



Community origins of industrial entrepreneurship in pre-independence India

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What are the drivers of industrial entrepreneurship at early stages of development? Formulating policies to foster structural transformation and industrial development in traditional societies requires a good understanding of this. Lessons from the history of advanced and partly developed countries are therefore valuable.

We, Bishnupriya Gupta, Dilip Mookherjee, Kaivan Munshi and Mario Sanclemente have conducted an EDI case study on the early origins of cotton and jute entrepreneurship in India.¹ We identified the social community of each partner or director in all listed firms in these two industries between 1850 and 1930, and the community composition of directors within firms. We find that the majority of partners/directors in each firm belonged to the same community. Moreover, presence of one community in the industry at its nascent stage predicted fast growth of future entrepreneurs from the same community. We interpret these results as reflecting trust and informal norms of cooperation within social communities which helped overcome problems faced by investors in raising finance, accessing technology or sharing marketing networks.

Our research and a complementary EDI study on China (Dai, Mookherjee, Munshi and Zhang 2018) illustrate the importance of community institutions. Larger and better-integrated communities offer greater potential for spillovers to policy stimuli, suggesting the role of 'community targeting' in industrial policy as a means of raising growth. However, such policies need to be balanced with the potential side-effect of increasing inequality between communities.

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Institutions matter for growth and inclusive development, but there is little evidence on how positive institutional change can be achieved. The Economic Development and Institutions (EDI) research programme will fill this knowledge gap, and take an innovative approach to ensuring world-class research is translated into positive policy change.

One unique aspect of this programme is its focus on policy engagement. The research team will seek to reflect policy 'demand' when defining research questions and engage key decisionmakers throughout the course of the programme. This will involve listening to the challenges encountered by in-country policymakers and looking out for opportunities to engage with and support ongoing reform processes.

¹ Bishnupriya Gupta, Dilip Mookherjee, Kaivan Munshi and Mario Sanclemente (2018), Community Origins of Industrial Entrepreneurship in Pre-Independence India. Available at: www.edi.opml.co.uk.

Background

Economic historians have mainly stressed the role of either market institutions (such as property rights, financial markets and investor friendly regulations) as in the case of the Industrial Revolution in the UK in the 18th century, or state support (tariffs, infrastructure development, credit subsidies, tax incentives, coordination, technology diffusion, facilitation of machinery imports etc.) as in the case of later industrialization of Germany, US, Russia, Japan and East Asia.

Countries that are less developed today were slower to industrialize, in the absence of both well-functioning markets and interventionist states. However, the vacuum has often been filled by ethnic networks which exchange intermediate inputs, share know-how, connections and capital; overcoming contractual moral hazards via informal community enforcement mechanisms. The role of community networks in early industrialization of less developed countries has not received comparable emphasis in the literature. Other factors stressed in recent literature are pre-industrial accumulation of wealth (Banerjee and Newman 1993) or experience in related upstream trading sectors (Sutton and Kellow 2010, Sutton and Kpentey 2012) based on studies of leading industrial enterprises in Ethiopia and Ghana.

Study overview

This project examines evidence from India's experience prior to its Independence in 1947 when financial markets and judicial institutions were poorly developed, and the British colonial state provided little support to Indian entrepreneurs. Yet Indian entrepreneurship emerged, first in Western India from the mid-19th century especially in the cotton textile industry, and later in Eastern India after the First World War in the jute industry. These two industries accounted for nearly half of total domestic investment by the turn of the century.

We create a yearly panel dataset of entrepreneurs that were partners or directors in all listed firms in these two industries from business directories, from 1850 until 1930. This enables us to track their career patterns, in particular their occupations prior to entering the downstream industry. Using the names of these entrepreneurs we identify the social community they respectively belonged to, and the community composition of directors within firms. This enables us to quantitatively estimate the roles played respectively by pre-industrial trading experience and wealth accumulation vis-a-vis community networks.

Pre-industrial experience in related trading sectors is measured by prior presence of entrepreneurs in upstream trading activities in raw cotton and jute. Wealth accumulation is proxied by their presence in these sectors during the US Civil War of 1861-65 and the First World War respectively when trade in raw cotton and raw jute grew rapidly in response to sharply escalating world prices. However, we find no evidence that either of these played a significant role in predicting entry into the downstream sector. The vast majority of entrants had no prior experience in the relevant commodity trading sector, and upstream trading presence was negatively correlated with subsequent downstream entry.

On the other hand, we find two sources of evidence of the role of community networks. The majority of partners/directors in each firm belonged to the same community, with entrepreneurs from distinct communities sorting into distinct firms. Second, initial presence of community members at a nascent

stage of downstream entrepreneurship (1865 in the case of cotton, 1919 in the case of jute) predicted faster growth of future entrepreneurs from the same community, after controlling for fixed community characteristics and year dummies which capture the role of price or other shocks affecting the industry. For instance, in the case of cotton, a community with one additional incumbent already present in 1865, was likely to have 1.6 additional entrepreneurs by 1880, and 4.4 additional entrepreneurs by 1890. Both these results are consistent with the role of trust and informal norms of cooperation within social communities characterized by high rates of inter-marriage and economic transactions, that helped overcome problems faced by investors in raising finance, accessing technology or sharing marketing networks.

Policy conclusions

These results echo similar findings in another EDI sponsored study on the role of community networks in the evolution of private enterprise in China since 1990 (Dai, Mookherjee, Munshi and Zhang 2018). Hence, the role of community networks continues to be relevant in more recent times as well. These projects highlight a hitherto neglected factor in the emergence of private entrepreneurship at early stages of industrialization in some developing countries. They indicate the value of understanding social communities within which potential entrepreneurs are embedded, the size of those communities and the strength of social and economic ties within these networks. Larger and better-integrated communities offer greater potential for spillovers to policy stimuli, suggesting the role of 'community targeting' in industrial policy as a means of raising growth. However, such policies run the risk of increasing inequality between communities. More research is needed to better understand the growth potential for such policies in specific contexts and assessing their side-effects.

Authors:

This brief was prepared by Bishnupriya Gupta, Dilip Mookherjee, Kaivan Munshi and Mario Sanclemente.

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Further Reading

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- Sutton, John and Nebil Kellow (2010). An Enterprise Map of Ethiopia. *International Growth Centre*, London.
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