East with Batavia as a base. A body of 17 shareholders, representing different chambers called the Heeren, had overall control, but did not limit the Governor's trading activities, or his conquests and diplomacy to support trading (Rei, 2012). Batavia (present-day Jakarta) was planned in 1619 as a strategic site for an administrative base at the Straits of Sunda, the center in the archipelago, and a path to the West (Weebers & Ahmad, 2014).

Unfair Labor Practices

A seven-month outward voyage from Amsterdam to the East consisted of a huge number of men, commodities, supplies and official communication from the Heeren. Men from the country and beyond were recruited as sailors, soldiers, merchants and servants to replenish casualties from disease and war (Adams, 1996; Roberts, 2011; Bochove & Velzen, 2014). Jobs were offered to job-seekers who were allowed loans for the family they left behind and to cover pre-departure expenditures advanced by recruiters (Bochove & Velzen, 2014). However, the labor rates including those of the officials, were locked in at the same nominal level for an astonishing 100 years (Adams, 1996).

This unethical labor practice negatively affected the finances of hired laborers. The unfairness played a role in internal corruption especially of those workers who wanted additional income. These hiring practices coupled with slave labor from Dutch colonies in Africa, increased the workforce in the East from 13,000 (1600s) to 25,000 (1700s). In comparison, ten DEIC officials in Batavia grew to 100 (Adams, 1996) over the same period.

Upon arrival in Batavia, the full responsibility of the shipments was transferred to the Governor General who traded the merchandise through the brokers of factories, roving merchant-purchasers, and other business settlements. For ten months, the brokers and roving merchants traded the European commodities or bought raw materials, intermediary items, and final goods to be sold for a hefty amount of profit in every transaction (Scheltema, 1907; Adams, 1996). Table 1 shows the goods

transferred from traders to traders. The voyage returning to the West was loaded with a huge number of commodities and were sold with a three-fold increase in prices to cover administrative costs, returns to investors, a portion of income to DEIC directors, and for reinvestment (Adams, 1996; Roberts, 2011).

The pressure to generate returns motivated the company’s aggressive relations in the East. These overstepped the rights and privileges of the laborers and local farmers by enforcing tributaries, and exclusive contracts of the commodity (Scheltema, 1907; Adams, 1996). For example, Governor Jan Pieterszoon Coen (1619-1623) secured the monopoly of the world’s supply of nutmeg by deceptive pacts and murder of competitors in the East (Adams, 1996), and through the siege of Batavia (Kian, 2008).

Conflicts of Interest: DEIC’s Officials

Nutmeg and other spices were the top commodities of DEIC until the early 18th century, when trading was extended to the selling of slave workers from Africa (Adams, 1996) and of opium (Scheltema, 1907). The company controlled these

Table 1. Accumulation of Goods Through the Eastern Route
(Scheltema, 1907; Adams, 1996; Erikson & Bearman, 2006; Kian, 2008)

<i>Trading Partner</i>	<i>Sold (provided)</i>	<i>Bought [tributary]</i>
Batavia	opium (military protection)	textile, rice, sugar, tin, [Spanish reals, rice, taxes, spices, coffee]
India	gold, copper	textiles, silk, sugar, cotton goods
Japan	silk	gold, copper
Persia	spices	silk
China	silver	silk, tea, chinaware
other partners		diamonds, rubies, rose attar, shiraz, dragonsblood, cardamom, lac, galls, rose maloes, sal amoniac, assafoetida, bezoar, brimstone

Source: Organized by authors.

commodities by keeping them out of the hands of smugglers, protecting local rulers of the region where the commodities were located, and restricting sale of any supply

to competitors. However, opportunities shifted to Chinese tea and Indian textiles with spices, coffee, cinnamon, sugar, and tin as secondary goods (Kian, 2008).

