Book Review
By Sten Jönsson


This book is a classic written by the Belgian de Roover, who worked as an accountant in a bank and then in a shipping company before travelling to the USA to get an MBA at Harvard in 1938. He received his PhD at the University of Chicago. He has published on the history of banking, negotiable instruments, and accounting. Mrs Florence de Roover, a renaissance scholar, introduced her husband to the Medici archives and helped him with critical reviews.

The book is a classic in business history and is focused on and based in archival work. The institutional background (e.g. usury, the money-changers guild, catasto (income return for taxation)), the antecedents to the starting of the bank, the glorious days of Medici under Cosimo’s directorship, and the organization of the bank (in many aspects similar to Handelsbanken) are described. This first section is followed by a description of the money market of the times (bills of exchange), the Medici as Merchants (alumn and iron), and as industrialists (wool and silk), and as bankers to the Pope. Three chapters are devoted to the different branches throughout Italy and Europe. A final chapter tells the story of the decline of the Medici bank.

**Institutional background**

From the Crusades to the Great Discoveries Italy was the dominant economic power in the western world. Merchants were the middlemen of spices from the Levant, silk, cloth, wool. Banking prospered with trade since the transfer of payment for goods best was accomplished through bills of exchange (transporting money over land or sea was risky). In bank dense Florence and some other centres there even was a market for those financial instruments. The Italians were good at organizing business in partnerships (the Medici bank was organized as a holding company), they had double entry book-keeping, and introduced what could be seen as insurance for marine transports. They developed a body of mercantile law. The Florentine were global
businesses with as many as 90 employees in branches across Europe. The Medici bank is remarkable because of its good archive; up to 1450 there are an unbroken series of account books (confidential ledgers). After 1450 the material is largely business correspondence. The Medicis are known for their role in Art and politics as well. As a matter of fact it seems like their politics was the cause of the decline.

The institutional background to consider is the problem that the Church forbade the taking of interest (usury). The banks solved this by focusing the business on Bills of Exchange (sometimes “dry”, i.e., without any goods transaction behind it). Fees were included and profit from differences in exchange prices of currencies (Florins were higher valued in relation to the pound in Florence than it was in London). A permanent problem throughout was the unbalanced trade (from Italy to Northern Europe, plus the flow of payments to the Vatican).

As bankers Medici had to be members of the Money-changers Gild. De Roover notes that the regulatory power of the Gild was rather limited and it did not interfere much in daily business.

There was a direct tax in Florence based on individual tax returns (catasto), which should not be expected to lead to overvaluation of assets.

The global firm of the 15th century.

The Medici bank, like many of its competitors, had branches in many centres of commerce across Europe. From a modest beginning in Italy (branches in Florence, Rome, Naples, Venice) in the early 1400s it expanded to 13 businesses in 1450 (branches in Ancona, Avignon, Basel, Bruges, London subordinated to Bruges, Florence, Geneva, Pisa, Rome, Venice, Woolshops 1 and 2, and a silkshop in Florence). The executive managers of the different branches were usually co-owners, and their duties were regulated in detail in management contracts for up to 5 years (which could be terminated by the principals (maggiori) at any time). It was quite common that the branch managers had a share in profits (and losses) that was larger than their ownership share. A factor was a manager who was authorized to enter binding deals for the firm. It was not the signature alone but the whole text of a Bill of Exchange that had to be written in the factor’s hand to be valid. A factor could be promoted to partner (invest his own money in the branch) and employees were groomed by being sent to different branches to learn the business. Employment was closely monitored by the
principals and was largely based on family and trust. The legendary Cosimo was not sentimental about dismissing non-performing managers, but his successors seem to have been too tolerant for the good of the firm, which contributed to the fall of the bank. In cities where Medici had no branch of their own they did business through representatives or silent partnerships.

The Rome branch was somewhat different from the other branches in that it was run without capital. This was a result of the flow of funds in this century, inward toward the pope, and of the fact that members of the Vatican court deposited money with the bank (against other remuneration than interest – usury).

