

How did the medici
bank become the
greatest and most
influential bank during
the ...

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The Medici bank is regarded as one of the most significant banks during the renaissance in Italy in the 1400s. This banking house was founded in the year 1397 when Giovanni di Bicci de' Medici relocated his bank from Rome to Florence. Under the governance of the Medici, this bank was responsible for the wealth and the power of Florence during this period. But how did the Medici bank rise to become the most influential and wealthiest financial institution in the Italian Renaissance yet the church forbade firms from taking interest rates? The secret is in its structure, operations as a holding company and the bank's source of funds. The Medici bank was the most influential and the wealthiest institution in the Italian Renaissance because of its decentralized structure, control mechanism as a holding company, source of funds and participation in international trade using instruments of payment and efficient checks and balances.

Decentralized Structure

First of all, it is correct to argue that the Medici bank was the most influential and the wealthiest financial institution in the Italian Renaissance because its decentralized form of management created a competitive advantage for the bank through international branches. There are two types of organizational structures mainly a centralized and a decentralized system. On the one hand, all decisions are made at the executive level under the centralized system. Consequently, the head of any firm has the mandate to hire, fire or transfer employees. However, one disadvantage with this form of government is that if a leader dies, then there is nobody to take up the leadership mantle because it is based on one partnership. For example, the bank of Orlando collapsed because of this form of structure. On one hand the

decentralized system of government encourages the collaboration of multiple partnerships. For that reason, the Medici bank under the Medici family embraced this superior organizational structure which gave them a competitive advantage over other banks.

How did these partnerships make the Medici Bank a formidable force during the Italian Renaissance? Under these partnerships, branch managers were perceived as governors of the bank. “Seniors” was a title used to refer to the Medici. Also critics may argue that branch managers are ordinary employees, the decentralized structure of the organization perceive them as a junior partners who’s input and ideas mattered in the bank. It is essential to understand that the success or failure of a firm depends on its ability to involve employees in the decision making process. Employees are the greatest asset of a company. They should be viewed as a company’s bloodline because they can make or break a company. When employees feel valued, then they become highly motivated to realize the goals and objectives of the firm. Therefore, the Medici bank became the most influential and wealthiest financial institution in the Italian Renaissance because its structure encouraged the delegation of roles to the branch managers for ease of decision making.

Means of Control

Secondly, it is correct to argue that the Medici bank was the most influential and the wealthiest financial institution in the Italian Renaissance because it had a striking resemblance of a holding company. A holding company is a firm that claims ownership over the stock of other companies. Interestingly, the Medici banking house had a 50% capital control of the other partnership

companies. This factor meant that the company controlled the stock of these partnerships undoubtedly making the Medici bank not only the most influential but also the wealthiest financial institution in the Italian Renaissance. As if the 50% control over capital was not enough, the Medici banking house still retained the trademark once it dissolved any partnership. Because of the goodwill that came with that title, the banking house could not afford to lose it.

Source of Funds

Thirdly, the Medici bank was the most influential in the wealthiest financial institution in the Italian Renaissance because of its source of funding. Firstly, the funds came from accumulated profits that were undistributed. Based on the articles of association, profits were withdrawn once the contract was terminated. Most importantly, the branches in Geneva and Lyon kept reserves to cater for unforeseen events which further consolidated the wealth of the bank. Secondly, the partners invested in money that surpassed the capital. Other than the required investment capital, the partners were at liberty to invest additional funds in boosting the operations of the Medici Bank. Also, the Medici invested in the various branches which further consolidated the wealth in the power of the family. Lastly, the funds were sourced from outsiders' money held by the bank. Because these were time deposits, the depositors were paid interest once the banking period lapsed.

It is essential to note that money from outsiders was not from ordinary people. Instead, it came from prominent people throughout Florence that were friends with the Medici. The higher investment returns attracted these

influential Florentines to become outside depositors. Foreigners were also not left out as outside depositors for the Medici bank. For instance, one of the depositors at the branch of Lyons was Ymbert de Bartanay who acted as the Chamberlain of the King of France. Politicians soon followed suit by investing in the Medici bank. For them, outside deposit meant that when their political career was over, and they had to flee the country, their investment would be free from confiscation. Therefore, it is correct to argue that these three primary source of funds contributed to the power and wealth of the Medici Bank.

