# Patterns of Legal Change: Company Law and Business Enterprise in the Middle East, 1850-1950 [1]

Seven Ağır[2]
Cihan Artunç[3]

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**Abstract**

Recent literature shows that legal institutions and the way they were built have important implications for business activity and economic growth. While the scholarship has provided insights on the differential experience of countries, including those which developed their own legal systems and those that transplanted law from abroad, the Middle East has remained largely unexplored. This study examines the transplantation and evolution of company law in the late Ottoman Empire and early Turkish Republic, drawing implications for the broader debate on the factors shaping the legal transplantation process and its implications for growth. We argue that the peculiar way in which company law was transplanted in the Ottoman/Turkish case depended on the complementary institutions (commercial know-how, accompanying court practices, and culture) and the political economy context that enabled or restricted access to these institutions by different components of business.

## I

Recent literature on economic history and finance shows that the availability of new forms of business organization has contributed to business performance and economic growth. Emergence of joint-stock company and private limited liability company, in particular, is shown to have provided business owners with a larger menu of tools to meet their various—sometimes conflicting—needs, such as facilitating access to finance, limiting liability, and preventing untimely dissolution. As the same time, however, these innovations gave rise to different sets of concerns such as moral hazard for external creditors and potential oppression of minority shareholders. The ability to develop the legal and cultural institutions that can balance such tradeoffs is regarded as an essential condition

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[2] Middle East Technical University, Department of Economics. E-mail: sevenag@metu.edu.tr
[3] University of Arizona, Department of Economics. E-mail: cartunc@email.arizona.edu.

for business performance and economic growth. Accordingly, many governments in developing countries attempted to improve the quality of legal institutions relating to business and finance by emulating models from more developed countries. These efforts have also been supported by the international organizations in line with their aim to standardize law across borders to reduce transaction costs for transnational businesses. Nevertheless, comparative studies on the quality of legal institutions have shown that wide disparities persisted between countries despite harmonization efforts around the globe.

An influential literature has focused on how these disparities have influenced business performance and growth by using cross-country regression models. Focusing on the differences between legal systems with civil-law origins and those with common-law origins, La Porta et al. (1997, 1998, 1999) argued that the legal origins of a country (common law vs. civil law) significantly matters in determining the quality of corporate governance (i.e., investor protection) and thus financial development. Other scholars, on the other hand, have argued that legal families have only limited predictive power with regard to the effectiveness of legal systems and difference between origins and transplants within each legal family is greater than the differences across legal families (Pistor et. al. 2003, Berkowitz et. al. 2003); countries that have imported their formal legal order, rather than having developed it internally may suffer from the "transplant effect,", i.e., they reveal less innovative capacity as indicated by the rate of legal change compared to the legal-origin countries. Yet, these studies also noticed remarkable differences among transplant countries and acknowledged that some transplant countries showed significant success in adapting the law according to local demands and qualified as "receptive transplants." (Berkowitz et. al. 2000)

Notably, a majority of the literature on the importance of legal institutions for business focused on the corporate form. Recent studies in economic history, however, have shown advantages of other forms of business organization such as private limited liability company (PLLC), especially for small- and medium-size enterprises (Guinnane et. al. 2007). This would indicate that success of a legal system needs to be evaluated not only with respect to the quality of its corporate governance rules (and their responsiveness and flexibility) but also its

ability to enable innovations such as PLLC to meet small and medium-size enterprises' contracting needs. Studies focusing on country cases in depth have also revealed substantial variation across transplant countries in this regard. In Japan, for instance, legal system showed great flexibility in allowing firms to mold existing legal types (such as traditional limited partnerships known as *goshi kaisha*) according to their needs (Hannay and Kasuya, 2015). In Spain, a seemingly "unreceptive transplant," legal system enabled small and medium-sized firms to use loopholes to mold legal forms of business organization according to their needs thanks to judicial flexibility (Guinnane and Martinez-Rodriguez, 2012).

While these country-specific studies have indicated that the differences among countries within same legal family can be vast, the idea that different legal systems played a role in shaping the systems of corporate governance has remained a valid one. For instance, several studies revealed that the strength of legal protections for minority investors is one of the factors that has shaped the ownership structure and the accompanying governance characteristics (La Porta et. al. 1997, Demirgüç-Kunt, 1998).[4] Other studies emphasized the extent to which law promotes responsiveness and change without creating a control vacuum (i.e., emergence of complementary control mechanisms as mandatory legislation diminishes) as an important indicator of an effective legal system (Pistor et. al. 2003). Hence, insomuch as the borrowed legal system determines the quality of corporate governance (i.e., entry conditions, legal rules protecting minority investors, availability of complementary control rights) or availability (and entry conditions) of hybrid forms such as PLLC, the choice of the legal system to be transplanted becomes important. The literature on the legal transplantation process, however, has largely focused on the experience of the colonized countries, in which the legal model to be transplanted is enforced by colonizers rather than chosen by local actors, and therefore neglected the question as to how countries make choices from which to borrow company law.

[4] Coffee (1998) presents a survey of competing theories aiming to explain divergent paths of ownership structure and corporate governance systems and (1998: 16) argues that different explanations (political constraints, liquidity preferences, and minority exploitation) could co-exist and contribute to a fuller theory of ownership structure.

For countries with an ability to chose the legal system to transplant, then, the question is twofold: First, how do countries chose which legal model to transplant? Second, what are the factors shaping the success of the transplantation process?

In this paper, we aim to answer these two questions by focusing on the transplantation of business law in the Middle East, in particular the regions of the Ottoman Empire which today constitute modern Turkey. The few studies on business history in the Middle East have focused on the period since the modern corporate form emerged in the region, in particular on the local impact of foreign and multinational companies in the region. Research on the earlier history of business institutions, on the other hand, emphasized the drawbacks of the Islamic/Ottoman law in enabling long-term and sizeable capital pooling.[5] As such, the question as to why modernization, and in particular modernization of business and business law, did not bring about the intended consequences, remained unanswered.

We explore the peculiar characteristics of the transplantation process in Turkey by using both legal documents including contemporary articles written by legal scholars and the available quantitative data on the spread of new legal forms of business organization. First, we argue that Ottoman reformers' choice to use the French code was not some haphazard decision; it was the culmination of a longer, drawn-out process and evolution of legal practices in the Eastern Mediterranean. In the eighteenth century, European consular courts in the Ottoman realms, which provided an 'exit' option for non-Muslim merchants out of the Islamic courts' reach, operated mostly according to the French law. This initial familiarity with the French legal system, both at the level of users of law (i.e., merchants) and legal intermediaries that are responsible for developing the law (i.e., the judges and legislators), must have contributed to the preference for the French law as the model to be transplanted. Second, the initial familiarity and harmonization of the law did not imply later convergence. In fact, the gap between the Turkish legal system and the French one widened over time, representing what scholars have called the "transplant effect". This "transplant

[5] Timur Kuran (2005) maintains that an aversion to the corporation in Islamic law held back the Middle East.

effect" manifests itself in two ways: First, the law hardly changed for many decades during which the country was undergoing substantial socioeconomic change. Second, legislature imposed more rigid controls on the corporate and the private limited liability forms, imposing substantial entry costs for companies created in these forms.

We reason that the lethargy of the legal system reflects both path dependency and the weakness of global competitive pressures during the later period of economic growth due to the war-driven isolation (1914-1945). By path dependence, we refer to three interrelated channels through which Ottoman political economy framework shaped the nature of transplantation:

i) **Lack of demand**: Lack of initiative to adapt the law to local conditions due to initial historical conditions that shaped the ethno-religious composition of the business class and the differences among components of business with regard to their access to complementary institutions (i.e., legal know-how, commercial courts and entrepreneurial culture)

ii) **Ownership structures and governance forms**: Availability of certain means of capital pooling vis-à-vis others that influenced the predominant ownership structure and corresponding governance forms due to political and ideological preferences.

iii) **Political-ideological constraints**: Policy makers' attitudes towards business entities based on their ideological concerns, including their presumptions about political and moral risks involved in business activity given different groups' uneven access to complementary institutions.

## II

Most countries received Western law by way of colonization. Ottoman Turkey is one of two major exceptions, along with Japan. As the military and fiscal challenges of the Ottoman state became obvious in the late eighteenth century, Ottoman bureaucrats have developed a willingness to recognize and adopt the successful policies and institutions of rival nations. In line with their increasing access to foreign ideas and practices, the Western corporate law also became of

interest to the Ottoman reformers as early as 1830s. Sadık Rıfat Paşa, who played a prominent role in the drafting of the Gülhane Edict (1839) that started the series of major political and social reforms known as the Tanzimat, wrote on the role of corporations in capital formation and economic development in his treatise on Europe (*Avrupa Ahvaline Dair Risale*) in 1837. Twelve years later, in July 1850, an Ottoman commercial law was codified based on the translation of the French *code de commerce* of 1807.[6] This law introduced corporation (*anonim şirket*) along with unlimited and limited partnerships (*kollektif* and *komandit*) as legal forms of business.

