Lessons from the Merchants of Venice

Many innovations underpinning Venice's commercial success during the late-medieval period hold true today.

Making the most of its position as an important sea port, Venice's remarkable economic development during the Middle Ages relied on network effects, contractual innovation and coordination among the players involved in long-distance trade. Companies today still exploit these mechanisms to succeed in underserved markets.

By the 15th century, the Republic of Venice was named *La Serenissima* (The Most Serene) due to its prosperity. Perfectly positioned midway between Constantinople (Istanbul), the gateway to the East, and Western Europe, Venetian merchants played a fundamental role in developing trade between the Mediterranean and the rest of the known world.

The Republic was, in fact, ruled by an oligarchy. While the Doge was head of state, the real governing power was exercised by the **Maggior Consiglio**, a political body comprised mostly of noble families. This body was strongly influenced by, and intertwined with, the needs of the commercial class.

The lack of infrastructure in medieval Europe meant long distance travel was both difficult and time consuming, while the lack of reliable communication mechanisms hindered coordination. Venetian merchants had limited knowledge of the specifics of many of the new markets in which they traded. Transportation risks were high, with vessels exposed to both piracy and unpredictable weather conditions.

Network economics

Venetian merchants of the time did not travel themselves, instead they employed agents who lived abroad and acted on their behalf. Merchants coordinated **multiple trade expeditions** from home. Agents and merchants were bound by an agency contract. The agent was paid a percentage fee of the amount traded. Agents knew the local markets and, although they received specifications of quantities and the types of goods the merchants wanted to deal in, they had freedom in deciding where to trade. Local knowledge was needed to develop this trade yet coordination and control were extremely difficult. Merchants sent letters to communicate with agents, often sending many epistles over different routes to maximise the chance that at least one of them was received.

To minimise agency risk amid such high environmental uncertainty, merchants relied on network economics. Agents were selected from the merchant's personal network. The threat of social punishment if agents failed to meet contractual obligations strengthened the trust between merchant and agent and decreased the risk of deviation from contracts.

Today, network mechanisms play a fundamental role for companies trading in underserved markets, as a mechanism for creating trust and strengthening local knowledge in a region.

Dubai-based transportation network company Careem, for example, leverages network effects to recruit reliable **drivers**. Their drivers refer other drivers to the platform. These relationships, complemented with extensive background checks run by the company, enhances control among drivers and creates a network of trust which has helped the company expand in less-known markets.

A similar *modus operandi* is used by **Prodigy Finance**, an organisation started by three INSEAD MBA graduates to help students finance international degrees. Initially, the funding was provided by INSEAD alumni to INSEAD students. As students were unlikely to default on the alumni network, network effects helped create a market for these loans.

Contractual innovation

The relationship between Venetian merchants and agents involved in long-distance trade was organised through a new form of contract called *Colleganza*. Under the arrangement, the merchants remained in Venice and provided all the capital and goods for expeditions while the agents sailed abroad to sell them, buying new goods with the proceeds and bringing them back for sale in the Venetian market. Profits were split on a pre-arranged percentage, an arrangement that limited the liability and risk for both parties and would later underpin the development of trade in the **East Indies**.

In today's underserved markets, organisations must think outside the box, implementing contractual innovations to seal the deal or compete in new arenas. Consider, internet.org, a partnership between Facebook and telecommunications operators in emerging markets. The arrangement provides mobile phone users with free access to selected apps and websites ('Free Basics') on their mobile devices. Although **opposed** by supporters of net neutrality, the initiative allowed Facebook to rapidly gain a dominant position in many African countries.

Contractual innovation also contributed to the success of Chinese e-commerce company, Alibaba, which launched its online payment system Alipay in 2004. Alipay reduced the risk of fraud and created trust in the system by holding payments in escrow until customers received and **verified** the goods.

Innovation in coordination

Another key factor for Venetian merchants' success was the coordination facilitated by the government. As ship-building was too costly an undertaking for merchants, vessels were built in the state-owned *Arsenale* and **contracted** to private groups of merchants through a public auction.

By controlling the ships, the government was able to coordinate the timing of trade expeditions, according to weather conditions and the commercial cycle of the far-flung markets. Ships were organised in groups, each with a specific destination. This organisation allowed the government to maximise trade opportunities by regulating the goods that were traded in certain locations at different times of the year, and to offer military protection to the convoys.

Today, coordination among companies exploring emerging markets plays an important role in knowledge sharing and protection for the 'home' country. China was aware of these benefits as its companies began to expand into Africa. The government's measures to enhance Sino-African relationships and the Beijing Summit Forum on China-Africa Cooperation in 2006, attended by 48 African leaders, facilitated the market entry of many firms by providing **ties** with African governments. Coordination also takes place in the consumer market. For instance, Nike's 'We Own the Night' runs provided for a safe and sociable environment for women to **run after dark**, as well as a great deal of publicity.

Similarities today

"My ventures are not in one bottom trusted, / Nor to one place; nor is my whole estate / Upon the fortune of this present year: / Therefore my merchandise makes me not sad." says Shakespeare's Antonio, merchant of Venice. Merchants like him, with the support of the Republic, built an economic empire that, at its height, dominated trade between East and West. By studying Venice's supremacy in long-distance trade and success in opening new markets over the centuries, we can see the importance of network effects, contractual innovations and coordination among players involved in commercial relationships. These three pillars are still applied by many companies with successful business operations in underserved markets today.

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