DEIC's continuous operations and trading in Batavia extended to Java. The company utilized its economic power as a military protector for local rulers or as peace mediators of conflicting tribes (Kian, 2008). DEIC officials, aside from their administrative duties, also moonlighted as roving merchants and took advantage of negligent monitoring by the Heeren. In numerous occasions, they gained from conflicting interests by serving as DEIC officials, acting as administrators, but also using the company's distribution channels, and acting as merchants selling their personal products. Other opportunities abounded for the company's officials to increase personal profits on shipments trading along the East route (Scheltema, 1907; Adams, 1996) through underreporting their official transactions and pocketing the excess (Erickson & Bearman, 2006). DEIC officials were also involved in diluting precious metals to produce currency, skimming off a percentage of goods from warehouses, and taking a brokerage percentage from suppliers (Adams, 1996). They bypassed middlemen to purchase goods directly from producers (Kian, 2008). These opportunistic practices of DEIC officials greatly improved their finances to complement the fixed salaries.

DEIC's Extreme Trading Measures

The pressure of generating returns led the DEIC to monopolistic practices, the use of coercion, and in extreme cases, it launched wars to maintain profitable trading channels and business partners (Adams, 1996). According to Rei (2012), the DEIC made huge loans from the state to finance the 4th Anglo-Dutch war (1780 to 1784) to establish trade routes and maintain overseas colonies. But they lost and had to surrender trading factories. The DEIC also burdened local leaders with onerous trade treaties such as the one imposed on Pakubuwana II. This treaty incited the sugar price-affected Chinese workers to oust the DEIC. The Chinese allied with another local leader, Sunan Kuning, to eliminate Pakubuwana II. However, Pakubuwana II turned back to the DEIC for help in exchange for agreeing to another treaty. Consequently, an estimated 10,000 ethnic Chinese were killed (Kian, 2008).



Photo Source: 1740 Batavia massacre,
Public Domain

The investors in Amsterdam were financially damaged with the failure of the Dutch in the war, disappointed with the lower production from the East, and terrified by the loss of lives in the massacre of the Chinese. These events, coupled with the change in demand of commodities and the internal mismanagement of the DEIC and its depleted finances, marked the start of the company's decline. Moreover, the nutmeg monopoly was threatened by smugglers as well as the 1778 tsunami in Banda Islands (Harris & Major, 2017). These events adversely affected investments in the production of the newly traded goods: pepper and related spices. Only Java was left for the company's economic survival with its associated dependence on coffee and sugar (Kian, 2008). The Dutch state found no strong justification for the renewal of the DEIC charter and took over its debts, property and settlements in Java (Weebers & Ahmad, 2014). The DEIC collapsed in 1799.

Lessons Learned

The DEIC's case study sheds light on the abuse of fiduciary duties and conflicting interests. First, corrupt and unjust hiring practices forced laborers to work for long durations without additional salaries. The lack in compensation forced helpless laborers to borrow from unscrupulous lenders, tying them for life to the unbreakable cycle of debt at high interest rates. In some cases, the recruitment agents of the DEIC also helped in perpetuating the cycle, enriching themselves in the process. The lesson is to institute transparent and fair hiring guidelines that offer opportunities for growth and additional benefits to all qualified laborers.

Second, incompatible administrator-trader roles were exploited by DEIC officials in the East. Reports reached the Amsterdam office after months, which rendered neither review nor investigation by the Heeren effective. The unethical culture motivated employees to take advantage of trading opportunities for personal gains. Therefore, the assignment of incompatible duties was evidence of tolerance for unethical activities. The lesson is to not assign conflicting duties (administrator vs. trader) especially without control and accountability.

Third, DEIC used its monopolistic position to coerce nutmeg farmers to act according to the company's own benefit. It used slave laborers, and in some cases, initiated wars to gain territories in the East. These practices bred resentment towards the DEIC. Consequently, its victims assisted competitors in smuggling nutmeg trees and seeds away from the company, ending its monopoly, and ultimately its existence.

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