Prior to 1850, the Ottoman entrepreneurs were able to form partnerships according to Islamic law which allowed limited partnership in the form of *mudaraba*.[7] In Islamic law, there was no concept of corporation as a separate legal entity. Foreigners and foreign-protected Ottoman subjects, on the other hand, could establish corporations since the Capitulations enabled them to operate according to the foreign jurisdiction in the Ottoman lands.[8] There is, however, little information on the formation and activity of these corporations established prior to 1850. After the transplantation of the French commercial code in 1850, Ottoman entrepreneurs, along with foreigners, were able to use the corporate form as a vehicle to raise capital, either to expand production or to start new ventures. Except for a few flawed tabulations of the numbers of Ottoman corporations incorporated during this period, however, little is known about these corporations and more specifically about their legal characteristics.

### *Political-ideological constraints*

The first part of the article provides a *longue durée* perspective on the Ottoman political economy by focusing on the two main institutions through which

[6] Between 1840-1879, other components of French law, such as penal law and procedure law, were translated and put into effect in the Ottoman Empire.

[7] This is a partnership in profit, but—for the passive partner—not in liability. In terms of the concept of liability, the Islamic *mudaraba* was very similar to *commenda*. Indeed, Udovitch (1962) traces the origins of *commenda* to Islamic *mudaraba*.

[8] Capitulations allowed Europeans to use consular jurisdiction in any dispute not involving Muslims. Capitulations also allowed foreign merchants to be exempt from various taxes levied on non-Muslims and also let them enjoy lower tariffs (i.e., for instance, in most of the nineteenth century, they only needed to pay 3 per cent duty on customs, unlike all other non-Muslim Ottomans, who were subject to a 5 per cent tariff). In 18th century, these privileges acquired through capitulations became accessible to non-Muslims through the sale of foreign protection by the consulates (*Berats*).

economic activity was organized—guilds and waqfs—with a focus on their implications not only for the capital accumulation and entrepreneurship, but also for the social and moral responsibilities associated with business. We show that these two institutions defined both the legal and moral constraints and collective-action opportunities of the urban economic activity in the Ottoman Empire. By doing so, they provided welfare-enhancing functions such as enabling businesses access to finance, reducing risks associated with trade, and providing tools supporting contract enforcement. At the same time, however, they stifled competition and efficiency for the sake of stability and equity. More importantly, they shaped one of the key nexus of state-business networks that persisted up to the Republican period. Although these institutions evolved over time due to the conjectural changes in the global context, they failed to generate growth-promoting enterprises.

**Ownership structure and governance:** The second part focuses on the borrowing and adoption of modern institutions such as corporations and limited liability companies in the late Ottoman Empire. We argue that the preexisting institutional context examined in the first part shaped the nature of legal and institutional borrowing: The nature of state-business collaboration, embodied in waqfs and guilds, continued to play a significant—albeit restricted—roles in both pooling capital and meeting certain social needs during the late Ottoman era, and also shaped the way modern instruments were adopted. The nationalist economic policies, along with the availability of new organizational forms such as limited liability, enabled these traditional institutions to evolve and pave the ground for primitive accumulation required for economic modernization. Yet, entry barriers persisted through political restrictions on access to these new forms, which not only undermined the potential for sustained growth but also weakened the co-existence of diverse ethnic and religious communities. As a result, neither the indigenous nor the borrowed institutions were able to align business interests with the long-term welfare concerns.

Ottoman historians, in general, have been unwilling to adopt the notion of 'business' as an autonomous, profit-seeking agent within the context of Ottoman economy. This is mostly due to the conventional portrayals of Ottoman political

economy. The dominant paradigm assumes that the Ottoman state in its "classical age" conducted what may be loosely termed a "command economy": The nature and degree of government intervention in the economy was different from that of the European political ruling classes. Decisions by the Empire's ruling elite on economic issues were based on the priority given to fiscal well-being and equitable welfare.[9] The regulatory policies [such as the trade privileges granted to foreign merchants, internal customs hindering domestic circulation, regulations suppressing luxury consumption, and interventions in the price mechanism] were generally attributed to a distinctive Ottoman mentality:[10]

> "It is obvious that the best interest of the Ottoman economy did not lie behind the protective measures given to all Ottoman *millet*s and foreign nationalities, regardless of whether they lived within or without the realm or whether they were attached to the land or not. The fact that the Ottomans were ridiculing/belittling the economic activities outside the established normative economic frame may be behind this attitude. This was complemented by a non-economic material viewpoint, tightly bound to the belief that the world order (*nizâm-ı alem*) could be sustained by freedom and justice."[11]

Despite these portrayals of an '*anti-capitalistic*' Ottoman political economy, recent studies, have demonstrated that moneymaking activities in the form of tax-farming, long-distance trade, and financial investments were widespread in the Empire. Ottomans, like their counterparts in other parts of the world, sought for channels to transfer their savings into income. The moral economy within which they acted might have been different from what is perceived to be the norm in modern Western capitalism. Yet, what interests us is how these differences manifest themselves in economic institutions—the institutions that enabled exchange, partnership and investment. Here, we would like to focus on

[9] See Genç (2000), İnalcık (1994), and McGowan (1981). İnalcık (1994: 51) maintained that "state interventions in the Ottoman Empire, namely regulations for customs and guild manufacture, fixing maxima in prices, market inspection on the quality and measures of goods, monopolies on the manufacture and sale of certain necessities, were different in essence and in intention from the regulation of a mercantilist state."

[10] Sayar (1986), Ülgener (1981), Ülgener (1951).

[11] Sayar (2000: 115). The main actor of this mental world was the Ottoman man; defined by Sayar as a kind of 'homo Ottomanicus' who was characteristically obedient to the state, religion and customs and had poor consumption patterns.

two institutions that prevailed in the Ottoman economy up until the late nineteenth century: guilds and waqfs.

Guilds (known as *esnaf* in Ottoman Turkish) could be broadly defined as groups of tradesmen and craftsmen that act collectively to preserve their interests.[12] In the pre-industrial world, guilds and guild-like institutions played a central role in regulating access to factors of production in urban centers.[13] Under the supervision of state, albeit with varying degrees of independence, guilds were in charge of setting prices, ensuring quality standards, and controlling distribution of inputs and outputs. Did these regulations serve to further private interests of the guild members or to ensure some socially beneficial outcomes? Were guilds rent-seeking institutions with adverse implications for efficiency, did they play any welfare-enhancing role? These are the issues on which no academic consensus has formed yet.[14] Yet, the fact that the craft and trade guilds continued to dominate economic activity, at least in major urban centers up until the late nineteenth century, points to one of the peculiar characteristics of the Ottoman economy.

The recent literature has showed that urban economic activity in the Ottoman Empire—prior to the arrival of modern forms of business—was mostly organized around guilds. Barriers to entry were central to the functioning of the

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[12] While the literature has, in general, differentiated the European and non-European guilds, the recent focus on the role of guilds as institutions of 'corporate collective action' has brought forward more generalizable aspects of the guilds. Tine de Moor uses the concept of "corporate collective action" to describe "the exclusive, self-governed autonomous institutions" that depended on the idea that a group of people could form a legal body, a *universitas*, a core idea which developed during the legal revolution of the twelfth and thirteenth centuries (p. 192). Explaining European guilds' capacity to act as corporate institutions able to take collective action, de Moor underlines that guilds, like commons, "differentiate insiders from outsiders, to set boundaries to the group and to the use of its resources by means of a set of rules that could be expanded or reduced according to the needs of the moment." See Tine de Moor, "The Silent Revolution: A New Perspective on the Emergence of Commons, Guilds, and Other Forms of Corporate Collective Action in Western Europe," *International Review of Social History* 53 (2008), Supplement, pp. 179-212. See p. 195.

[13] Jan Lucassen, Tine de Moor, and Jan Luiten Van Zanden, "The Return of the Guilds: Towards a Global History of the Guilds in Pre-industrial Times," *International Review of Social History* 53 (2008), Supplement, pp. 5–18. "The Return of the Guilds" Conference and the resulting publications aim to asses the role guilds and guild-like institutions played in the pre-industrial economy from a comparative perspective and constitute an excellent source to take stock of recent advances in the field.

[14] Stephan R. Epstein, "Craft guilds in the pre-modern economy: a discus- sion", The Economic History Review, 2008, 61 (1), 155-174; Charles R. Hickson, and Earl A. Thompson, "A New Theory of Guilds and European Economic Development", *Explorations in Economic History*, 1991, 28 (1), 127-68; Ogilvie, Sheilagh, "Guilds, Efficiency and Social Capital: Evidence from German Proto-Industry", *The Economic History Review*, 2004, 57 (2), 286-333.

guild system: in order to open a shop or operate an itinerant business in any sector, one needed to become a member of the relevant guild. Membership was restricted through various means, such as the requirement of formal apprenticeship, the imposition of an entry fee, the existence of a *numerus fixus* (a fixed membership size). In this sense, guild membership functioned like a modern-day license needed for practice in some professions today, such as admission to the bar, acquisition of a taxi medallion, or a pharmacist's degree, which aim to ensure not only quality standards but also stable earnings in these professions. There is, however, a significant difference between the modern forms of licensing and process of admission into the guild: while today most barriers to entry are impersonal (barriers are set by objective criteria such as passing an exam or paying a certain fee or 'first come, first serve' rule), in traditional guild system the barriers discriminated potential entrants as much according to their personal qualifications as to impersonal criteria. In acceptance into a guild, family ties, ethno-religious affiliation, and gender played a role as important as the payment of an entrance fee or the requirement to be a resident of the town. When legal barriers distinguish potential entrants with respect to their personal characteristics and ties, transferability is limited at the outset. Guild membership, unlike a taxi medallion, was not conceived as a property to be bought, sold, or transferred.

In the Ottoman Empire, the most obvious tool for entry restriction was a legal code that limited the number of individuals or stalls that were allowed to operate in a certain branch of business and in a certain district. This legal code, known as *inhisar-ı bey ü şira* (or shortly *inhisar*),[15] was effective in all sectors until the last decade of the eighteenth century and prevented people outside the guilds to legally perform any trade or craft in urban areas. In retail sectors, *inhisar* served to regulate demand for inputs and supply of outputs, thus enabling control over prices and profits. Taking an active role in the allocation of factors of production and intermediate goods, guild administration had both monopsonistic and monopolistic power, which it was authorized to use for setting the price of final commodities at just levels ensuring both the subsistence of the guild members and the wellbeing of the consumers.

[15] For a brief definition of *inhisar*, see *Encyclopaedia of Islam*,2nd ed.

While in retailing sectors, entitlement to one's daily bread was the main point on which the rules against opening of new shops were based;[16] in craft guilds, especially guilds regulating the production of the necessities, restrictions were justified with reference to the consumers' welfare. Limiting the number of suppliers in such sectors was considered a way to control demand for inputs and thereby input and output prices. In guilds regulating skill-intensive crafts, only skilled journeymen, upon approval of the guild administration, were allowed to acquire the status of master and to practice alone. The requisite of in-guild training aimed to guarantee the quality of work. Through regulations governing apprenticeship, guilds facilitated technical training—and thus served to sustain preindustrial crafts—but also "potentially restricted legal entitlements to work in the industry."[17] Since access to in-guild training and the consequent privileges associated with mastership would require first and foremost one's acceptance as an apprentice by a master, relations established through social networks (such as family, neighborhood, and religious community) played a crucial role access to work and workplace.

Another social function of traditional guild regulations originates from the nature of pre-modern credit relations. The sustenance of business depended on the long-term credit relations between suppliers—long-distance traders—and local shopkeepers, which required either formal credit institutions or 'community responsibility systems'. In the absence of the former, guilds functioned as community responsibility systems by creating mutual liability schemes that reduced the risks for suppliers and wholesalers dealing with urban shopkeepers mostly on a credit basis. In these mutual liability schemes (*müteselsil kefalet*), guild members stood surety for each other for the purchases they made on credit and therefore personal knowledge and social ties through which this knowledge was acquired played an important role in one's admission into the guild.

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[16] Eunjeong Yi, *Guild Dynamics in Seventeenth-century Istanbul: Fluidity and Leverage*, Brill, 2004.See p. 157 where Yi refers to the arguments made by guilds with reference to their rightful entitlement to legitimate gain.

[17] Ogilvie, 'Guilds,' p. 302. Minns and Wallis also argue that the guilds restricted the number of apprentices in order to secure payment in the form of labor from apprentices. See *Rules and Reality*.

Of course, it is questionable whether the guilds were ever able to regulate handicraft production and retail shop keeping as effectively in practice as they were supposed to do according to the official discourse. There was considerable variation as to the extent of autonomy and profit-making capacities of the individual members.[18] There can, however, be no doubt that there were barriers to entry that rendered production and trade in certain sectors more costly for potential entrants. Otherwise, urban craftsmen and tradesmen in guilds would not rigorously organize and claim for exclusive dealing in their sector prior to the nineteenth century.[19] In the Ottoman Empire, guild members' efforts to prevent entry are documented to have surged especially in times of economic contraction, as was the case in the seventeenth and eighteenth centuries.[20] During this period, organized craftsmen and tradesmen solicited charters limiting the number of legitimate businesses in their respective sectors, prohibiting potential entrants within a certain geographical area.[21]

Whether through entry barriers guilds furthered only private interests of its members or also served to ensure some socially beneficial outcomes depended on the overall framework of regulations.[22] Many Ottoman guilds were not legally allowed to set output prices above the "fair price" imposed by the government authorities.[23] Towards the end of the eighteenth century, however, central authorities considered the entry barriers as the main cause of high prices in the marketplace.[24] Indeed, the fact that many craftsmen and tradesmen appealed to the authorities to obtain and defend guild privileges suggest strongly that the guilds delivered some real economic gains to their members. The private gains associated with occupational licensing (such as access to a risk-free, stable stream of income or monopoly profits) were accompanied with social returns

[18] Suraiya Faroqhi, ''Ottoman Craftsmen: Problematic and Sources with Special Emphasis on the Eighteenth Century'', in Faroqhi and Deguilhem, *Crafts and Craftsmen of the Middle East*, pp. 84–118,
[19] Yi, *Guild Dynamics,* 146-7.
[20] Yi, *Guild Dynamics*, p. 150; Faroqhi, *Artisans of Empire*, p. 120; Kütükoğlu, 'Oto-Kontrol Müessesesi', p. 60; Yıldırım, 'Ottoman Guilds'.
[21] C. BLD. 1698 (1764), IM 76/17 (1797), IM 76/23 (1792), IM 98/12 (1805), C. BLD. 15 (1808).
[22] For a recent and heated debate on the efficiency and social benefits of the European guilds, see Epstein, 'Craft guilds' and idem, *Freedom and growth*, and Ogilvie, 'Guilds'; idem, 'Whatever is, is right'?'; idem, *Institutions and European Trade*.
[23] The archival evidence of price supervision and sanctions exists only for products such as bread, meat and candles.
[24] HAT 192/9342 (1791), HAT 180/8133 (1791), C. IKT. 34/1867 (1797).

obtained through guild regulations, such as quality standards, in-guild training and transmission of technology and know-how. We tend to view that Ottoman guilds were pillars of a market welfare system "that partially stifled competition and efficiency for the sake of economic stability and equity for those established within its boundaries."[25] In other words, the guilds had two implications: i) creating entry barriers that stifled competition and created rents—including access to a risk-free, stable stream of income; ii) generating social benefits such as facilitation access-to-credit, technical training, and quality standards.

Another issue related to the Ottoman guilds concerns what they imply for financialization and capital accumulation. Recent research shows that the rents generated by the guilds, gradually transformed into tradable assets in a wide variety of sectors during the late eighteenth century.[26] The entitlement to workplace and capital goods acquired through guild membership (known as *gedik*), in response to the needs of the economic actors, became—albeit with some restrictions—tradable in a wide variety of sectors at the end of the eighteenth century. Through sale of *gedik*s and *gedik* shares, guild members could raise funds from investors that were not directly involved with guilds. These tradable assets also enabled diversified investment and speculation. As Kuran points out for other cases of Ottoman institutional change, however, *gedik* markets failed to mobilize savings for large commercial and industrial ventures. *Gedik*s emerged within the confines of small-scale economic activity supplying domestic markets, whereas the instruments that emerged in Western Europe were adopted by capital-intensive, large enterprises oriented towards overseas markets. While the latter gradually evolved into forms that standardized credit and provided higher ease of transfer, the former disappeared after a century of vibrant existence.