The instrument on which most of the banking business was built was the bill of exchange. The basic value of this financial instrument was that it was a much safer way of transporting payments across Europe (land or sea). For this to function smoothly there had to be a money market that could liquidate such instruments (and provide for some trade credit). The power of the Italian banks in Europe came from this money market effect – there were several dozens of banks in Florence at the time. The Hansa League had, according to de Roover, a much clumsier and slow way of dealing with payments and could not compete in Western Europe (except perhaps in London).

Trade was the very reason for doing banking business. As mentioned Medici had two wool shops and one silk shop during most of its lifetime. One could see that good management made a difference by comparing the two wool shops in Florence. The best wool was imported from Britain, which was difficult business since the King would control the trade and collect custom fees (or borrow money on the promise for the lender to collect fees during a certain period). The Medicis also had trade in materials like alum, which was used to clean wool. However, contracts with the pope to secure monopoly in (sometimes threatened by the Turks) did not work out so well. Political games were frequent around trade. The most dramatic, and one reason for the decline of the bank, was the ill-conceived strategies of its representative in Brügge, Portinari (who had intrigued his way to the top there). The issue of appointing Portinari to manager in Brügge came up in 1464, the year Cosimo died. The contract was written by Piero (Cosimo’s elder son) in 1965. Both of them hesitated because they considered Pontiari
too reckless in business. Once installed he ventured into projects like buying the rights to the toll on wool at Gravelines (bordering on the English enclave of Calais) hoping to collect on all import to the Low Countries now that the Duke of Burgundy had banned all English cloth from his dominions. Unfortunately he did not include English counter measures in his calculations. Furthermore he persuaded the Medici to buy two Burgundian galleys, surplus material from the Burgundian fleet now that the crusade against the Turks did not materialise due to the death of the pope (Pius II). Those galleys were costly and difficult to fill with cargo both ways as required for profitability. Brügge and its relation to London was a constant problem to the maggiori.

The decline
During Cosimo's reign the Medici policy was to avoid lending money to princes, or the court (the state as it were) because princes often had no intention of repaying. Still Cosimo was not foreign to use his financial resources politically. He avoided death by bribes, but was expelled from Florence in 1433, when his enemy Rinaldo degli Albizzi had him arrested and argued for execution – only to be called back a year later. Florence was involved in complex and shifting alliances and wars at the time (Machiavelli, 2010). When Cosimo died in 1464 the Medici bank was already past its prime. His older son Piero had been trained in politics rather than banking. Machiavelli (2010) claims that Piero caused discontent and many business failures by calling many outstanding loans. De Roover (1963) says, true that Piero initiated an audit to see what state the business was in and that audit revealed that the bank was in poor condition. He therefore took steps to close down the Venice branch that was unprofitable, and he sent Tani to try to solve the London problem by negotiating a deal with Edward IV. He also ordered the Milan branch to reduce its loans to the Sforza court. Still de Roover maintains that it is doubtful whether the retrenchment of the Medici bank was the cause of “the epidemic of bankruptcies which broke out in Florence shortly after Cosimo’s death” (p. 359). It was rather that many of the firms that went bankrupt had business with the Levant, which was cut off with the war between Venice and the Sultan that lasted between 1463 and 1479.

There was more to come. Piero died already in 1469, and was succeeded by his sons Lorenzo and Giuliano, aged 21 and 18, who necessarily became dependent of their father’s advisors. Lorenzo soon developed into a gifted politician but was not interested
in banking. He relied completely on Francesco Sassetti, a long term employee, who became the real manager at the headquarters. Due to Sassetti’s policy of allowing branch managers too much room for extravagant manoeuvres the “maggiori” lost control of the Medici group and mismanagement in some branches was allowed to go on for too long. The Brügge branch and Portinari has been mentioned above (his brother Pigello was not much better as manager in Milan as he got entangled in ever increasing loans to the Sforza court). The other cause of decline was the Lyon debacle of Lionetto de’ Rossi.