International Trade

Most importantly, the Medici bank became the most influential and the wealthiest financial institution in the Italian Renaissance by using instruments of payment and employing some checks and balances through bookkeeping while practicing in international trade of silk and cloth. First of all, as a financier, money had to change hands while conducting international business. For that reason, the Medici bank used the bills of exchange which were acceptable in foreign markets. Secondly, the bank had to ensure that it applied some checks and balances to ensure efficiency during international trade. Consequently, it adopted the bookkeeping method for accurate and efficient recording of financial transactions and to solve the complexities created by the bills of exchange in foreign currency. Two accounts, Nostro and Vostro, were opened where by the Nostro encouraged the transaction of international and local currency. Therefore, this approach not only minimized

transaction errors, but it also enhanced the reliability of the Medici bank while recording profits and losses.

But how did the bills of exchanging boost the influence and the wealth of the Medici bank during international trade? Based on extensive research, it is evident that the bill of exchange was popular in the Medieval period for two primary reasons. The first reason was the ease of carrying out the financial transactions during trade. Interestingly, there was no need to carry gold or silver coins during the whole process. The other reason was that the bills of exchange sped up the transaction process. A bill of exchange may be thought of a piece of paper that holds a little or no value. However, this seemingly worthless piece of paper held value in terms of gold or silver during this period. The idea that gold or silver could be transferred from one party to another boosted the amount of the bills of exchange and the financial institution such as the Medici bank that embraced them.

Nevertheless, it is interesting to note that just like the glaring differences in the banking system during the medieval times and present times, the international trade during this time was unique. For that reason, merchants had the aim of penetrating the foreign markets and diversifying their investments to reduce risks. The Medici handled aristocratic clientele who traded in silk, jewelry as well as silver plates. Also, the banking house treated in the spices, olive oil, and wool. Therefore, the Medici bank was tasked with protecting such merchants because it played the role of a financier. One of the significant functions that the bank played during this time was minimizing the risks of trade by partnering with other merchants.

Because some risks could cripple the bank, the bank was not inclined to engage in international trade. Instead, it sought to rely on commissions by selling goods with minimal risks. Another role was Medici was providing loans to its clientele. However, lending to princes and kings was dangerous because if the loan accumulated, then it became difficult to sell off the security given such as the crown jewel. Consequently, such loans took up a significant percentage of the lender's resources.

Comparison of the Medici Bank with Commercial Banks

However, one may argue that the Medici bank's operations do not compare with those of the commercial banks today. During this period, banking operations were affected by the doctrine of usury adopted by the church that prohibited interest, unlike today. For that reason, bankers had to operate within the guidelines given by the church unlike commercial banks today, which led to the enactment of the bills of exchange to conceal interest charges and escape usury. On the one hand, the bills of exchange were very much prevalent during the Renaissance Period. On the other hand, commercial banks operate using checks. Nevertheless, these bills of exchange not only enhanced international trade operations for the bank, but they also helped the Medici bank to escape exploitation by concealing interest charges in these bills. Further, these bills strengthened financial orders that were made orally rather than written as in the case of checks. For that reason, one may argue that the bills of exchange played a role in making this banking house the most powerful and wealthiest at a time when interest was prohibited.

Also, the Medici bank's operations do not compare with those of commercial banks today because profit during the medieval period was not guaranteed. In fact, during this era, it was difficult to calculate the interest rate that a borrower owed a lender. For that reason, banks such as the Medici bank relied on the fluctuating exchange rates. But how did the Medici bank thrive during this period? It is interesting to learn that the bank derived profit based on the differences in exchange rate rather than the interest charges. Instead of recording the profit from interest charges, the bank filed the profit and loss derived from the difference in the exchange rates. Also, the massive wealth was derived from the commission that was earned from the bills of exchange which acted as the letters of payment. However, commercial banks today calculate interest rates based on percentages. For that reason, their interest charges are guaranteed unlike in Medieval times.

In conclusion, the Medici bank was the most influential and the wealthiest financial institution in the Italian Renaissance because of its decentralized structure, control mechanism as a holding company, source of funds and participation in international trade using instruments of payment and efficient checks and balances. First of all, its decentralized structure with foreign branches gave the bank a competitive advantage over its competitors. Secondly, the bank derived power by operating as a holding company that controlled 50% capital of its partners. Thirdly, the Medici bank got funds not only from accumulated profit, but also from partners that exceeded the capital, as well as money from outside depositors. Most importantly, the bank's role in international trade as a lender also

contributed to it a massive wealth and influence. The bank employed reliable instruments of payment and checks and balances such as the bookkeeping to maintain accurate records of its foreign and local transactions.

Works Cited

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