The tradability emerged in response to financial needs of the small actors operating within the confines of a domestic economy (the guild members' need for using collateral to sustain trade)[27] and was conditional upon guilds'

[25] This definition is proposed by Shechter, *Market Welfare*.
[26] Seven Ağır, "The Rise and Demise of Gedik Markets in Istanbul, 1750-1860," *Economic History Review*, forthcoming in 2017.
[27] In the second half of the eighteenth century, the political and military difficulties of the empire had disrupted the traditional supply networks of Istanbul, raising the price of inputs and thereby creating payment difficulties, especially in sectors that depended primarily on these networks.

prerogatives. Depending on the sector in which they operated, guilds imposed limitations on outsiders' access to *gedik* markets. Due to these restrictions, *gedik*s' tradability was far from perfect and thus the asset value of *gedik*s as financial instruments was not optimal. More importantly, the same institutions that ensured the emergence and sustainability of *gedik* markets prevented them from responding to welfare-enhancing opportunities: It was guild-imposed entry restrictions that made *gedik*s valuable at the first place. These very restrictions, however, prevented use of *gedik*s to reallocate capital towards more productive uses. Unlike negotiable instruments that emerged in Western Europe, *gedik*s could not be put into use to expand production and therefore could not contribute to the financing of growth-promoting, large-scale capital investments. While the emergence of *gedik* markets reveals the flexibility in the Ottoman institutional framework, it also attests to its limitations: Restricted access to factors of production embedded in the Ottoman political economy enabled emergence of a financial instrument stripped of growth-promoting qualities.

The case of guilds and *gedik*s attest to the institutional potentials and limitations of the Ottoman economy for businesses: Guild serves some significant social and economic functions within the moral economy context of the Ottoman Empire. They reserved collective-action problems among urban tradesmen, balanced interests of consumers and producers and shaped standards of production. Yet, they also institutionalized state-business relations in a way that restricted entry into business, stifled competition and limited opportunities for capital accumulation. Waqfs, like guilds, served some significant social and economic functions, yet at the same time, had some shortcomings in terms of enabling investment and promoting growth. Waqf is defined as a trust (founded under Islamic law) by a person for the provision of designated service in perpetuity. Endowing a property as waqf provided it a substantial immunity against expropriation, but in return, its founders agreed to supply a designated

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Traditionally, long-term credit relations between suppliers and local shopkeepers were sustained by mutual liability schemes that reduced the risks for merchants dealing with urban shopkeepers mostly on a credit basis. As the defaults on debt increased, the merchants' unwillingness to extend further credit placed all guild members under pressure. As a result, the guilds and merchants agreed to recognize *gedik*s as collateralizable property in those sectors. Accordingly, the earliest *gedik* transactions were the resale of *gedik*s expropriated by the guild officials aiming to pay the debts of guild members to various actors, including the suppliers. See Agir and Yildirim, 'Gedik'.

social service in perpetuity.[28] Like a corporation, waqf had the capacity to outlive its founder, employees, and beneficiaries. But, it had also some limitations in terms of enabling directing funds for investment:

> "First, whereas an association could turn itself into a corporation through the collective will of its members, ordinarily the founder of a waqf had to be an individual. Second, whereas a corporation was meant to be controlled by a changing membership, a waqf was supposed to be controlled forever by its founder, through directions enunciated in the founding deed (*waqfiyya*). Accordingly, a waqfs mission was irrevocable; not even its founder was authorized to alter its declared purpose retroactively. A third difference concerned self-governance. Unlike a corporation, which could remake its own rules, a waqf's rules of operation were meant to be fixed; the founder's instructions were enforced through judges and, where the deed was silent, according to local custom."[29]

While waqf, as the main vehicle for financing both commercial and public ventures in the Ottoman Empire, could serve as a model for social entrepreneurship, help relieve problems such as poverty, and provide a protection against expropriation, it did not allow emergence of innovative instruments such as securitization. Furthermore, by design, the waqf had little capacity to solve collective action problems and therefore not able to serve as a tool for representing 'business interests' vis-à-vis state. Eventually, they were not able to form a substitute for autonomous business organizations, which could have generated an effective demand for innovations in business law and protection of property rights.

Guilds and waqfs point to two aspects of Ottoman political economy that render it relatively less competitive' vis-à-vis Western European economies in retrospect: First, the political and social restrictions on entry were not to be challenged from within the Ottoman economy. Non-Muslims, who had access to certain legal privileges, dominated the large-scale commercial and financial activity and had access to certain legal privileges (such as access to foreign jurisdiction and exemption from custom duties) but had little political sway. Proto-industrialization that might have undermined guild-imposed regulations was restricted to rural regions in the Balkans. Furthermore, the Janissaries, originally an elite section of the infantry corps, came to integrate into the urban

[28] Kuran, *Waqf System*.
[29] Kuran, *Corporation*, p. 800.

commercial life during the seventeenth and eighteenth centuries.[30] This was another element in historical contingency that led to the persistence of entry barriers and the state-business networks oriented towards rent-seeking.

Second, foreign trade constituted a minimal fraction in the Ottoman economic activity up until the mid-nineteenth century.[31] In the mid-nineteenth century, trade opening had led to the demise of political and social restrictions, but at the same time distorted terms of trade with adverse impact on domestic industry and indigenous businesses that could have played a role in industrialization and modernization.

**II. Modernization of Corporation Law in the Ottoman Empire**

Most countries received Western law by way of colonization. Ottoman Turkey is one of two major exceptions, along with Japan. As the military and fiscal challenges of the Ottoman state became obvious in the late eighteenth century, Ottoman bureaucrats have developed a willingness to recognize and adopt the successful policies and institutions of rival nations. According to Timur Kuran, the fact that financial modernization was impossible through indigenous means motivated the transplantation of the Western law and institutions. But as we will show in this part, institutional borrowing was also contingent upon pre-existing political economy context and institutional heritage. In this sense, the Japanese and the Ottoman cases stand as two strikingly different yet informative examples of the nature of institutional borrowing.

In line with their increasing access to foreign ideas and practices, the Western corporate law became of interest to the Ottoman reformers as early as 1830s. Sadık Rıfat Paşa, who played a prominent role in the drafting of the Gülhane Edict (1839) that started the series of major political and social reforms known as the Tanzimat, wrote on the role of corporations in capital formation

[30] There were many examples in which Janissaries employed coercive methods to circumvent existing rules and regulations in the commercial life for their advantage. In other words, the corps had become "an institutional base by which various urban elements tried to protect their privileges and interests against the ruling elite." This integration of the Janissaries with urban elements enabled the guilds to enjoy more autonomy, limiting the central administration's efforts to reorganize the economy. In fact, the guild members played a significant role in the popular riots of the eighteenth century, including the one that led to the dethronement and death of Sultan Selim III, who attempted to abolish Janissary corps and remove entry barriers during his tumultuous reign.

[31] Eldem, *French Trade*.

and economic development in his treatise on Europe (*Avrupa Ahvaline Dair Risale*) in 1837. Twelve years later, in July 1850, an Ottoman commercial law was codified based on the translation of the French *code de commerce* of 1807.[32] This law introduced corporation (*anonim şirket*) along with unlimited and limited partnerships (*kollektif* and *komandit*) as legal forms of business.

Prior to 1850, the Ottoman entrepreneurs were able to form partnerships according to Islamic law which allowed limited partnership in the form of *mudaraba*.[33] In Islamic law, there was no concept of corporation as a separate legal entity. Foreigners and foreign-protected Ottoman subjects, on the other hand, could establish corporations since the Capitulations enabled them to operate according to the foreign jurisdiction in the Ottoman lands.[34] There is, however, little information on the formation and activity of these corporations established prior to 1850. After the transplantation of the French commercial code in 1850, Ottoman entrepreneurs, along with foreigners, were able to use the corporate form as a vehicle to raise capital, either to expand production or to start new ventures. Except for a few flawed tabulations of the numbers of Ottoman corporations incorporated during this period, however, little is known about these corporations and more specifically about their legal characteristics.

We have surveyed the Ottoman Archives, contemporary primary and secondary sources to estimate the number of corporations established during this period (1850-1918). Data on the corporations established during 1914-1918 come from special folders in the Ottoman Archives (*İ.DUİT*s) designed solely for keeping records of corporate charters and seems to be more comprehensive. There was no such source or registry for the previous period. Therefore, we had to build our estimate for the number of corporations established prior to 1914 on a variety of sources that were created for different purposes and hence the

[32] Between 1840-1879, other components of French law, such as penal law and procedure law, were translated and put into effect in the Ottoman Empire.
[33] This is a partnership in profit, but—for the passive partner—not in liability. In terms of the concept of liability, the Islamic *mudaraba* was very similar to *commenda*. Indeed, Udovitch (1962) traces the origins of *commenda* to Islamic *mudaraba*.
[34] Capitulations allowed Europeans to use consular jurisdiction in any dispute not involving Muslims. Capitulations also allowed foreign merchants to be exempt from various taxes levied on non-Muslims and also let them enjoy lower tariffs (i.e., for instance, in most of the nineteenth century, they only needed to pay 3 per cent duty on customs, unlike all other non-Muslim Ottomans, who were subject to a 5 per cent tariff). In 18th century, these privileges acquired through capitulations became accessible to non-Muslims through the sale of foreign protection by the consulates (*Berat*s).

numbers may not add up to a definitive account of corporate sector. Our survey indicates that 221 "Ottoman" corporations (corporations established according to the Ottoman jurisdiction) were established in the core Ottoman lands (Balkans and Anatolia) prior to 1914.[35] While this number may be flawed, it is the most reliable estimate at the moment, given available sources. If we make an unrealistic assumption and suppose all these corporations have survived until 1914, the number would still indicate a very small corporate sector in the Empire.[36] Furthermore, more than half of these 221 corporations were public utility corporations (providing services such as electricity, gas, water, railroads) and banks established mostly by foreign capital. In other words, between 1850—when the corporate form was introduced—and 1914, use of the corporate form by the Ottoman subjects was extremely limited.

This is in striking contrast with Japan, which allowed general incorporation (corporations could be established without prior permission from the government) in 1899. In Japan, there were 5253 registered joint-stock companies, making up more than one third of multi-owner enterprises in 1911.[37] Later, in 1920s, joint stock companies came to account for the largest share of all enterprises in Japan.[38] The prevalence of the joint stock form in Japan is striking in itself and has been examined with comparison to European cases. But, the sources of its success are also worth examining in comparison to the diametrically opposite case of Turkey, which, as we will discuss further below, had seemingly similar motivations such as modernization and development in transplanting the Western law.

Apart from the low level of savings and capital accumulation given the underdeveloped state of Ottoman economy, there are two major factors embedded in Ottoman legal framework that might account for the low level of

[35] In our initial data set, we had information on 15 corporations established on the Arab lands. We omitted these companies because the lists for these regions seem to be far from comprehensive and comparison with the Turkish period would not be possible. Almost all companies registered for these regions were public utility companies.
[36] On the eve of the World War I, there were 250,000 corporations in the US (about 2.5 corporations for every 1000 people); 5,100 in Germany (less than 0.1 per 1000); 13,000 in France (more than 0.3 per 1000), and 63,000 in the UK (more than 1.3 per 1000). See Guinnane et. al. (2007: 9).
[37] Statistical Yearbook of Japan. I am grateful to Professor Shimizu for providing me with the information on Japan.
[38] Tom Nicholas, "The Organization of Enterprise in Japan." *The Journal of Economic History* 75.02 (2015): 333-363, p. 341.

incorporation prior to 1914. The first one concerns the nature of legal transplantation and change. Until well into the second half of the nineteenth century, in all countries recognizing corporation as a legal business form, incorporation was a privilege granted only by a special act of the legislature for purposes deemed to be in the public interest.[39] This was also true for the French commercial code of 1807 transplanted into the Ottoman legal system in 1850, in which the charters of corporations were still granted upon concession.[40] In the second half the nineteenth century, however, the laws governing incorporation evolved rapidly, allowing general incorporation—a registration system that does not require state approval prior to the establishment of the company—to take hold and spread in Western Europe and the United States. In France, the shift from the concession to the free registration system took place in 1867.[41] In the Ottoman Empire, however, the transplanted law of 1850 did not change for decades.

The late Ottoman Empire and early Republic retained the French commercial law, albeit with some minor alterations and additions, for more than seventy years, up until 1926 when a new commercial code was introduced based primarily on the French code of commerce of 1925. While the new code introduced private limited liability firm (*limited şirket*) as a new legal form of business, it also diverged from the new French commercial code in some significant aspects. Most importantly, it retained the concession system, which had eroded in the origin country many decades ago, and as a result incorporation continued to be a highly difficult and costly process in the Turkish Republic. Under these circumstances, it was understandable that the corporate form was used almost exclusively in very large enterprises, such as public utility enterprises with high capital needs and high prospects of return guaranteed through monopolistic regulation that allowed these companies to pass on the

[39] In Lamoreaux and Rosenthal's words (2006: 127), "at the beginning of the nineteenth century, corporations were still regarded as quasi-governmental institutions."
[40] In France, free registration of all private companies was proclaimed in 1791, in the aftermath of the revolution, which was reversed in 1793. The principle of free incorporation was reintroduced in 1796 to be removed back again in 1807. Pistor referring to Norbert Horn, *Gesellscheftsrecht in Frankreich* (Coing ed. III Tb.1 1988).
[41] By the late nineteenth century, Germany (1860s), the United Kingdom (1855-56), and the United States (1860s-70s, depending on the state) had all introduced general incorporation. See Guinnane et al. (2007) p. 692, Table 1.

costs to their customers. We will discuss the possible reasons of the persistence of the concession system in the last section.

Second, up until 1914, there was an asymmetry between foreigners and the Ottoman subjects in terms of their access to the corporate form. In the concession system, the state had control rights and veto power over incorporation. Ottoman entrepreneurs aiming to incorporate firms had to go through a process through which their proposed charters were examined by the concerned departments of the state before a concession was granted. The documents that record official correspondence between applicants and the state bureaus indicate a very lengthy and cumbersome process that might last up to 24 months.[42]

In short, an Ottoman entrepreneur hoping to form a corporation had to petition the state legislature for a charter and go through a process that was accessible only to wealthy and well-connected entrepreneurs. The foreigners and foreign-protected non-Muslims (*Beratlı*s), on the other hand, were exempt from such procedures in accordance with the extraterritorial privileges granted by the capitulations. In other words, capitulations restricted the judicial power of the Ottoman state, which made the incorporation process so cumbersome for Ottoman (non-protected) subjects of the Empire. There is not much evidence on the use of corporate form (or limited liability form) by the *Beratlı* merchants. In fact, non-Muslim Ottomans could access foreign jurisdiction through purchase of *Berat*s prior to the general incorporation laws and when general incorporation laws were introduced in Europe, *Berat* sales had already stopped.[43] In other words, as long as they were not naturalized by the government that protected them, the Ottoman non-Muslims did not have an advantage over Ottoman Muslims in having access to the corporate form. After the general incorporation laws, however, foreigners were able to establish corporations in the Ottoman Empire without going through the concession process. Because of capitulations, foreign companies could operate as if they were operating in their own country, which means they were operating according to the "general incorporation laws."

[42] See Appendix 1 summarizing the official stages through which a corporate charter was granted. For instance, it took 24 months to receive the charter for Konya Osmanlı Anonim Şirketi. For most corporations, the approval process lasted at least 6 months.
[43] See Artunç's forthcoming article (2015) on Beratlı merchants.

For instance, even though private limited liability company was not yet legally recognized, there were British PLLC companies operating in the Empire. Indeed, there were various articles about the relative ease with which foreigners established firms in the Empire and the problems associated with the absence of supervision over these firms.[44]

The concession system along with foreigners' exemption from it rendered the corporate form a means of capital pooling available primarily for foreign entrepreneurs in the Ottoman Empire. In 1887 and 1906, the Ottoman Government attempted to subject foreign companies to the Ottoman legislation by enacting statutes requiring foreign corporations to acquire an official permission from the Ottoman Ministry of Commerce to operate in the Empire.[45] Yet, neither of these statutes could be put into effect due to the objections that foreign ambassadors and consuls raised on the grounds of concessions obtained through the Capitulations. Eventually in December 1914, the Committee of Union and Progress was able to enact a new statute aiming to level the playing ground for the foreigners and Ottomans.[46] The new statute required foreign corporations operating in the Ottoman Empire to acquire permission from the Ministry of Commerce by submitting the documents pertaining to their registration and activity in their home country. Unlike its predecessors, this statute on foreign corporations could be put into effect since the outbreak of World War I offered the Committee of Union and Progress (CUP), the authoritarian party in power, a chance to abolish the capitulations.[47]

The unilateral abrogation of the Capitulations in October 1914 enabled the Ottoman Empire to exercise unrestricted sovereignty on domestic affairs, including commercial activity. The 1914 Statute, enacted two months later, was an outcome of this authority implemented in the realm of business activity and

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[44] Gülsoy ve Nazır (2009: 183).
[45] "*Memalik-i Ecnebiyede Teşekkül eden Anonim Şirketlerin Memalik-i Devlet-i Aliyye'de Icra-yı Muamelat için Kuşad ve yahud Tayin Edecekleri Acenteler Hakkında Nizamname*" (1887) and "*Memalik-i Mahruse-i Şahane'de İfa-yı Muamele Etmekte Olan Ecnebi Anonim Şirketleriyle Sigorta Kumpanyaları Hakkında Nizamname*" (1906).
[46] "*Ecnebi Anonim ve Sermayesi Eshama Münkasim Şirketler ile Ecnebi Sigorta Şirketleri Hakkında Kanun-ı Muvakkat*" (December 1914).
[47] Towards the end of the nineteenth century,the capitulations came to be seen not only as a yoke on the Imperial sovereignty but also the foremost barrier to the development of the Empire and all previous efforts of the Ottoman government to weaken the capitulatory system were undermined by the European powers.

helped eliminate the gap between foreigners and Ottomans in terms of their access to corporate form. Incorporation was still subject to concession for the Ottoman subjects and the legal process, through which foreigners could establish corporations, as it was specified in the 1914 statute, seems to have been simpler and shorter than the one Ottoman subjects had to go through.[48] Yet, the conditions created by the war and the policies favoring Muslim over non-Muslim Ottomans, coupled with this legal transformation, paved the ground for the emergence and spread of the Muslim owned corporations in late Ottoman Empire and early Turkish Republic. These corporations, however, did not exhibit certain characteristics associated with the corporate form in the modern literature (i.e. the secondary markets for shares).

### 3. The Rise of the Muslim/Turkish Corporation (1914-1919)

To understand the emergence and spread of Muslim-owned corporations during the late Ottoman period, it is important to understand the political economy of the Empire's last decade. In the last decade of the nineteenth century, a group of young intellectuals known as the *Young Turks* in the West, formed an organization called the Committee of Union and Progress, which restored the constitutional rule in 1908. The Young Turk revolution, which started as a liberal reform movement, claimed to present all the ethnic groups of the Empire. However, the regime change did not stop the unrest among the different nationalities. After the Balkan Wars of 1912-13, the Empire lost most of its European territories, including places such as Macedonia, Albania and Thrace, which have been the heart of the Empire for centuries. After 1913, the CUP rather than the parliament came to dominate politics in the Ottoman Empire based on its members' power and influence in the military.

During World War I, the CUP government undertook some legislative and political actions favoring Muslims/Turks in the economic sphere. As mentioned above, unilateral abrogation of the Capitulations provided the government with unrestricted sovereignty. In December 1914, the government enacted the law concerning foreign corporations in the Ottoman Empire. Custom tariffs were

[48] According to the 1914 statute, the ministry had to respond to the foreigners' application in three months. There was no such time limit for the grant of Ottoman corporate charters.

increased first in October 1914 (from 8 percent to 15 percent) and then in May 1915 (to 30 percent). In 1916, ad valorem tax structure was annihilated and replaced by a protectionist one based on a specific tariff structure to support domestic industry. At the same time, there was an Empire-wide policy of 'Turkification' that included harassment, boycott and exclusion from employment, targeting especially Armenian and Greek subjects of the Empire.

The 1914 Act, along with the "national economy" policies of the CUP government within the context of World War I[49] led to a substantial increase in the number of corporations incorporated by the Ottoman Muslims vis-à-vis corporations established by non-Muslims and foreigners.[50]

**Table 1:** Corporations' Founders, 1908-1918 (254 Companies).

| | **Number** | | | **Percentage** | | |
|---|---|---|---|---|---|---|
| **Origin**[51] | **1908-1914** | **1915-1918** | **Total** | **1908-1914** | **1915-1918** | **Total** |
| **M** | 52 | 99 | **151** | 40.6 | 78.6 | **59.4** |
| **F** | 40 | 8 | **48** | 31.3 | 6.3 | **18.9** |
| **N** | 23 | 6 | **29** | 18 | 4.8 | **11.4** |
| **NM** | 7 | 7 | **14** | 5.5 | 5.6 | **5.5** |
| **MF** | 1 | 4 | **5** | 0.8 | 3.2 | **2** |
| **FMN** | 2 | 2 | **4** | 1.6 | 1.6 | **1.6** |
| **FN** | 3 | 0 | **3** | 2.3 | 0 | **1.2** |
| **Total** | **128** | **126** | **254** | **100** | **100** | **100** |

While the share of corporations established by the non-Muslims and by the foreigners decreased significantly (from 18 per cent to 4.8 per cent and from

[49] When the World War began, France and Britain, major foreign investor states up until then, withdrew from the Empire; while Germany and Austria continued to invest (Geyikdağı, 2011: 526).

[50] Ethnic restructuring in the Empire should have also contributed to the decreasing number of new corporations established by the non-Muslims. By 1914, 150000 Greeks were already expelled from the Empire.

[51] F: Foreign, FN: Foreign-Non-Muslim, FMN: Foreign-Muslim-Non-Muslim, MF: Muslim-Foreign, M: Muslim, NM: Non-Muslim-Muslim, N: Non-Muslim

31.3 per cent to 6.3 per cent respectively), there was a substantial increase in the share of corporations established by Muslim subjects in total number of corporations (from 40.6 per cent to 78.6 per cent). The sectoral distribution of these corporations indicates that it was not the "industrial support" programs that caused an increase in the number of corporations. As Table 2 below shows, the Ottoman corporations mainly did business related to trade and banking, followed by construction and transportation sectors. There was no significant change in terms of the sectoral distribution of corporations established after 1914.

**Table 2: Sectoral Distribution, 1908-1918 (254 Companies).**

| | **1908-1914** | | **1915-1918** | | **Total** |
|---|---|---|---|---|---|
| **Sectors** | **Number** | **%** | **Number** | **%** | **Number** |
| Trade | 48 | 37,5 | 61 | 52,5862 | 119 |
| Manufacture | 27 | 21,09375 | 27 | 23,2759 | 54 |
| Banking | 19 | 14,84375 | 12 | 10,3448 | 31 |
| Construction | 9 | 7,03125 | 6 | 5,17241 | 15 |
| Transportation | 13 | 10,15625 | 2 | 1,72414 | 15 |
| Mining | 6 | 4,6875 | 2 | 1,72414 | 8 |
| Public Utilities | 6 | 4,6875 | 2 | 1,72414 | 8 |
| Insurance | | 0 | 4 | 3,44828 | 4 |
| **Total** | 128 | 100 | 116 | 100 | 254 |

How did the Ottoman Muslims finance the corporations established during this period? Did tradable shares, considered as one of the most significant advantages on the corporate form, enable capital pooling? Were there other means through which these corporations finance themselves? To answer this question, we examined a sample of charters of the Ottoman corporations established by Muslims. The charters provide us with the information on the identity of the founders and the rules concerning ownership and voting and share transferability. Along with the supporting evidence on how these corporations were financed from other archival sources, these charters reveal an idiosyncratic characteristic of the Ottoman corporate activity: The Ottoman

government, non-profit associations supported by the government, and the traditional organizations of waqfs and guilds played a significant role in financing these corporations. As a result, the corporate ownership, even widely dispersed, reflected personal networks depending on political and social affiliations.

In 1909, Ottoman government enacted *the Law of Associations (Cemiyetler Kanunu*).[52] According to this law, there was no need to get official permission from the Ottoman government before establishing an association, unlike corporations.[53] Accordingly, the years following the Law of Associations (1909) witnessed the emergence of many associations all around the empire. Here, we will focus on one of these associations, the Artisans' League *(Esnaf Cemiyeti)*, which played a crucial role in establishing connections between political authorities and potential investors and enabled capital pooling in spite of the absence of capital markets. The Artisans' League was an association created with the direct support and involvement of the Ottoman political authorities, which was a modified versions of the traditional guild organization of the Muslim-Turkish merchants, artisans and shopkeepers.

With the abolishment of the traditional guild system, the CUP tried to reform the organization of the Ottoman urban craftsmen and tradesmen (*esnaf*) in line with the modern business practices.[54] Indeed, the Ottoman government had attempted to encourage re-organization of Muslim tradesmen before the second constitutional era. For example, the Industrial Reform Commission (*Islah-i Sanayi Komisyonu*) was founded in 1864 in order to increase the custom tariffs and offer support to Muslim businessmen who wanted to establish new factories. One of the objectives of the Commission was to encourage the traditional urban craftsmen and tradesmen (*esnaf*) to create corporations. The Artisans' League represented the culmination of these efforts during the CUP period and indicated that there was a persistent need, on behalf of the Ottoman reformers, to merge

[52] In the literature, the word *"Cemiyet"* is translated to English as league, community, society, association, or union.. Kuran (2012: 127) considers this law as the first corporate law in the Middle East. However, the law explicitly refers to "non-profit" organizations. See Toprak (2013).
[53] Article-2.
[54] The guild system had survived for centuries with several alterations until its abolishment by the CUP (Tuna, 1941: 959).

the remnants of the traditional institutions of the Ottoman economy, such as guilds, with modern institutions borrowed from the West, such as corporations.

The League contributed to financing of the three largest "national" corporations established during the World War in the Ottoman Empire:

**Table 3: Corporations supported by the Artisans' League[55]**

| Company | Year | Initial Capital (OL) |
|---|---|---|
| Anadolu Milli Mahsulat Osmanlı Anonim Şirketi | 1915 | 200,000 |
| Milli İthalat Kantariye Anonim Şirketi | 1916 | 200,000 |
| Milli Ekmekçiler Anonim Şirketi | 1917 | 100,000 |

All three corporations were established, as defined in their charters, with the aim of provisioning food within the Empire. They had relatively higher amounts of initial capital compared to other corporations of the period and it was the Artisans' League who helped raise the capital for the above-mentioned corporations by obliging its members to purchase the company shares.

*Anadolu Milli Mahsulat Osmanlı Anonim Şirketi* was founded in 1915. Half of the initial capital (100000 Ottoman Liras) was provided by the Council of Trade (*Heyet-i Mahsusa-i Ticariyye*)—a governmental organization in charge of provisioning Istanbul. The rest of the capital was collected from the Muslim traders and merchants living in both Anatolia and Istanbul. The shares of these companies were not sold in the stock exchange; rather the local officials of the CUP gathered capital through its networks. The second company, *Milli İthalat Kantariye Anonim Şirketi* was founded in 1916. Again, the Council provided half of the capital and the CUP collected the rest from the grocers in Istanbul through the League, by distributing shares of the company to the League members in exchange for sugar. All founders of this company were Muslims and most of them were artisans. The third corporation, *"Milli Ekmekçiler Anonim Şirketi"* was founded in 1917. Once more time, half of the capital was paid by *"Heyet-i Mahsusa-i Ticariyye"* while the other half was gathered from the bakers who were members of the League in Istanbul.

[55] Sources: BOA., İ..DUİT,120-6; BOA., İ..DUİT,120-21; BOA., İ..DUİT,122-2.

The Artisans' League was an example of how government-supported non-profit associations played a role in the establishment of the Muslim/Turkish corporations. There were other associations who were involved in raising revenue for the corporations established during this period.[56] The fact that most of these corporations restrict the transferability of the shares (either through restricting share transferability to foreigners or non-Muslims or just assigning a significant percentage of shares as "*titres nominatifs*") also indicates that the capital pooling in these corporations was not enabled through impersonal share markets. The role of political networks in the emergence of the Muslim/Turkish corporations during this period is also corroborated by the data on the founders' identity. Among 151 Muslim corporations established during this period, we were able to identify that at least more than 40 per cent have a politically affiliated person[57] as one or several of its founders.

**Table 4: Identity of the Founders/Managers[58]**

| Founder | Number of Companies | Percentage (%) |
|---|---|---|
| Merchant | 47 | 31.1 |
| **Political Authorities** | 40 | 26.5 |
| **Political Authorities & Local Notables** | 17 | 11.3 |
| Local Notables | 28 | 18.5 |
| Unknown | 18 | 11.9 |
| Women | 1 | 0.7 |
| Total | 151 | 100 |

In short, the Muslim/Turkish corporations that emerged during the World War were based on the deliberate attempts of the government to create a 'national economy.' The local Muslim interest groups, such as small town gentry and rural landlords (*eşraf* and *ayan*), who had already infiltrated the ranks of the local government branches to some extent, collaborated with the government in these

[56] Another association, which played an important role, in the establishment of national corporations was the Navy Association (*Donanma Cemiyeti*), which is examined in detail in Gokatalay's forthcoming M.S. thesis (2015).
[57] "Politically affiliated person" refers to the CUP members, bureaucrats, Pashas, and the military.
[58] Many corporate charters identified their founders as the original administrative board to hold power during five years after the establishment.

efforts to build a Muslim business class. Yet, the fact that most of these corporations disappeared during the transition to the Republic indicates the importance of political alliances and the limitations imposed by the state legislation. The post-war period (including the Independence War) presented significant economic obstacles for the survival of these corporations, in addition to the political turmoil that made such alliances highly risky.

How does the introduction and spread of corporate form in Turkey stand in contrast to the Japanese case? As we know well, the business leadership of reformers such as Eiichi Shibusawa (1840-1931) played an important role in promoting corporation as a tool for modernization and industrialization. He stated: "To make the nation truly prosperous, we must enrich the country, we must make scientific progress and help commerce and industry thrive; to help commerce and industry thrive, we must establish joint-stock corporate organizations" (Shimada 2012, p. 9). While we find a similar discourse on the importance of joint-stock companies for industrialization and development among Ottoman reformers (see the first section), the way company law was transplanted and applied in the latter indicates a significant difference between two cases. While both countries transplanted their commercial laws from same/similar sources (France and Germany), in Japan, general incorporation was adapted quite early, while in Turkey it was delayed until 1957. We tend to argue two factors were important in this reluctance: First is the political elite's (who is happened to be Muslim Turks) apprehension that the corporate form could be a vehicle for the already-existing dominance of foreigners and non-Muslims over Muslims in the economic realm. We should keep in mind that the large infrastructural investments that required the use of joint stock form was realized through national companies in Japan, while foreign capital—which came to enter the country through special concessions—played a crucial role in Turkey. In the latter, there would not be any need or pressure for developing the corporate law to enable capital pooling from indigenous resources.

Second, the already-existing means of enabling collective action and capital pooling to form the limited number of corporations in the late Ottoman context (i.e., guilds and waqfs) depended on and sustained a political economy pattern that precluded emergence of relatively autonomous business interests. In other words, the state-business relations continued to depend on competition-stifling and rent-seeking norms. As a result, the state, reluctant to release its extensive control on access to finance, was not to be pressured by Muslim and Turkish business interests, whose power also depended first and foremost on

their relationship to the state. Non-Muslims, who held more human and physical capital and who would be probably more willing and able to use corporate form in an extensive way, on the other hand, were stripped of any political influence within the context of late nation-state building. As such, there was no reason for the emergence of widespread demand for new organizational forms in the Ottoman-Turkish context. Consequently, the familiarity with the benefits and risks of these new forms as well as the public pressures to deal with them, which seems to have played an important role in the development of stock exchange and the accompanying governance structures in Japan,[59] was scant. The later development in the Turkish commercial law and enterprise activity, examined below, attest to these observations.

**4. The Emergence of Limited Liability Company in Turkey**

The 1850 Commercial Code defined the legal framework within which Ottoman corporations were established. The law, with very minor changes and modifications, survived until after the Independence War. Both the Turkish and foreign corporations were subject to a concession process. Turkish firms had to acquire the Council of Ministers' approval by a special decree and there was no specification as to how much time approval process could take. The process was more clearly defined for the foreigners. In 1926, American Consul in Istanbul, Bie Ravdal, described the procedure that foreign corporations had to go through in detail (203-204):

> "Corporations and Stock Companies, desiring to do business in Turkey, must register with the Ministry of Commerce. Registration consists of filing a declaration as to firm's proposed activities, its capital and financial resources, and its estimated volume of business, accompanied by a copy of its charter authenticated by the diplomatic representative in charge of Turkish interests in the country in which the home office is located (…) These formalities usually consume about six weeks, and the cost in fees, stamp taxes, etc., amounts to approximately £T125, plus attorney's and other expenses (…) There is no registration for partnerships and individual businesses; these are merely required to obey the laws and pay the taxes provided for by the law."

In 1926, a new commercial code was introduced based primarily on the French code of commerce of 1925. While the new code introduced private limited liability firm *(limited şirket*) as a new legal form of business, it also diverged from

[59] Tom Nicholas, 'Enterprise in Japan'.

the new French commercial code in some significant aspects. Most importantly, it retained the concession system, which had eroded in the origin country many decades ago (1867). Incorporation required a governmental decision signed by the Council of Ministers, the highest executive authority, and as such continued to be a very cumbersome process until the new commercial code of 1957.

The aversion of the Turkish authorities towards general incorporation can be traced back to the late Ottoman period. In 1918, Mehmet Asım, editor-in-chief of the Ottoman newspaper *Vakit*, who also became a member of the parliament during the Republican era, writes the following about the corporations (*Vakit*, 1918):

> "In order to understand the actual (or "true") economic development of a country, one must first examine the quantity and worth of the corporations in that country. Corporations are an important means of bolstering the economic prosperity of a country. Yet if these corporations are not kept under strict control, especially in countries such as ours whose inhabitants generally lack a good economic education, they can provide an opportunity for a group of crooked men to swindle away the wealth of the nation. In particular, if foreign investors are allowed to mingle among these crooked men, it is not difficult to guess how much harm they would do."[60]

While in the late Ottoman period and early Turkish republic, the concession system was justified with reference to potential risks (pertaining especially to the activities of the foreigners), in 1930s the concession system came to be justified with reference to the *etatist* (statist) outlook of the Turkish state. Ernst Hirsch, a German Jewish legal scholar specialized in commercial law, who immigrated to Turkey and trained a whole generation of legal scholars in the Istanbul Faculty of Law in 1930s and 40s, defended the concession system in following words:

> "In a country ruled by a statist (etatist) government, the legal license of any legal entity cannot be unrestricted. That is why the formation of corporations are subject to concession by the legislator in Turkey."[61]

Halil Arslanlı, Hirsch's student and later collaborator who became one of the most important legal scholars of 1940s and 1950s in Turkey, wrote his thesis

[60] The original text is transcribed in Yılmaz (2011: 437-441).
[61] Ernst Hirsch, *Ticaret Hukuku Dersleri*, 1938

on the "The Effect of Statism on Corporations" and argued that a corporate entity cannot hold unlimited legal license in an '*etatist*' state and explained the Turkish commercial code's article regarding the concession system (Article 280) according to this principle.[62] Furthermore, Arslanlı points to some contradictions in the law due to the hybridity of the law, in particular inserting the "concession system" and related articles into French legal code, which was prepared according to the general incorporation principles.[63]

While incorporation was still subject to legislature's concession in the 1926 code, the introduction of the private limited liability form might be considered a significant novelty that made 'limited liability' more accessible for small and medium enterprises. According to the 1926 law, PLLC could be established by minimum of 2 persons and 1000 Turkish Lira as initial capital. These requirements were considered as the primary advantage of the PLLCs (Özbey 1940, 10). Furthermore, there was no official requirement of general meeting and auditor assignment for PLLCs that have less than 20 partners. These were also considered as a source of convenience provided by the PLLCs (Özbey 1940, 11).

There were, however, two issues that restricted the use of the limited liability form in the Turkish Republic. First, the provisions on the limited liability were taken from the French code in a condensed form. The reasons for this condensation is not clear,[64] but 7 years after the code was enacted, Mehmed Ali, the undersecretary of Trade, wrote a 200-page book on the legal features of the limited companies to clarify ambiguous elements in the Turkish commercial code and help illustrate the benefits of the form to the Turkish potential entrepreneurs.[65]

Second, in order to establish a limited liability firm, one needed to acquire permission from the Ministry of Trade. While this requirement was easier to meet compared to the Council of Ministers' approval needed for incorporation, it

[62] "*Etatist bir devlette hükmi şahsın hukuki ehliyeti gayri mahdut olamaz*". See Arslanlı (1938).
[63] Arslanlı referring to Articles 280, 300, 301, and 385.
[64] Mehmet Ali mentions that part of the law was taken from Germany, which had a separate act for the limited firms and part was taken from France. He says that the part that specifies contractual requirements for the limited firm were forgotten ("*her nasılsa unutulmuş*") in the process of the transplantation. In another part, he says that lack of provisions concerning limited liability firms resulted from "absence of mind" ("*zuhul eseridir*"). See p. 68 and p. 79.
[65] Dr. Mehmet Ali, *Limitet Şirketler*, 1933.

still made the Turkish law significantly more cumbersome compared to the French law, where a simple registration was sufficient for the firm to exist. In the above-mentioned book written to encourage spread of limited liability form, the author underlines the easy registration process as one of the advantages of the limited liability firms in other countries such as France and Germany. Yet, he also justifies the requirement on two grounds: First, the corporations, in Turkey, also required concession. In other words, Turkey was different from other countries in this respect as well and the reasons that require concession for corporations—without explaining what they were—would also justify a concession process, albeit a less demanding one, for the PLLCs as well. Second, as mentioned above, the legal provisions about the PLLC in the Turkish commercial code were incomplete/deficient and therefore, most rules concerning the company had to be incorporated into the contract. This, according to Mehmet Ali, implied too much freedom that might lead to creation of companies that would not fit into the 'limited' form and could harm stakeholders, most importantly the creditors of the firm (1933: 64-65).[66]

Both the problems in the transplantation process (especially for parts concerning the limited form) and the averseness to adapt easier registration processes for the establishment of the private limited liability company might indicate a certain reluctance or ignorance on behalf of the policy makers about the introduction of this form in the country. Actually, it took 14 years after the Code of Commerce that introduced PLLC, for serious critiques of the concession system (for PLLC) to be raised by the Turkish legal scholars. In 1940, the chief editor of *Hukuk Gazetesi* (The Law Journal), Cevat Hakkı Özbey, published an article titled "There is a need for altering the legal provisions to promote limited companies and small scale enterprises." In this article, Özbey argued for abolition of official permission requirement for the establishment of the private limited liability company. Yet, he also emphasized that he disagreed with the scholars who suggest, along with removal of the concession requirement, the abolition of official auditing for PLLCs. He considered the 'official audit' requirement as a legal provision in line with the two main principles of the Turkish state, statism (*devletçilik*) and populism (*halkçılık*). Legal scholars used

the ideological underpinnings of the Turkish state as a justification for the strict state control. Whether this discourse reflected an actual ideological resistance against free incorporation and free registration (for PLLCs) inherited from the late Ottoman national economy or based on any observed threats to the so-called statist objectives of the Turkish government in 1940s is not clear.
Yet, even in 1940s, the number of private limited liability companies established in Istanbul seems to have been relatively small compared to partnership forms. [In late 1920s, 97 per cent of all multi-owner firms were corporation or limited liability in France; whereas only 32 per cent of all multi-owner firms were limited liability private company or corporation in Turkey. Furthermore, the limited liability firms were mostly restricted to the very large firms, firms that are considered in the highest initial capital range (f*evkalade*) according to the Istanbul Chamber of Commerce.]

**5. Conclusion**

Ottoman statesmen legitimized corporations as a means of technical borrowing and catch-up; but the institutional framework within which these corporations were adopted exhibit some features peculiar to the political economic structure of the Ottoman Empire. The introduction of General Incorporation Acts was very late (1957) in the Ottoman/ Turkish case. Furthermore, the private limited liability company, which was introduced as a more flexible, convenient form for small and medium enterprises, was also subject to a burdensome bureaucratic procedure. The transplantation process was incomplete and contained serious contradictions that legal scholars acknowledged and tried to solve for many decades. The law, however, barely changed between 1850 and 1926 and between 1926 and 1957 in response to these problems.

This legal stagnation could not be explained solely with reference to lack of legal experience and bureaucratic learning gap. The pre-existing institutions based on competition-restricting regulations (such as guilds) have survived into the later period of incorporation into the world economy, with little capacity to industrialize but with social-political power base to participate in a nationalist agenda, that works mostly along the lines of primitive accumulation and wealth transfer from non-Muslim businesses. Within this context, the capital-pooling

depended mostly on traditional political and social networks inherited from waqf- and guild-like institutions, rather than modern instruments such as stock exchange. The Muslim entrepreneurs—with sufficient means and political/economic capital—did probably benefit from the political support and the evolution of traditional institutions into 'corporate' practices; but had no incentive to demand further reduction of barriers to entry (to demand easy access to corporate and limited liability form), to demand legal innovations or governance structures improving investor rights.

There were important differences between the transplant (Turkey) and the origin countries (France and Germany) in terms of legal rules concerning business organization. The difference is most pervasive in the rules on the private limited liability company, which did not enjoy the same degree of popularity in Turkey than in Europe. These differences persisted due to a lack of initiative to adapt the law to local conditions and the initial historical conditions that shaped the ethno-religious composition of the entrepreneurial class and relative political and economic strength of its various components. the socio-political networks that , and heterogeneous access to the new law across different demographic groups.

Moreover, in the case of late developing countries, business models aiming not only to make profit but also to foster modernization and enhance welfare were shown to have contributed to economic development.[67]

[67] In fact, the first phase of the current research project, "Gappon Capitalism—The Economic and Moral Ideology of Shibusawa Eiichi in Global Perspective," demonstrated the significance of Shibusawa Eiichi's thinking and business activities in creating such a successful model in Japan.