Up to 1463 the leading fair for merchants had been Geneva, but that year the French king Louis XI issued a decree that exempted all merchants that came to Lyon from toll. Medici’s Geneva branch moved to Lyon in 1466 to be where the business was. The name of the branch became Francesco Sassetti & Co (although the Medici provided 66% of the capital. At first the Lyons branch was successful, but soon the first branch manager was expelled from France (for supporting enemies of the King). The second managers died within a year, and the third manager, (appointed in 1470) was the infamous Lionetto de’ Rossi, who had been a factor with the branch (first in Geneva and then in Lyon) since 1453. The first sign of problem appeared in 1976 where headquarters complained that the balance sheet submitted by Rossi was “too full of slow debtors and stocks of merchandise”. An intervention from Leonardo made him promise to mend his ways, but soon, by 1480, the balance sheet showed a loss and Medici’s agent in Montpellier (Lorenzo Spinelli) was sent to investigate. Rossi did not like Spinelli’s spying on him. In 1482 Rossi sent two balance sheets, one to Sassetti and one to Lorenzo (this one with lots of explaining text). Rossi claimed that business had picked up and the future looked bright. He had managed to collect a lot of bad debts and build reserves. The letter to Lorenzo contained a number of accusations against Sassetti. The real problem was that Rossi had come into the habit of drawing on the Rome branch for payments but fail to remit promptly. Rome complained but matters soured when that branch refused to honour a draft by a French merchant on the Lyon branch. Another set of accounts sent in 1484 claimed that the Lyon branch was now free of bad debts and generated a profit. Spinelli was sent to investigate again and found Rossi “out of his senses”. Lorenzo trying to mediate called Rossi to Florence for a conference. Rossi took his time to set out on the trip. When he arrived, months after being called, he was put in the debtors’ jail. An audit of the books showed manipulation and a frightening loss. Spinelli was persuaded to take
over and clear things up, which were a formidable task since “the maggiori” were slow to provide fresh capital at the same time as they insisted on reducing debt. Turnaround by entrenchment is not an easy task. Sassetti, who had a (-n arrogant) son at the Lyon branch promised to stay on as manager at headquarters until the mess was cleared up. He visited the branch from May 1488 and found improvement and helped restore confidence. His departure was delayed for different reasons. A new management contract was set up in February 1489, but Sassetti died soon after his return to Florence, in March 1490. Soon Lorenzo de Medici also died and the entire Lyon branch was expelled from France as a result of new hostilities between the French king and Florence. After the failure of the war efforts of the king Spinelli and staff returned to Lyon but were unable to run a profitable business without capital. The fate of the Lyon branch illustrates how accounting fraud undermines trust and how difficult it is to re-establish trust by the new regime when there is insufficient capital infusion.

Lorenzo devoted his energy to try to save the bank from 1478 until 1494 when the Medici rule of Florence was overthrown and all property seized. Giovanni Tornabuoni and his son were charged with continuing to run the bank but without capital it soon perished.

It should be mentioned, to illustrate business conditions of the time that the Pazzi bank, probably the second largest bank in Florence, saw what trouble the Medici bank was in. Was it heading toward bankruptcy or did it need a push? The Pazzi conspiracy was based in the idea that by toppling the bank one could also remove the Medicis from political power. There was an attempt to assassinate the two Medici brothers (Lorenzo and Giuliano) in a church in April 1478. Giuliano was murdered but Lorenzo escaped with his life...

What one can learn from Medici:

1. The Medici bank was run on trust with branches given much leeway during the growth period under Cosimo. Still Cosimo was a strong willed and watchful “maggiori”. He had a co-manager (Benci) who matched him in diligence. Lorenzo de Medici had a co-manager too (Sassetti) but did not pay much attention to banking during the first decade
of his reign. A key to success for Cosimo seems to have been careful selection of trusted branch managers and a watchful central eye on branch performance.

2. The lack of loyalty of some branch managers (Portinari and de’Rossi) resulted in accounting fraud that was dealt with all too leniently; Lorenzo claiming that he “did not understand these things” by a second-in-command principal.

3. Mismanagement, which included tying up capital in bad debts (sovereigns not intending to pay but to borrow more against promises of future cash flows like toll income) and merchandise, made the bank vulnerable to declines in business due to the war between Venice and the Sultan.

4. Involvement in politics and establishing bonds with power centres are risk generators.

Further reading:
